

Contributions to Management Science

Bistra Svetlozarova Nikolova

Tax Audit and Taxation in the Paradigm of Sustainable Development

The Impact on Economic, Social and
Environmental Development

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The Impact on Economic, Social and
Environmental Development

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ISSN 1431-1941 ISSN 2197-716X (electronic)
Contributions to Management Science
ISBN 978-3-031-32125-2 ISBN 978-3-031-32126-9 (eBook)
<https://doi.org/10.1007/978-3-031-32126-9>

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This Springer imprint is published by the registered company Springer Nature Switzerland AG
The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

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Part I
Contemporary Trends and Challenges
of Tax Audit and Taxation

Chapter 1

The Effective Tax Policy as a Goal and Realization



1.1 Introduction

Taxes have been known since antiquity and have evolved along with human civilization, in connection with the state's needs for material resources and financial resources. Taxation is established as the main method for accumulating the necessary revenues for the budget. Over time, in addition to the fiscal function that is inherent in taxes, they begin to perform other functions—economic, social, environmental and control. The role and functions of taxes and taxation are expanding and becoming more complex. They are reflected in the conducted tax policy. Thus, in modern conditions, taxes and taxation can be used as part of the tools to ensure and maintain sustainable development. To this end, the implementation of tax policy can seek solutions to issues related to environmental protection, reducing inequalities, poverty, social exclusion and the informal economy.

In this regard, this chapter addresses issues related to the role and functions of taxes and tax control in the context of the Sustainable Development Concept. The possibilities of the different types of taxes—income taxes, property taxes, sales taxes and environmental taxes, to be used as a tool for achieving the goals of sustainable development have been studied. The components of the system of tax control in a democratic society are clarified—institutional and non-institutional (civil) control for compliance with tax norms. The modern problems of taxation and tax audit are studied, on the basis of which possible solutions in the following aspects are systematized: (1) Degree of autonomy of the tax administration and guaranteeing the implementation of its activity in public interest; (2) Increasing the efficiency of the tax administration through the use of IT technologies, incl. the capabilities of Big Data technology; (3) Increasing the collection and reducing the expenses of the tax administration; (4) Increasing tax morale and compliance with tax legislation; (5) Effectiveness of the control impact; (6) Counteracting cross-border tax fraud; (7) Anti-corruption in the tax administration. From the standpoint of the Concept for

Sustainable Development, the expectations and possible results of the implementation of modern tax policy are analyzed. This chapter aims to explore current opportunities for effective tax policy, which serves as a tool to achieve the goals of sustainable development.

1.2 Background

Understanding the role and functions of taxes implies clarifying their nature. Three main theories about the nature of the tax are popular: insurance theory, sacrificial theory (debt theory) and equivalent theory (Stoyanov, 2000).

According to the *insurance theory*, the tax is equated with the insurance premium or contribution paid to the insurer, in the person of the state, against the coverage of risks related to the protection of property, protection of interests and safety of citizens. The following objections can be made against such an interpretation of the tax: the amount of the insurance contribution is determined by the degree of risk; after the occurrence of an insurance event the insurance organization pays to the insured person a certain indemnity depending on the scale and degree of the damages; in the case of insurance for both parties there are certain obligations of a financial nature—payment of insurance premiums and insurance indemnities; insurance is generally voluntary. However, these characteristics are not inherent in the relationship between the state and taxpayers in the performance of their tax obligations, as the tax is determined unilaterally by the state, is mandatory and enforceable.

Sacrificial theory (the theory of debt) considers the state as an objective necessity without which modern society cannot exist. After the person realized this necessity, the so-called “Social contract”, by virtue of which the state was created as a guarantor for the organization and functioning of civilized human society. Because this need is recognized by members of society (citizens of the state), they should make a certain “sacrifice” in the name of preserving and strengthening the state, without which the existence and development of human civilization is impossible. It is the tax that is seen as a form of this sacrifice. As a critique of this theory, it can be said that the use of the term “victim” is inappropriate in this case, as the victim is associated with the exercise of free will, which is not present due to the mandatory nature of taxes. Therefore, it is more appropriate to talk about debt theory, which considers tax as debt.

The equivalent theory of the nature of the tax has gained the greatest popularity. According to her, the state is useful for the citizens, as it provides them with various services, such as: protection of property, maintenance of internal order and security, protection from external attack, etc. However, these services are not free—their price is taxes. This confirms the widespread modern understanding of the nature of the tax, such as the price of public goods and services (goods), the production of which is ensured through taxes. At the heart of this theory is the understanding of the market-equivalent nature of the tax: the state produces and sells public goods and services to citizens, who pay them through taxes. On this occasion, Stoyanov (2000, p. 24)

states: “In principle, it is true that the state provides the population with a number of services or provides them with public goods (goods)” the price “of which are taxes. However, if we try to concretize this thesis in relation to individual taxpayers and specific taxes, we will encounter insurmountable difficulties. It can be assumed that the more an individual owns, earns more and earns more and better consumption, the more he needs the state and the more taxes he has to pay. However, this is not always the case in practice, which is why every tax is a gratuitous payment, and its remunerative nature is very general and abstract.” These arguments of the author against the logic of the equivalent theory are completely justified. They are an expression of a realistic understanding of the tax sovereignty of the state, which gives grounds for taxation of taxpayers and for the enforcement of tax obligations, regardless of the benefits they may receive from the state in the form of public goods.

From an economic point of view, the tax is part of the income of individuals and legal entities, of their purchasing power, which is seized and made available to the state. On the other hand, the democratic nature of the state, the ability of the population to exercise control over parliamentary decisions and government policy shape the shape of the tax system. In addition, tax revenues are managed by parliament and government, but in a democracy, taxpayers are able to control the efficient spending of public funds. Therefore, citizens are not only a passive party in tax relations with the state. Stoyanov (2000) points out that the scale and structure of the state apparatus (etacracy) crucially determine the level of taxation and the tax burden. According to him, the more democratic the society, the more reliable the election and control of MPs, the lower the tax burden and the more democratic the tax system.

Theories about the nature of the tax reveal some of its characteristics and the specifics of the relationship between the state and taxpayers. The integrative perception of theoretical concepts provides an opportunity to understand the complex nature of taxation and serves as a basis for clarifying the modern role and functions of taxes, which are realized through tax policy, and tax control (audit) ensures its successful implementation.

1.3 Interpretation of the Role and Functions of Taxes and Tax Audit from the Standpoint of Sustainable Development

1.3.1 Modern Role and Functions of Taxes

The emergence and development of taxes accompanies human civilization and is associated with the needs of the state for material resources or financial resources. In its thousand-year history, the tax has been established as the main method for accumulating the financial resources needed by the state. The functions that can perform taxes in modern society are the following:

- **Fiscal function:** Provide the necessary financial resources for the functioning of the state and for the creation of public goods.
- **Economic function:** Affect employment, economic development and growth.
- **Social function:** Redistribute the income of individual taxpayers and influence social processes.
- **Environmental function:** A tool for conducting environmental policy and influencing the behavior of tax subjects in order to protect the environment.
- **Control function:** Assist in carrying out lawful activities, keeping regulatory records, declaring the required data, administering taxation and monitoring compliance with tax laws in order to accumulate regular revenues in the budget.

From the tax functions considered in this way, the fiscal function has been established as primary and intrinsic to taxes. The active social function of taxes dates back to the second half of the nineteenth century, and the economic function dates back to the 1930s (Stoyanov, 2000). Proponents of the theory of functional taxes consider the economic function of taxes to be dominant in accordance with the postulates of Keynesian doctrine. According to them, the main purpose of taxes is not to provide revenue to the budget, but to have the desired impact on the reproduction process and the national economy. In connection with the adoption of the principles of sustainable development, the expectations for the ecological function of taxes and the possibilities for achieving ecological effects through the taxation system are growing.

The concept of sustainable development and its practical implementation is aimed at achieving results in *three main areas*—economic, social and environmental, which should be considered together and equally, i.e. holistically (Elliott, 2013). This leads to the current widespread understanding (Mladenova, 2015) that “sustainable” is a development that rests on three pillars—economic, social and environmental. That is, “sustainable” is a development that achieves in unity the three groups of goals: (1) economic—growth of welfare, (2) social—social equality, reduction of social differentiation and (3) environmental—ecological balance and nature conservation.

Therefore, it can be concluded that the three key areas of sustainable development—environmental, social and economic—directly correspond to the modern functions of taxes in the following aspects:

- **Economic aspect:** Maintaining a low level of unemployment by pursuing an adequate income and taxation policy so as to stimulate employment and economic development, limit the “gray economy” and ensure optimal receipt of tax and social security revenues in the budget.
- **Social aspect:** Reducing income inequality, ensuring social justice and stability through the taxation system.
- **Environmental aspect:** Stimulating environmental protection by pursuing a tax policy aimed at rational choice of resources and use of innovative environmental technologies.

The immanent fiscal function is also important for achieving sustainable development—without financial security and regular tax revenues, the state will not be able to provide its citizens with all those public goods that are valued in modern society—free and quality education, healthcare, modern infrastructure, innovative technologies, etc. The implementation of large-scale environmental projects, innovations, technological transformations, retraining and redirection of human capital are mostly the result of public investment (Stiglitz, 2012), although opportunities are being sought to expand the so-called public-private partnership.

From a scientific and practical point of view, the possibilities of the different types of taxes—income taxes, property taxes, sales taxes and environmental taxes, to be used as a tool for achieving the goals of sustainable development are of interest.

1. **Income taxes** (personal income tax and corporate tax). Characteristic of this type of tax is that their fiscal function decreases, and priority is given to their social and economic function.

Economic research (Iliev, 2013) shows that the tax burden and social security payments are the main reasons for the emergence of the “gray sector”, which undermines financial stability and the rule of law in the country: the greater the difference between total labor costs and wages taxation, the greater the incentive to avoid this difference and work in the informal sector. Conversely, reducing income taxes can help increase employment, while at the same time reducing poverty and social exclusion.

Income taxes can stimulate labor activity and entrepreneurial initiative, i.e. economic growth, which reflects *the economic function of taxes*. These taxes can also be seen as a tool to reduce income inequalities, which reflects *the social function of taxes*: redistribute income from higher paid individuals and households to the poorer through progressive tax scales, the introduction of non-taxable minimum, tax reliefs and incentives for income taxation.

Family income taxation can also bring social justice, as it takes into account the total amount of annual individual income and the family status of the taxpayer—the number of dependent dependents, the number of children and others. *Family income taxation* is considered to have a positive role in supporting families and stimulating the birth rate, which could help address demographic challenges (Kotsev et al., 2008).

Some additional—environmental functions of income taxation can be distinguished. For example, when determining the annual tax base, amounts for: the use of public transport instead of personal cars may be deducted as tax relief; the acquisition of a “passive house” and/or an electric car; introduction of ecological sources of electricity in the household. Therefore, the modern functions of income taxes are complex, which makes them a powerful tool for sustainable development (Nikolova, 2021).

2. **Property taxes** (land tax, real estate tax, inheritance tax, vehicle tax)—the accumulation of tax revenues from real estate taxation at the expense of labor income brings some fairness to the tax policy, as the tax burden is shifted on the

wealthy who are their owners or users. In this way, income inequality is mitigated. In addition, property taxes can create incentives for the acquisition of ecological homes and cars, for the implementation of environmental improvements to the owned movable and immovable property.

3. **Sales taxes** (duties, VAT, excises and other taxes levied on sales or trade turnover)—when the burden of taxation shifts to taxes on consumption, with increasing incomes and sales, increasing revenues will be provided in the budget. In addition, consumption taxes distribute the tax burden according to the actual consumption of tax subjects and thus a kind of fairness in taxation is realized: more taxes are paid by those who consume more and who use harmful goods and services. In addition, lower tax rates can be provided for environmentally friendly products to encourage their consumption. For example, to reduce VAT rates or to provide tax credits for energy efficient products and energy saving materials.
4. **Environmental taxes**—shifting the tax burden from income taxes to environmental taxes, such as a tax on CO₂ emissions (so-called “carbon tax”), can bring fairness to taxation and at the same time help reduce the harmful effects on environment: more taxes are paid by those who pollute the environment, i.e. the “polluter pays” principle is being implemented. Environmental taxation is an important tool of tax policy that supports long-term sustainable development. Its definition can be relatively broad, although in general it is a tax whose impact is primarily on the environment, which significantly regulates the impact of certain environmental conditions (Kotlán et al., 2021).

The European Parliament calls for the introduction of a system of taxes and fees aimed at limiting the use of pesticides and encouraging the use of less toxic and harmful substances for the environment and health. This should include changes in tax systems so that Member States reduce taxes on labor and increase taxes on pollution, reduced resources, etc., so that a positive impact on the environment can be realized (European Commission, 2019, p. 26).

Therefore, tax systems where income tax rates are high with relatively low burdens on consumption taxes, property taxes and environmental taxes allow for a shift in the tax burden from earnings to other tax bases.

1.3.1.1 Modern Role and Functions of Tax Control (Audit)

In connection with the statement made, the current role and functions of tax control (audit) can also be clarified. From the standpoint of the Concept for Sustainable Development, the tax control system is a guarantor of a successful tax policy. Without adequate tax control (inspections and audits) it will not be possible to comprehensively implement the tax functions, incl. accumulation of the necessary tax revenues, ensuring social stability and targeted economic impact, as well as assistance in preserving the ecological balance.

Tax revenues provide funds that the state uses to maintain infrastructure, education, health, security, public order, research, technical progress, and other public

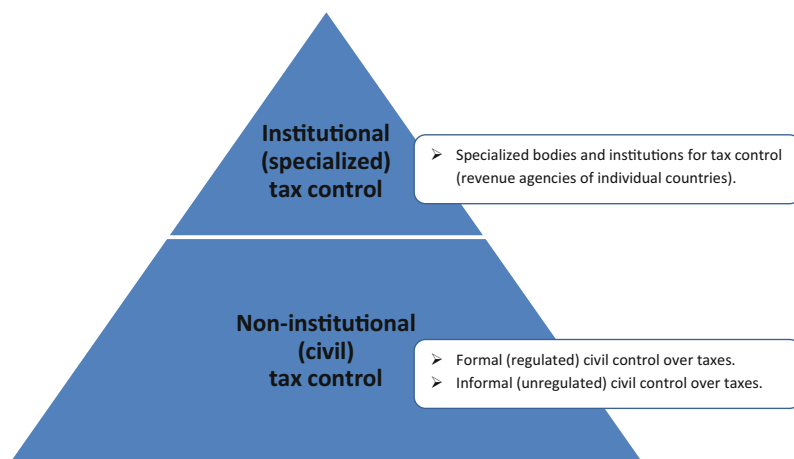


Fig. 1.1 Structure of the tax control system in a democratic society. Source: The author

expenditures that ensure sustainable economic growth. If tax control is weak, it will not be a reliable barrier to tax fraud and tax evasion; it will not be possible to provide sufficient funds to finance government spending that stimulates economic development. Low tax collection is the reason for the deterioration of the budget balance; hence the increase in the budget deficit and the increase in government debt, which in turn is an unfavorable condition for maintaining stable public finances. All this requires effective tax control in accordance with the dynamic changes of the economy and society. If taxpayers have expectations for permanent, comprehensive and in-depth tax control, then tax compliance will be higher. The joint fight against tax evasion and avoidance should also be stepped up. To this end, it is necessary to strengthen international cooperation against tax havens, which undermine the tax base of both developed and developing countries.

In a democratic society, the tax control system consists of *institutional tax control*—specialized bodies and institutions for tax control (revenue agencies of individual countries, such as the Internal Revenue Service in the USA, Canada Revenue Agency, HM Revenue and Customs in the United Kingdom, National Revenue Agency in Bulgaria, etc.) and *non-institutional tax control* exercised by non-governmental organizations and citizens. The structural components of the tax control system in a democratic society are presented in Fig. 1.1.

Non-institutional control over compliance with tax legislation is formal and informal. First, the formal (regulated) civil control over taxes is realized, for example, by creating a legal obligation for buyers to keep their fiscal vouchers until they leave the store and to inform the tax administration in case of non-issuance by the seller. In order to ensure the conditions for the fulfillment of this obligation, it is required that telephone numbers for communication with the control bodies be indicated in a visible place in the commercial sites. Second, the education of public intolerance to tax violations and the emergence of negative public reactions to them

are an expression of informal (unregulated) civil control over taxes, which is realized mainly through the media.

1.4 De Jure and De Facto in Taxation and Tax Audit: Status, Problems and Solutions

1.4.1 Independence and Autonomy of the Tax Administration

The issue of the degree of autonomy of the revenue authorities and ensuring independence from the executive branch (government) is related to the possibilities for increasing the efficiency of the tax administration and the results of the control impact.

The tax system is responsible for generating the bulk of the revenue needed to finance public goods. Given the wide range of tax laws being administered, the quality management and self-assessment systems in place, and the large number of taxpayers, revenue authorities need both broad powers and a degree of autonomy to be as operational and efficient as possible to carry out their activities efficiently and impartially. On the other hand, they must work reliably, which can be ensured through reliable accountability and regular supervision, in order to ensure transparency and legality in their activities and the overall administration of taxation. This requires ensuring the independence of the tax authorities and at the same time ensuring the implementation of lawful and socially useful activities on their part.

The European Commission has developed a set of fiscal projects (fiscal blueprints), which were originally aimed at guiding EU candidate countries and member states in strengthening their revenue bodies. In this regard, the priority is to ensure an adequate level of autonomy, and the key indicators for evaluation are: the envisaged degree of autonomy in a normative way; the provisions for reporting by the manager; the impact of autonomy on the organizational structure and operational responsibilities; the development and implementation of its own operational policy by the tax administration.

With regard to institutional design and autonomy, the IMF's Fiscal Affairs Department provides some practical advice and recommendations to individual countries as part of the technical assistance it provides to them under the Fund's programs. The IMF usually recommends that the revenue authority have sufficient autonomy with regard to the organization and planning of activities, budget management, performance measurement and human resource management, incl. recruitment and career development (OECD, 2015).

The practice of creating a single body for tax administration of all taxes, and sometimes duties, outside the official structure of the Ministry of Finance (or its equivalent), with a wide range of autonomous powers has become widespread in structuring modern tax administrations. According to a large-scale comparative OECD study conducted in 56 countries, more than half of them apply this model

Table 1.1 Scope of delegated autonomous powers

Delegated autonomous powers	Evaluation criteria
Budget expenditure management	<ul style="list-style-type: none"> • Independent assessment of the allocation or adjustment of the administration's budget, which enables the revenue authorities to use their resources more rationally
Planning of the internal organization and administrative structure	<ul style="list-style-type: none"> • Location of the tax authorities • Formation of strategic and operational plans for the activity of the revenue bodies, according to the changed circumstances in order to increase the overall efficiency and effectiveness
Performance standards	<ul style="list-style-type: none"> • Setting own standards for administrative implementation, for example to provide services to taxpayers
Recruitment, development and remuneration of human resources	<ul style="list-style-type: none"> • Effective use of human resources by providing opportunities to set qualification standards for newly appointed employees; to recruit and dismiss staff; to create staff training and development programs • Negotiation of staff remuneration in accordance with public sector policies and arrangements
Information technology	<ul style="list-style-type: none"> • Administer own internal IT systems or outsource such services
Interpretation of tax legislation to help taxpayers	<ul style="list-style-type: none"> • Clarify the application of the law and its administration
Execution	<ul style="list-style-type: none"> • Powers to exercise, without referral to another body, certain actions related to the administration of taxes. For example, receiving information from taxpayers and third parties, seizing property for unpaid debts • Ability for revenue authorities to respond quickly to tax discrepancies
Sanctions and interest	<ul style="list-style-type: none"> • Right to impose administrative sanctions and interest for non-compliance with tax laws • Right to simplify administrative sanctions and interest for non-compliance with tax laws under certain conditions

Source: The author according to OECD data (2015)

to the revenue agency structure (OECD, 2015). The arguments in its favor relate to increasing efficiency and results: (1) a single-purpose agency that can focus its efforts on common tasks; (2) an autonomous organization that can carry out its activities without political interference in day-to-day operations; (3) better opportunities to recruit, retain or dismiss and motivate staff.

The same OECD study (2015) presents the delegated autonomous powers that are found in the practice of some revenue authorities. They can serve as criteria for assessing the level of autonomy of a revenue agency. The delegated autonomous powers and the evaluation criteria are presented in Table 1.1.

Even with increased autonomy, revenue authorities must work within frameworks to ensure that they remain accountable to government and citizens. Reliable mechanisms for oversight of revenue authorities and adequate accountability for the implementation of their activities are needed. To this end, in some countries

management or advisory boards have been set up between the Revenue Agency and the Ministry of Finance, for example: the Public Board of the Federal Tax Service, the Board of Her Majesty's Revenue and Customs in the United Kingdom, the Internal Revenue Service's Oversight Board in United States. They consist of external staff, outside the revenue agency, who are tasked with overseeing the day-to-day running of the tax system. Management boards perform a supervisory function and participate in strategy development and planning, policy approval, signing of official budgets and plans, as well as an overall evaluation of implementation. The members of the board do not participate in issues related to the taxation of individual taxpayers and do not have access to specific data about them.

In some countries, there are specialized bodies, independent of the Revenue Agency, to report on the work of the tax system, for example: in Australia (Inspector-General of Taxation) aims to report and make recommendations to the government on ways to improve administrative systems tax legislation so as to reduce the administrative burden for taxpayers; in the United States (Treasury Inspector General for Tax Administration) aims to ensure independent oversight of the activities of the Internal Revenue Service (IRS). These bodies operate separately and independently of national audit bodies, which monitor the work of all government agencies (OECD, 2015).

In many countries, special bodies (Ombudsmen) have been set up to deal with individual complaints against revenue bodies submitted by citizens and businesses. The main objective is to ensure that citizens and businesses have the opportunity to seek assistance when they feel they have been treated harshly or unfairly, and to address these issues independently of the agency to which they relate. Examples include: Taxpayers 'Ombudsman in Canada, Mexico's Office of Taxpayers' Advocate (Prodecon), Tax Office of the Ombudsman in South Africa, Taxpayer Advocate Service in the United States (OECD, 2015).

In view of the above, *it can be concluded* that the lack of operational autonomy of a revenue agency, as well as the direct subordination of the line minister (usually the Minister of Finance) deprive specialized tax control of independence and create conditions for it to be targeted and one-sided. Thus, the broad powers of the tax authorities could be used as a kind of instrument to put pressure on individual taxpayers or groups of taxpayers.

1.4.2 Improving the Efficiency of the Tax Administration Through the Use of IT

The use of IT technologies makes it possible to reduce the costs of tax administration and meet the growing demand of taxpayers for modern services from the tax administration. This creates opportunities for increasing the efficiency of the tax administration and higher satisfaction of taxpayers in fulfilling their obligations, which has a positive impact on tax collection.

The proliferation of electronic devices simplifies access to administrative services on the go. On a daily basis, taxpayers use technologies that speed up information sharing and access to a range of electronic services. This creates higher expectations regarding the quality of services they seek from revenue administrations.

Many taxpayers are reluctant to invest their time and effort in learning the details of how to comply with tax laws that are constantly changing and becoming more complex. In this regard, revenue authorities need to consider how to develop their services to help and guide taxpayers to meet their tax obligations in a timely and convenient manner or to obtain their rights administratively. Many administrations take an approach to providing services related to key events in the life of the taxpayer or his family, such as having a child, registering a company, starting school or higher education, starting a job, buying a home, retiring or dying family member. Thus, revenue authorities could look for a way to combine taxation with other services that taxpayers use (OECD, 2016). The development of electronic services in the tax administration can be considered in the context of the creation of a common digital platform for government programs, which provides a single digital access for all interactions with the so-called. “e-Government”. When confidential information about taxpayers is not included, the data can be shared between all government agencies. This eliminates the need for taxpayers to provide the same information on events to multiple agencies (OECD, 2016).

Big Data technology provides an opportunity to create new tools to help revenue authorities provide proactive services, better manage tax avoidance and tax evasion risks, and improve other activities, such as collecting of debts. Big data is a large and complex, often unstructured data set that is difficult to work with using conventional tools and techniques. This is data collected from a wide variety of sources, including the Internet, social media, sensors, text messages, video, images and audio files, and other often unstructured sources. The ability to analyze data in real time or in a timely manner offers revenue authorities the ability to change the way they manage the risks and services they present to taxpayers (OECD, 2016).

Public sector agencies are increasingly taking advantage of the streams of big data on their work, including crime prevention and public safety, as well as facilitating disaster response and improving social services. Revenue authorities must also look for opportunities to use Big Data technology to administer taxes and collect revenue. The challenge for revenue agencies is to learn how to turn big data into useful information for complying with tax laws, improving services and reducing costs. Collecting large data from third-party sources and combining them with tax data can allow revenue authorities to develop and create personalized electronic services to address the specific needs of individual and business taxpayers. Increased efficiency is expected from combining big data with modern analytical technologies, such as geospatial analytics, network analytics, text and voice analysis, click flow analysis, operational information and real-time analysis. Real-time data availability will enable revenue authorities to check real-time or timely tax assessments instead of verifying transactions that have taken place in the past, provided that their tax systems are integrated with the natural environment of taxpayers (OECD, 2016).

Combining Big Data technology with digital tax filing will have a significant effect on tax administration in the future. Revenue authorities will be able to introduce real-time or timely risk monitoring and assess compliance. All this creates improved opportunities to counter tax fraud and curb the informal economy. Big data can help revenue authorities research and understand the historical activities and behavior of taxpayers. Given that most taxes are related to business transactions carried out by taxpayers, it is possible that over time, revenue authorities may be able to move taxation to the point of transaction using Big Data technology, eliminating the need to file most tax returns. Big data processing technologies can also allow revenue authorities to review all transactions in the wider economy and industry, group and compare, and not just analyze the risks of selected taxpayers. Thus, the perspective for revenue authorities is to move from an analysis of historical transactions to a state in which they can view the activities of taxpayers in real time (OECD, 2016).

Big data technologies provide an opportunity to improve many aspects of the work of revenue authorities. The aim is to make a digital transformation and transition from an institution that extracts most of its data from information provided by taxpayers to one that extracts information from third parties in order to use it for optimal interaction with taxpayers in assessing risk and the provision of modern tax services. Big data technology features new data sources and improved access to data that can be accessed in real time or in a timely manner, and also provides an opportunity to combine data and analysis. This creates an opportunity to extract better business information from existing taxpayer data and thus improve the support that revenue authorities provide to taxpayers in fulfilling their tax obligations. Thus, preconditions can be created for increasing tax compliance, reducing administrative burdens and increasing taxpayers' trust in revenue agencies (OECD, 2016).

1.4.3 Increasing the Collection and Reducing the Costs of the Tax Administration

In modern conditions, many governments seek to improve the state of their budgets by increasing the collection of tax receivables and reducing the cost of tax administration. In this regard, opportunities are being sought for more efficient revenue collection, including through the integration of tax and social security collection. Most OECD countries still have separate administrations to collect taxes and social security contributions. Despite the dominance of this approach, the last two decades have seen a trend towards integrating their collection both in developing countries, which seek to reduce the cost of public administration, and in advanced economies, which are looking for opportunities to improve efficiency and effectiveness. The main arguments for integrated tax and social security collection, which are highlighted in the IMF (2004) working papers, are the following: (1) General nature of the main processes involved in tax and social security collection; (2) Full use of

the capacity of the revenue administration; (3) Focus only on the competences related to the collection of taxes and social security contributions, without the need to develop special competences for the payment of benefits; (4) Reduction of the expenses for the state administration, as the duplication of the main functions related to the processing and verification of declarations, payments and compulsory collection of receivables is eliminated; (5) Reduction of the expenses for the observance of the tax-insurance legislation by the taxpayers by filling in general forms and optimization of the systems for audit of the documentation.

1.4.4 Increasing Tax Morale and Tax Compliance

The modern tax system is focused on pursuing a sustainable tax policy and improving “tax morale”. This concept is generally understood as the motivation for voluntary compliance with tax legislation. The OECD (2013) emphasizes the role of tax morality and points out that promoting the voluntary fulfillment of tax obligations must be a key objective of revenue authorities in improving tax administration (OECD, 2001).

According to Luttmer and Singhal (2014), people may have some inherent motivation to pay taxes or feel guilty and ashamed of failing to meet taxes. They can also be driven by reciprocal motivation: a willingness to pay taxes in exchange for goods (public services) that the state provides to them or to other members of society. People can be influenced by the behavior of individuals in their environment and the possibility of social recognition or sanctions from them. Cultural or social norms can affect the strength of these internal stimuli, reciprocal motivation, or sensitivity to other people’s opinions. The authors conclude that tax morality significantly improves compliance with tax legislation, but the leading factor in the implementation of tax obligations is law enforcement. They clarify the main mechanisms through which tax morality operates and its consequences on the implementation of tax policy. According to the results of their research, tax morality depends on the law enforcement environment and there is a relationship between them. At one extreme, if law enforcement is so strong that compliance is perfect, then tax morality does not play a role. At the other extreme, without any law enforcement, tax morality can be destroyed, as the lack of law enforcement signals that compliance with tax law is unimportant (Luttmer & Singhal, 2014).

DeBacker et al. (2012) found that corporations with owners from more corrupt countries avoid more US taxes. Based on a survey of data from more than 25,000 IRS corporate tax audits, they linked corporate tax avoidance to foreign corporations in the United States to levels of corruption in owners’ countries of origin. This clarifies the link between the propensity to avoid taxes and the level of corruption in the country concerned. From this, *it can be concluded* that tax morality directly depends on the efficiency and effectiveness of the judiciary and the level of corruption in a system. When tax fraud and abuse remain undetected or unpunished, and

when taxpayers feel that public revenues are being used inefficiently or illegally, then the propensity to voluntarily meet tax obligations is significantly reduced.

Torgler (2008) points out that the willingness to evade taxes depends on the level of tax fraud of others in a society. Therefore, a person's willingness to be corrupt depends on the behavior of other citizens. The more others are perceived as corrupt, the greater the individual's willingness to be corrupt. He stressed the importance of social norms and trust in institutions to reduce tax fraud.

Alm (1999) examines non-economic factors influencing tax compliance and concludes that: (1) Social norms and social customs matter—the taxpayer will fulfill his obligations as long as he considers compliance with tax laws to be the social norm. Conversely, if non-compliance becomes pervasive, then the social norm of compliance disappears; (2) Some taxpayers define any payment of taxes as a loss, which is why they are likely to declare less income than real; (3) If taxpayers give more weight to the probability of an audit than usual, then the level of tax compliance will be higher. Therefore, compliance with tax legislation depends on the level of tax morale and the implementation of adequate control in the field of taxation.

1.4.5 Anti-corruption in the Tax Administration

Corruption can be seen in a narrow sense, as bribery, and in a broad sense, as any abuse of power for personal gain (Klitgaard, 1988). Corruption exists when the individual wrongfully puts his personal interests above those of the people or the ideals he has promised to serve. It manifests itself in various forms; may include promises, threats, or both. The initiator may be a civil servant (official) or an interested client, and the result may be an action or inaction of one of the parties. Corruption can affect various areas, such as the tax authorities, customs agencies, public procurement, and the police. The fact that corruption benefits people in power makes it a difficult problem to tackle. According to some authors (Noonan, 1987; Klitgaard, 1988), corruption is fundamentally an ethical issue. Shleifer and Vishny (1993) draw an analogy between bribery and tax, emphasizing that, unlike taxation and taxation, corruption is illegal and must be kept secret so that it is not detected and punished.

The tax system is one of the areas that can be seriously affected by corruption through tax evasion, “settlement” of tax differences, extortion and bribery to speed up services. In addition, there is any other practice that may facilitate tax crimes or hinder tax crime strategies. Based on a study by Klitgaard (1988), the characteristics of the main types of corruption can be systematized:

1. *In case of tax evasion, the* benefits shall be for the persons evading taxes. Non-tax evaders and users of public services financed with tax revenues have been harmed. The reasons for this type of corrupt practices can be found in the presence of difficulties in fulfilling tax obligations; high tax rates; small penalties; lack of review of tax audits.

2. In “*settling*” the tax differences, the benefits are for the corrupt taxpayers and the employees. Non-tax evaders and users of public services financed with tax revenues have been harmed. The reasons for this type of abuse can be found in the lack of computerization; low effectiveness of penalties; lack of review of tax audits; payment through the tax administration; low salaries of the revenue authorities.
3. In case of *extortion*, the benefits are for the corrupt employees. The direct victims have been harmed. The reasons for this type of abuse can be found in the presence of complex regulations, rates and procedures; extortion is difficult to report and/or there is no reliable protection for the reporter against revanchism; small penalties; lack of review of tax audits; low wages.
4. When *giving a bribe to speed up the services*, the benefits are for some taxpayers and corrupt employees. The damage is to most taxpayers due to deliberate maintenance of delays and to the tax administration due to deteriorating reputation. The reasons for this type of abuse can be traced to the existence of complex administrative procedures; lack of computerization; payment through the tax administration; small penalties; lack of control over the work of the tax administration; low wages.

Kotlán et al. (2021) study the study of environmental taxation in conditions of high levels of corruption, turning Note that corruption, especially if it is systemic in nature, has the potential to limit the implementation of sustainable development policies, including the European Green Deal. Therefore, corruption in the system of tax administration hinders the implementation of tax functions and the conducted tax policy, incl. in its part for limiting the harmful impact on the environment through the tools of ecological taxation.

1.4.6 Realization of Effective Control Impact

In order to limit tax evasion, ways are being sought to increase tax morale and improve the control impact. In turn, the control impact can be increased through two approaches: *extensive*—expanding the scope and frequency of control and *intensive*—improving the current risk assessment, optimal targeting and competent performance of tax audits. Alm and McKee (2006) examine the impact of the likelihood of tax audits and the productivity of tax audits on the level of voluntary tax compliance. They conclude that only if higher audit productivity is combined with a greater likelihood of tax audits can a positive effect on voluntary tax compliance be expected.

For the results of the tax control a tax act is issued, in which the amount of the established tax liabilities and the due interests for the respective period is entered. The tax laws provide for administrative and penal provisions for violation of tax norms. In such cases, in addition to an act on the results of tax control, acts for establishing administrative violations are drawn up, and on the basis of them penal

decrees are issued, which impose—a fine on individuals and property sanctions on legal entities and sole traders. Thus, the administrative-penal responsibility of the taxable persons is realized, the purpose of which is to re-educate and discipline the perpetrator of the violation, as well as the other potential violators. However, in order to realize the deterrent effect of the administrative penalty, its amount must be rational.

Pashev (2006) points out that according to classical models of tax evasion, the amount of sanctions should be linked to the amount of hidden income or hidden tax. According to him, when administrative sanctions are not determined in this way, but are regulated in a wide range of lower and upper limits in absolute terms, which is determined at the discretion of the implementing body, then there are two negative consequences: (1) large amounts, as it is regressive above the ceiling of the sanction, where the marginal cost of each additional hidden lev is zero. (2) Creates opportunities for judgment in imposing the penalty and respectively for corruption pressure. The author points out that fixed minimum levels and a progressive scale, depending on the size of the tax violation, are more effective preventive measures.

As a result of the performed tax control, in addition to the reimbursement of fiscal damages, through the accrued tax liabilities and interest on them, the revenue authorities may seek administrative and criminal liability from violators of tax regulations. In addition, in cases of proven tax offenses, the perpetrators should be held criminally liable under the Criminal Code by the judiciary. In this way the control impact in the field of taxation will be effectively realized.

1.4.7 Interaction and Cooperation to Combat Cross-Border Tax Fraud

Cooperation and interaction with the competent authorities and bodies, at national and international level, are key to achieving efficiency and effectiveness in tax control, as they are related to the realization of a synergistic effect in combating tax fraud. In this regard, it should be borne in mind that tax fraud is very often combined with other financial crimes, for example: tax crimes and money laundering; tax crimes and corruption; tax crimes and organized crime.

The OECD (2021) calls for enhanced international cooperation for the effective detection, cessation and sanctioning of tax crimes. He points out that tax and other financial crimes are becoming increasingly global, which, if left unchecked, could undermine the rule of law and public confidence in the legal and financial system. Technological developments are also leading to new risks, including the rise of cybercrime.

A tax administration that communicates and exchanges experience with other control bodies and the judiciary can achieve better results in tax compliance, ensure greater punishability of tax crimes and recover damages from evaded taxes. The possible interactions between the authorities related to taxation and the fight against

tax fraud can be numerous and unique in each legal system (PROTAX, 2020). Therefore, it is difficult to specify and list, but they could be presented in summary form.

1. **At national level:** Tax administration, health and pension insurance administration, payment of pensions, benefits and allowances, customs administration, independent financial auditors in the private sector, auditors and financial control bodies in the public sector, economic police, prosecution, authorities to fight organized crime and corruption.
2. **At EU level:** EUROPOL, EUROJUST, OLAF, EU Financial Units Platform, European Public Prosecutor's Office (EPPO), European Justice Network.
3. **At the international level:** World Bank, IMF, OECD, J5 (USA, UK, Canada, Australia and the Netherlands).

The Joint Chiefs of Global Tax Enforcement (known as the J5) are cooperating in the fight against international and transnational tax crime, cybercrime and money laundering by gathering information, sharing intelligence, conducting operations and building capacity to counter tax crimes.

As part of the mechanisms for international cooperation and cooperation in combating tax fraud, the timely exchange of information between tax authorities and the judiciary is crucial for the successful conduct of complex proceedings involving assets and persons outside a jurisdiction. In this regard, the OECD (2010) makes formal recommendations to facilitate cooperation between tax and law enforcement authorities in the fight against serious crime (e.g. money laundering, corruption, terrorist financing), whereas tax authorities can play an important role in the detection of all serious crimes. Sharing information from tax authorities with other law enforcement agencies can help detect and investigate serious crime.

Detecting complex cross-border tax fraud schemes, which are often accompanied by other financial crimes, may require bringing together a team of professionals with different sets of competencies and skills needed to deal with a particular tax case, such as: judicial accountants, computer forensic scientists, surveillance experts, forensic psychologists, investigative interview experts, tax inspectors, prosecutors and asset managers. In other cases, a joint working group may be needed, in which customs and excise officials, justice, foreign affairs, financial intelligence and immigration officials can be included in the team. Joint control actions at national and international level can prevent duplication of effort, enhance the exchange of information, experience and good practice. This increases work efficiency and productivity. As cases become more complex, the establishment of joint working groups and information exchange groups, both domestically and internationally, is becoming increasingly important.

In 2017, the OECD published the first comprehensive guide to combating tax crime, entitled "Fighting Tax Crime—The Ten Global Principles", which was updated in 2021 in a second edition (OECD, 2021). The ten global principles cover the tools that countries can apply: the introduction of comprehensive laws that criminalize tax crimes; developing a comprehensive tax crime strategy; the introduction of mechanisms for confiscation of profits from the crime after

conviction. This proposes a comprehensive framework for developing an effective system for identifying, investigating and sanctioning tax crimes, while respecting the rights of accused taxpayers. Special attention is paid to issues related to cooperation and interaction against tax crimes, in national and international aspects, which are distinguished as separate principles (OECD, 2021):

- **Principle 8. Have an effective framework for domestic inter-agency co-operation:** According to this principle, courts should have an effective legal and administrative framework to facilitate cooperation between tax authorities and other national law enforcement and intelligence agencies in the fight against financial crime, which includes—prevention, detection, investigation and sanctioning of crimes, as well as recovery of the proceeds from them.
- **Principle 9. Ensure international co-operation mechanisms are available:** According to this principle, tax agencies should be able to cooperate effectively in the investigation and sanctioning of crimes, as tax crimes are increasingly international in nature, for example, foreign jurisdiction is was used to conceal assets or income, or the proceeds of illegal transactions were seized abroad without being declared to the tax authorities.

Combating financial crime can include a number of government agencies and bodies: the tax administration, customs administration, financial control, anti-money laundering, financial intelligence, specialized law enforcement, anti-corruption, police and prosecutors. Different agencies and bodies may have unique information or powers that can improve the investigation of a crime. This makes cooperation between the relevant agencies important and useful, especially through the exchange of information.

International cooperation can take a number of forms: sharing information, serving documents, obtaining evidence, and facilitating the taking of testimony from witnesses; transfer of persons for interrogation in execution of detention and seizure orders; joint investigation. In order for such cooperation to take place, there must be a legal agreement setting out the conditions and procedural requirements (OECD, 2021). Examples are: tax information exchange agreements (TIEAs), information exchange and administrative assistance agreements, bilateral tax treaties and other instruments (such as the multilateral convention on mutual administrative assistance in tax matters), and cooperation agreements on investigation (such as MLATs).

1.5 Expectations and Results of Tax Policy

In the context of the Concept for Sustainable Development, the conducted tax policy is expected not only to solve fiscal issues by meeting the regularly growing needs for tax revenues to finance quality public services and goods in the field of health, education, social payments, etc., but also to help solve social and economic problems, such as inequality, unemployment, social exclusion, gray economy.

Reducing personal income taxes can be a tool to promote higher employment levels and bring about desired social effects. Information documents of the European Commission (Evropeyska komisija, 2017) state that reductions in labor tax for vulnerable and more vulnerable groups, such as low-income workers or second-time household members, can help increase employment levels while reduce poverty and social exclusion. As not all countries have enough fiscal space to be able to consider reductions in personal income taxes without adequate compensation, a way must be sought to finance these reductions. In this regard, shifting the tax burden to other tax bases is a possible option. High levels of personal income taxes, together with the relatively low tax burden of consumption taxes, periodic property taxes or environmental taxes, may indicate that there is scope for shifting the tax burden from labor income. From the point of view of economic growth, certain types of tax bases are considered less harmful, such as consumption taxes, periodic housing taxes and environmental taxes.

In a study on personal income taxation and its effects on economic development and growth, Nikolova (2021) concluded that pursuing a tax policy aimed at shifting the tax burden from personal income to other tax bases can not only reduce barriers to economic growth, but also to promote sustainable development and social stability. For example, when the burden of taxation shifts to indirect taxes, with increasing incomes and consumption, increasing revenues will be provided in the budget. In addition, indirect taxes distribute the tax burden according to the actual consumption of the tax subjects and thus a kind of fairness in taxation is realized. In this regard, it should be borne in mind that when the role of indirect taxes in the tax system increases at the expense of direct taxes, the provision of higher budget revenues is possible in conditions of economic growth, as there is an increase in income and consumption; however, in times of economic crisis and depression, such an approach will have a negative effect. The accumulation of tax revenues from real estate taxation at the expense of labor income can also bring some fairness to the tax policy, as the tax burden is shifted to the wealthy who are their owners or users. Shifting the tax burden from personal income taxes to environmental taxes, in turn, can also bring fairness to taxation and at the same time help reduce the harmful effects on the environment, which is especially necessary given the growing negative climate change.

A World Bank report entitled “Toward a New Social Contract: Taking on Distribution Tensions in Europe and Central Asia” argues in favor of higher taxes on capital and higher incomes. In addition, it points to the need to provide better social support in order to reduce inequalities between people caused by new technologies. According to the World Bank report, EU labor market, tax and social security policies need to be renewed to protect vulnerable workers and reduce growing inequalities caused by rapidly changing labor markets and new technologies (Bussolo et al., 2018).

Kyuchukov (2018) points out that the World Bank recommends the implementation of three common policy approaches: increasing protection for all types of employment contracts; putting into operation universal social systems with better social services and protection mechanisms; and expanding taxation beyond income

and consumption (taxpayers' costs). Currently, income, expenses (including VAT) and property and cars are taxed, but the taxation of billions of dollars in company capital is ignored. In this regard, the World Bank calls for a fundamental rethinking of social policies to alleviate inequality. It is pointed out that ineffective policies in this area have led to a decline in institutional trust and increasing polarization in society (Kyuchukov, 2018). While feelings of inequality of opportunity are growing, the election results also show a growing influence of populist parties that offer radical solutions to voters dissatisfied with the status quo. The World Bank report identifies four types of inequality that undermine the existing social contract, namely: differences between young and old; inequalities between workers in different professions; unequal access to opportunities based on geographical location; and inequalities based on—gender, ethnicity, origin and other factors, instead of individual efforts and abilities (Bussolo et al., 2018).

According to modern financiers (Neykov, 2021), the tax on net wealth is the most favorable for capitalism, as it would direct most of the capital of the economy to those who distribute it best. Neykov (2021) refers to Martin Sandbu, who is the Financial Times's European Economics Commentator, and points out that, paradoxically, it is still possible to approve a net wealth tax. According to him, the tax burden on capital owners is expected to increase; as capital wealth has grown much faster than income (the ratio of wealth to gross domestic product has doubled since the 1980s), its relative contribution to the treasury must also increase.

Neykov (2021) is of the opinion that of all the ways of taxing capital, the progressive tax on net wealth is the most favorable for both the owners of capital and capitalism itself. This is an annual tax on the net position of taxpayers—their total assets, reduced by their debts, which gradually increases above the non-taxable amount. He points out that only a few countries have such a tax, but among them are some of the most successful economies in the world, such as Switzerland and Norway. Instead, they levy taxes on assets when they are exchanged from one form to another, such as capital gains tax on sales or when assets are transferred from one person to another, as well as inheritance and donation taxes. All countries impose regular taxes on wealth in the form of real estate. Wealth taxation only in transactions stimulates the accumulation and not the investment or redistribution of capital (Neykov, 2021).

There have been a number of criticisms of traditional wealth taxes. For example, inheritance and donation taxes actually impose a lighter burden on those who live longer or amass more wealth than those who die earlier or transfer assets faster. The capital gains tax "punishes" those who make the best investment choices, as it only taxes capital growth by deducting losses. The net wealth tax is also better than the capital gains tax—corporate profits, dividends and interest. What they have in common is that the greater the profit from investing an amount, the more tax is paid. Thus, if you invest a billion badly, you may be taxed less than if you invest a million very well.

In the case of the net wealth tax, the tax burden does not depend on the return. It follows that the most successful investors would retain more of the return and their capital will accumulate faster. Over time, this would direct most of the capital of the

economy to those who invest it best. It is believed that this model of taxation rewards success and strengthens the potential of capitalism for good investment of the state (Neykov, 2021).

When the tax burden on labor income is significantly higher than the tax burden imposed on capital income, social injustice in taxation arises, which contributes greatly to inequality in society (Momchilov, 2021). Income from capital includes all types of passive income from various types of financial assets, cash and real estate; not only dividends, which are income from financial assets, are included, but also interest, which is income from cash, income from renting real estate, capital gains from the sale of financial assets, etc.

At a meeting of finance ministers in London in June 2021, the world's seven largest economies, united in the G7, discussed issues related to the introduction of a global corporate tax at a minimum rate of 15%. The aim is to introduce mechanisms according to which multinational companies pay taxes in the countries in which they operate. The issues discussed at the G7 summit are focused on global guarantees for the taxation of multinational businesses such as Google, Facebook, Apple and Amazon. The solution could raise hundreds of billions of dollars and help governments address a number of current challenges, such as the effects of Covid-19. The expected effect is that companies will no longer be able to evade their tax liabilities by directing their profits to the countries with the lowest taxes. The abolition of national taxes on digital services collected from the UK and other European countries is also being discussed. The United States believes that these taxes unfairly burden American technology giants (Mediapool, 2021).

Summers (1986) examines the effects of various tax policies pursued in an open economy where capital is mobile. It analyzes the likely impact of alternative tax reforms on international competitiveness. According to him, when formulating tax policy in an open economy, it is important to distinguish between taxes on savings and taxes on investments. Savings taxes refer to taxes on capital gains, such as the tax on interest income. Investment taxes refer to the taxation of capital, such as corporate income tax. In open economies, where there is room for capital flows, savings taxes and investment taxes will have different effects. First, *tax policies that stimulate investment but do not affect savings* can lead to a decline in international competitiveness if capital is freely mobile internationally. This effect will be present, as tax measures that encourage investment attract funds from abroad, increase the real exchange rate and reduce the competitiveness of local industry. Second, *tax policies that encourage savings but do not have a direct impact on investment* will improve the trade balance. These notions are based on the general assumption that capital flows freely internationally. If capital is not internationally mobile, investment incentives will not lead to capital inflows and therefore will not lead to a deterioration in the trade balance (Summers, 1986).

Summers (1986) tests the hypothesis that capital is internationally mobile, but countries systematically use economic policy instruments in an attempt to achieve a current account balance and there are virtually no large inflows of capital. This hypothesis is confirmed. In addition, the author analyzes the very high correlation between domestic savings and investment rates in OECD countries and concludes

that countries with high savings also have high investments, while countries with low savings have relatively low levels of investment. According to him, tax policies that increase savings are likely to significantly increase domestic investment. Investment-oriented policies are unlikely to lead to a lasting increase in investment unless domestic savings also increase. Therefore, national investment cannot be increased without increasing national savings (Summers, 1986).

1.6 Solutions and Recommendations

Based on the research conducted in this chapter, some possible solutions and recommendations related to the studied issues are systematized in the following aspects: (1) increase of tax compliance; (2) enhancing the independence of revenue agencies as well as the transparency and legality of their administrative activities; (3) improving measures to tackle corruption in the tax administration; (4) assessment of the possibilities for realization of the effective control impact in the field of taxation.

1. **Increasing tax compliance.** Compliance with tax legislation depends not only on the economic characteristics of taxation, such as the level of tax rates, mechanisms for taxation and distribution of the tax burden, but also on the level of tax morale in society and the ability to exercise adequate control in the field of taxation. In order to increase tax compliance, the following recommendations can be made:
 - (a) Ensuring constant and comprehensive tax control, which leads to a systemic nature of the control impact.
 - (b) Tax audits should be assigned at random, which is a prerequisite for achieving objectivity and impartiality of control.
 - (c) Increasing the competence of the revenue authorities, which is related to the quality of acquired knowledge and skills both in the education system and through periodic training of employees in the tax administration to maintain and expand their professional competence throughout professional life. In this way, the likelihood of tax evasion could be limited, as well as tax violations and abuses that remain undetected and unpunished.
2. **Increasing the independence, transparency and legality of the administrative activity of the revenue agencies.** To this end, the following recommendations can be made:
 - (a) The governing bodies of the revenue agencies to be elected by the parliament, after a wide public discussion.
 - (b) Revenue agencies should periodically report to parliament.
 - (c) Establish a body with supervisory functions, which is autonomous and independent of the revenue agencies, to monitor the effective and efficient functioning of the tax system.

3. Improving measures against corruption in the tax administration. To this end, the following recommendations can be made:

- (a) Focusing on the “tone of the top” and the reputation of managers in revenue agencies: Management philosophy, work style, personal commitment and the example of managers in the tax administration determine the “tone of the top”. Each manager has a specific approach to work, which has an impact on the level of integrity in the administration, ethical behavior and anti-corruption in the administration. The personal integrity and professional ethics of the leaders and employees of the organization have an impact on the adequate implementation of the set strategic goals and on the results of the activity. In this way they form the public image of the revenue administration and have an impact on the level of tax morale and compliance with tax legislation.
- (b) The application of ethical standards: The framework for the conduct of managers and employees is defined in a code of ethics or code of conduct. The actual application of the adopted ethical norms in the institution leads to a reduction of corrupt practices.
- (c) Motivation of revenue authorities for productive and honest work: The more satisfied the revenue authorities are with their work, the less likely they are to succumb to corruption pressure. Motivation depends mainly on the level of remuneration, opportunities for professional development, the availability of an ethical work environment. This is a prerequisite for high revelations of tax violations and abuses.
- (d) The expansion of electronic services and the electronic processing of declared data: This limits the direct contacts of taxpayers with the revenue authorities, reduces their dependence on the goodwill of employees in tax administration, reduces opportunities for inaction and tendentious delays by tax authorities. Employees, the need for personal judgment in operational control is reduced. These are possible prerequisites for reducing corruption practices and corruption pressure in the tax administration.
- (e) Transparency of activities: If there is sufficient information about the activities of employees, the likelihood of vicious practices and corruption schemes decreases and vice versa, if employees realize that their wrongdoing can not be detected, will continue to participate in corruption schemes. Insufficient information is a major source of corruption, and improving information systems is a prerequisite for solving the problem (Klitgaard, 1988).
- (f) Protection of whistleblowers: An important factor in the successful fight against corruption is the availability of reliable protection of whistleblowers in the tax administration system. Given the broad powers of the revenue authorities, the lack of adequate protection in this regard could lead to an unfavorable response on their part and revanchism. In this regard, it is not enough just to have convenient opportunities for reporting corruption in the tax administration, but also to ensure reliable protection of the reporting agent.

4. Assessment of the possibilities for realization of the effective control impact in the field of taxation. Two main criteria can be used for this purpose:

- (a) Scope of criminal liability: Provided that only tax evasion is declared, which is not declared, but non-payment of taxes is not considered a crime, then criminal liability is limited; moreover, if special treatment and criminal liability for VAT evasion is not regulated, which is different from tax evasion and is closer to organized crime, this undermines the realization of liability.
- (b) Efficiency of justice: Given that the number of convictions for tax crimes is low and the criminality of tax crimes is low, for example, within the 5-year period the prosecutor's office has given 2200 cases, of which only 4 have ended with a sentence, as 3 of them are conditional, then there is a strong incentive for taxpayers to break the law (Pashev, 2006).

The effective counteraction to tax violations, abuses and frauds presupposes the realization of complex tax control impact, which includes: accrual of taxes and interest, realization of administrative-penal responsibility by imposing fines and property sanctions, which are proportional to the hidden incomes and taxes, as well as seeking criminal liability from the perpetrators of the incriminated tax crimes. In addition, in the current conditions of globalization of economic processes and digital transformation of business, the effective tackling of tax abuses requires the joint efforts and synergy of bodies and professionals from different fields at national and international level. Therefore, efforts should be focused on deepening cooperation and interaction in the field of tax control, which is part of the financial control system.

1.7 Future Research Directions

Scientists have long studied various economic aspects of taxation, such as: allowable and maximum levels of taxation; its impact on price stability, economic growth and unemployment; the distribution of the tax burden among different groups of taxpayers (Song & Yarbrough, 1978). However, these studies are not enough to form a comprehensive understanding of modern tax systems in democracies to enable the development of sustainable tax policies. To this end, it is also necessary to study the behavioral characteristics of taxpayers, their attitudes and perceptions about compliance with tax legislation, as well as the determinants of tax compliance in the short and long term.

The processes of digital transformation and the introduction of Big Data in the activities of the tax administration will raise more and more ethical issues for discussion, given the broad powers of the revenue authorities. In this regard, scientific interest in studying the ethical aspects of the use of innovative big data technology in revenue agencies can be expected to grow.

1.8 Conclusion

Based on the presentation so far, it is concluded that without stable tax revenues the state cannot ensure the satisfaction of the constantly growing need for quality public goods. On the other hand, with a weak democracy and the presence of bureaucratic and vicious practices in society, it is likely that the state will take advantage of the opportunity to seize from taxpayers much more of their income than actual needs. It is therefore important to ensure both an effective tax policy and an efficient financial control system that ensures the rational and efficient management of public finances in the public interest. It is also necessary to develop international cooperation for the exchange of information, experience and good practices, as well as for cooperation in dealing with abuses in this area.

The implementation of an effective tax policy in modern conditions will increasingly require a comprehensive approach, according to which taxation should be used not only to accumulate financial resources for the functioning of the state and government programs, but also as a means to achieve the Sustainable Development Goals. Modern tax policy will increasingly be based on the voluntary fulfillment of tax obligations, expanding incentives, guidance and support for compliance with tax legislation. The realization of the Concept for sustainable development presupposes the evolution of morality and increasing the integrity of society. Therefore, the focus will increasingly be on tax morality, the education of good faith and integrity of taxpayers, as compliance with tax laws is driven by the same mechanisms that generate the rule of law in general. Given the dynamic socio-economic processes and digital transformation in the modern world, tax policy should be flexible and adaptable in order to be able to respond to accelerated changes in systems at the local and global level. In an increasingly interconnected world, it can be expected that the structuring of national tax systems and their settings will increasingly reflect global processes, and international tax arrangements will increasingly shape the specific tax policies.

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Chapter 2

The Impact of the Concept of Corporate Social Responsibility and the Principles of Good Governance on Tax Audit and Taxation



2.1 Introduction

The concept of corporate social responsibility (CSR) is closely related to the existing corporate culture in the organization, as the unity of values and norms, beliefs, convictions and moral imperatives shared by members of the organization, which guide their behavior in the process of interaction with stakeholders. The principles underlying CSR are sustainability, accountability and transparency (Peycheva et al., 2016). The principle of sustainability is based on the understanding that the actions taken now have an impact on future opportunities. The principle of responsibility is related to the conscious understanding of the organization that its actions affect its internal and external environment. This requires the organization to be accountable for its actions to all stakeholders, as well as to report on the impact of its activities on the environment. The principle of transparency requires external and internal users of information to have data on the actions taken by the organization and their impact on all stakeholders. Adoption of the principles of CSR leads to a change in business ethics so that it is in line with the Concept of Sustainable Development. The appearance of the socially responsible organization is determined not only by the announced strategies, announced programs and codes of ethics, but also by the actual compliance with the current legal norms. The socially responsible business ensures transparent implementation of the activity and disclosure of information, incl. on tax issues. The observance of ethical standards in the conduct of business provides prerequisites for the correct fulfillment of tax obligations, which leads to an increase in tax morale in society.

In recent decades, many companies have adopted the principles of CSR as their corporate mission, and the Sustainable Development Goals as an integral part of their strategy for competitiveness and growth (European Commission, 2019). It can be expected that this trend will lead to increased tax compliance, as the example of socially responsible companies, for example the disclosure of tax information and

compliance with tax legislation, can have a multiplier effect in society. In this way, it will be possible to establish social norms for voluntary fulfillment of tax obligations and disclosure of paid taxes, as an expression of the contribution that the respective business organization has in the financing of public goods.

The concept of sustainable development has an impact on the public sector through the adoption of the principles of good governance. The application of these principles is the basis of modern public administration at local and central level, as well as institutions and organizations in the public sector. The application of the principles of good governance requires ensuring the rule of law and ensuring fairness, impartiality and predictability in the activities of public institutions and the administration. Respect for human rights is important for building a stable democracy and a coherent society—ensuring that all citizens are protected and their human dignity is respected, and that none of them is discriminated against. The principle of ethical conduct requires: the public good to take precedence over personal interests, the introduction of effective measures to prevent and combat all forms of corruption, and the timely declaration of conflicts of interest. Ethics in the behavior of civil servants has a significant contribution to the quality of democratic governance and sustainable economic development. It contributes by strengthening civic confidence in the governance and operation of state institutions. High ethical standards, transparency and accountability of public sector institutions are necessary prerequisites for good governance and sustainable development. They not only strengthen public policy and the work of the public sector, but also play an essential role in preventing corruption. Transparency is a necessary condition for integrity and trust in public institutions at local and national level, as well as internationally. Public institutions that implement “transparency” practices work better and are highly valued by the public. Transparent procedures include open meetings and meetings, a clear budget preparation and spending process, free access to public information and audit (Ombudsman na Republika Bulgaria, 2009). All this is also valid for the activity of revenue agencies, such as public sector institutions. Therefore, the implementation of the principles of good governance in the administration of taxation and tax control (audit) will help to improve implementation in line with the Sustainable Development Goals (SDGs), as well as to increase confidence in the activities of revenue agencies. In this way, preconditions are created for increasing the tax morale and regular provision of the planned tax revenues.

In this regard, three main sets of issues are addressed in this chapter. First, the impact of the CSR Concept on the activities and behavior of business organizations, which increasingly seek to coordinate their strategies and programs with the SDGs, to operate in a way that generates value and meets the needs of stakeholders, is studied. In addressing these issues, the emphasis is on tax transparency and disclosure of tax information, increasing tax compliance and the level of tax morale. Second, the possibilities for applying the principles of good governance in revenue agencies, the expected positive effects and the evaluation criteria were studied. Third, the possibilities for improving the implementation and increasing public confidence in the activities of revenue agencies through the application of modern quality management systems (QMS), which require a holistic approach to the

organization. The purpose of this chapter is to examine the impact of the Concept for Sustainable Development on the activities of business organizations and revenue agencies, focusing on opportunities to increase tax transparency, tax morale and compliance with tax laws.

2.2 Background

The popularity and wide application of the Concept of Corporate Social Responsibility (CSR) in modern conditions leads to the existence of many definitions of this concept, which, according to Dahlsrud (2006), complicates its unambiguous perception. It analyzes 37 definitions of CSR by examining the similarities and differences between them. As a result, the author concludes that the definitions are very similar in terms of content. Many of them relate to ethical values, ethical behavior, ethics and responsibility.

According to the definition in ISO 26000: 2010 of the Working Group on Social Responsibility (International Organization for Standardization, 2010): “Social responsibility (e)—the responsibility of the organization for the impact of its decisions and activities on society and the environment through transparent and ethical behavior which is in line with the sustainable development and well-being of society; takes into account the expectations of stakeholders; complies with applicable law and international standards of conduct; it is integrated throughout the organization and is practiced in relationships.”

Based on the study by Dahlsrud (2006), it can be concluded that, regardless of the specific context and field of action, CSR is always inextricably linked to ethics and integrity. Given the scope of the popular definition in ISO 26000: 2010 of the Working Group on Social Responsibility (International Organization for Standardization, 2010), CSR requires business to be conducted in compliance with laws and generally accepted norms of conduct. Therefore, the implementation of the Concept of Corporate Social Responsibility presupposes the harmonization of the business with the moral and ethical norms for behavior and compliance with the current legislation.

Hohnen (2007) refers to the definition in ISO 26000: 2010 of the Working Group on Social Responsibility (International Organization for Standardization, 2010) and points out that CSR means the way in which companies integrate social, environmental and economic issues related to their values, culture, decision-making, strategy and operations, in a transparent and accountable way in order to establish better practices in the company, create wealth and improve society. The author points out that CSR usually includes commitments and activities related to: corporate governance and ethics; health and safety; environmental management; human rights (including fundamental labor rights); sustainable development; working conditions (including safety and health, working hours, wages); industrial relations; community participation, development and investment; the participation and respect for different cultures and disadvantaged people; corporate philanthropy and employee

volunteering; customer satisfaction and compliance with the principles of fair competition; measures against bribery and anti-corruption; accountability, transparency and accountability of the activity; relationships with suppliers for domestic and international supply chains (Hohnen, 2007).

One of the greatest challenges facing humanity at this stage is to ensure sustainability, justice and balanced development. The needs of present and future generations cannot be met without respect for natural systems and international standards for the protection of fundamental social and environmental values. In this context, the role of the business sector is increasingly recognized as crucial. It is in the interest of business to contribute to solving common problems, as it is part of society. In the long run, business can only thrive when the communities and ecosystems in which it operates are healthy (Hohnen, 2007). This strategic perspective helps explain the growing interest among businesses around the world in sharing credible information, experiences and good practices on corporate social responsibility. In this regard, the International Institute for Sustainable Development (IISD) in 2007 developed a guide for companies that do not yet have formal CSR policies or programs, which can be useful for public agencies and civil society organizations in their efforts to achieve sustainability.

In modern conditions, there is a growing understanding of the significant effect that private sector activities have on—employees, customers, communities, the environment, competitors, business partners, investors, shareholders, governments and others. Opinion polls and corporate behavior show that the link between socially responsible business and successful business is increasingly recognized. Also, investors and financial markets are aware that CSR activities aimed at solving broader societal problems are evidence of good governance. Responsible treatment of workers and other stakeholders can increase public confidence, provide competitive advantages to business, attract good customers and employees, and help generate value for companies and their shareholders (Hohnen, 2007).

To the characteristics made so far can also be added: (1) The concept of corporate social responsibility is a holistic approach to the organization, according to which it participates as a full partner in public relations and cares for the welfare of society (Dimitrova, 2015); (2) through the implementation of CSR activities the ethical image of modern business is built (Nikolova, 2021).

The growing focus on CSR in recent decades can be explained by globalization and the pressure on business by non-governmental organizations (NGOs)—especially in post-communist countries, where the focus of democracy is on people (Smith, 2003). The wider media coverage, combined with advances in information technology, allows for the rapid and widespread exposure of corporate abuses even in more remote parts of the world through the use of the Internet and social networks. Therefore, reputational risk, exacerbated by greater business visibility and criticism of corporate practices (especially by NGOs), is becoming an important factor in the behavior of many companies. Maintaining the corporate reputation and brand image is becoming increasingly important as markets become more competitive and reputation and image more vulnerable. Businesses can be “punished” by consumers and other stakeholders for actions that are not considered socially responsible.

According to Smith (2003), product markets are not the only source of pressure to develop CSR—employees have concerns about socially responsible corporate practices, as do consumers. In the labor market, employees prefer to work for more socially responsible companies.

The notion (Smith, 2003) that the fear of damaging the business reputation of corporations in the global world, under pressure from powerful NGOs, has given impetus to the development of CSR in recent decades, can be developed and supplemented. Thus, not only the reputational risk and the fear of business failure, but also the desire to raise the image and improve the business by engaging in socially beneficial activities and important social causes, can be seen as a factor in the development of CSR. In this way, consumer trust and employee loyalty are won, which is a condition for the long-term success of any business.

The concept of sustainable development affects both business organizations—through the adoption of the principles of CSR and public sector institutions—through the adoption of the principles of good governance that underlie the modern state (Nikolova, 2021). The aim is to achieve stable development, increase the well-being and prosperity of society.

The term “good governance” was first used in the field of sustainable development policies to denote the understanding that public institutions should make their decisions, manage public resources and guarantee human rights without tolerating abuse and corruption., respecting the rule of law. With this philosophy, the International Monetary Fund and the World Bank, as early as the 1980s, began tying their aid and loans to developing countries to good governance. Thus, at the beginning of the twenty-first century, the model of good governance was established as a concept and policy. The main criteria for good governance are set out in a number of documents and acts of the Council of Europe, the European Union, the United Nations and international financial institutions. These include: the rule of law and the protection of human rights; transparency and efficiency in the work of the administration at all levels; accountability of state and municipal authorities (Ombudsman na Republika Bulgaria, 2009). The key areas of good governance, such as policy and practice, are three: public administration; provision of administrative services; open data, official exchange of information, unified electronic environment and e-government (Institut po publichna administratsia, 2015a).

2.3 Corporate Social Responsibility: Regular Payment of Real Taxes

The Reflective Paper on Sustainable Europe 2030 (European Commission, 2019) pays special attention to issues related to responsible business behavior, corporate social responsibility and new business models. It states that enterprises have an important role to play in the transition to sustainable development. At the present stage, they realize that socially responsible business can create sustainable profits

and growth, new market opportunities and value for shareholders in the long run. Therefore, in recent decades, more and more companies are integrating the Sustainable Development Goals (SDGs) into their competitiveness and growth strategy. According to the European Commission, in 2017, 78% of the world's leading companies have included issues of corporate social responsibility in their annual reports (European Commission, 2019).

Venter et al. (2016) conducted a study that found a natural link between two global corporate developments, namely integrated thinking and transparency of tax disclosure. They surveyed 45 large companies and, through regression analysis, found that there was a positive relationship between the transparency of tax disclosure in corporate accounts and integrated thinking, which is reflected in integrated reporting. In order to assess the complex role of companies in modern society, it is necessary to improve transparency in reporting their activities, which leads to the development of integrated reporting, also called accounting for sustainable development, reporting on sustainable development, "The Triple Bottom Line" (The three "P"—profit, planet, people). This report aims to present a comprehensive view of the company, combining in one document financial and non-financial information about the relationship between—economic, environmental, social and managerial performance of the company. In this way a holistic approach to the disclosure of information about the company's activities, which is necessary for the implementation of sustainable development.

The International Integrated Reporting Council (IIRC) has been endorsed by The International Integrated Reporting Council (IIRC), a global coalition of regulators, investors, companies, standard setters, accountants, academics and NGOs. This framework (International Integrated Reporting Council, 2021) includes eight main elements that are interrelated:

1. **Organizational review and external environment:** Presents the company's mission and vision, as well as the legal, commercial, social, environmental and political factors that affect the business's ability to create value.
2. **Leadership and management structure:** Explains how the organizational and management structure contributes to value creation in the short, medium and long term.
3. **Business model:** Simplified description of the process of transforming resources, through business operations, into final products, services and results.
4. **Risks and opportunities:** Clarifies their specificity and impact on the organization's ability to create value in the short, medium and long term, and how the organization handles them.
5. **Strategy and resource allocation:** Clarifies the goals of the organization and how it intends to achieve them.
6. **Productivity:** Presents information about the results of the organization's activities.
7. **Perspective:** Future forecast for development and efficiency, as well as assessment of possible challenges and uncertainties for business.

- 8. Basis for preparing and presenting the integrated report:** Explains how the organization determines what data and information is important to include in the integrated report and how they are measured or evaluated.

The International Integrated Reporting Council (2021), in the part for presenting the business model, recommends providing information on the results of the organization in two aspects: (1) internal, for example—employee morale, the organization's reputation, revenue and cash flow and (2) external, for example—customer satisfaction, tax payments, brand loyalty, social and environmental effects.

According to Andrew Packman—Tax Transparency and Total Tax Contribution Leader, PwC UK—tax transparency will continue to grow as a result of increased requirements for mandatory tax reporting and the willingness of companies to meet the expectations of such information stated by more and more stakeholders. An example is Paying for Tomorrow Citizens' Jury, which requires transparency from the government on raising and spending taxes. The business jury, another component of the same project, identified the need to increase people's knowledge of how the tax system works and about the objectives of tax policy. Additional voluntary tax reporting by corporations is one way to improve the level of understanding. Mandatory tax reporting is linked to the development of requirements for the provision of detailed information on the taxes of multinational companies, as well as on profits and the number of employees in each country. The UK is one of the first countries to adopt the OECD's Base Erosion & Profit Shifting (BEPS) for the information that multinational companies have to submit to the relevant tax authorities. Voluntary disclosure of tax issues is associated with increased interest from many stakeholders, such as customers, shareholders and the media. Also contributing to tax reporting is the Dow Jones Sustainability Indices, which has included evaluation criteria related to tax strategy, tax disclosure and tax risk (PwC, 2014).

PwC (2014) notes that it uses the Tax Transparency Framework each year to review the tax returns of leading UK companies. The framework was initially developed following discussions with leading companies and various stakeholder groups, including governments, investors, analysts and civil society organizations. It is designed to help companies consider the risks and benefits of greater transparency and what they would like to disclose about their tax issues. The framework (PwC, 2014) covers three areas of corporate taxes:

1. **Tax strategy and risk management:** Discussion of tax goals and strategy; disclosure of policies in key business areas, such as tax planning and transfer pricing; how the tax strategy and functions are managed, who is responsible and supervising; discussion of significant tax risks.
2. **Tax figures and implementation:** The harmonization of the tax liability with the statutory rate; discussion of tax payments and their connection with tax liabilities; forthcoming tax measures, such as indications of the future direction of the company's tax rate.
3. **Total amount of tax contributions and the wider impact of taxes:** Clarify how taxes affect the company's business strategy and results; discussing tax advocacy

Tax compliance	➤ Filing compliance: The degree of voluntary fulfillment of the obligation to file a declaration
	➤ Reporting compliance: The extent to which the declaration corresponds to what is actually due
	➤ Payment compliance: The extent to which the declared liabilities have been paid

Fig. 2.1 Indicators for assessment tax compliance. Source: The author according to Pashev (2006)

and lobbying; the impact of taxes on shareholder value; clarification of the economic contribution from all taxes paid.

Based on the above-mentioned studies on the tax reporting of leading corporations and given the growing need of stakeholders to disclose information on the performance of corporations and their public utility, it can be concluded that the framework for integrated reporting is forthcoming. to develop and expand so as to include the disclosure of more and more tax issues.

Given the literature review made so far, the implementation of CSR can be associated with the level of tax morale and compliance with tax legislation. The modern tax system is oriented towards pursuing a sustainable tax policy and increasing “tax morale”. This concept is generally understood as the motivation for voluntary compliance with tax legislation. Three indicators can be used to assess tax compliance: Filing compliance, Reporting compliance and Payment compliance. They are presented in Fig. 2.1.

Therefore, if we look at compliance with tax laws for business organizations, we can assume that where a corporate culture of ethical behavior and integrity is built, where CSR is a strategic commitment of management, the principles of integrated accountability are adopted and ensured. Transparency on tax issues—the level of tax compliance will be much higher. This is because the mechanisms that drive behavior aimed at implementing CSR have a moral and ethical basis, which is a prerequisite for compliance with tax legislation.

Research (Luttmer & Singhal, 2014) on tax morality suggests that people may have some inherent motivation to pay taxes or feel guilty and ashamed of failing to meet taxes. They can also be guided by reciprocal motivation: willingness to pay taxes in exchange for goods (services) provided by the state to them or other members of society. People can be influenced by the behavior of individuals in their environment and the possibility of social recognition or sanctions. Cultural or social norms can affect the strength of these internal motives, reciprocal motivation or sensitivity to the opinions of others. From this, it can be concluded that the development of CSR, the adoption and implementation of this concept by leading business organizations can contribute to increasing tax compliance and tax morale in society as a whole. On the other hand, the propensity of a business organization to regularly pay taxes in real amounts will depend not only on the perception of CSR,

but also on its assessment of how effectively and appropriately the state spends accumulated tax revenues or diverts them.

Other studies (DeBacker et al., 2012) found that corporations with owners from more corrupt countries avoid more US taxes. Based on a survey of data from more than 25,000 corporate tax audits of the Internal Revenue Service (IRS), they link corporate tax avoidance by foreign corporations in the United States to levels of corruption in owners' countries of origin. This clarifies the link between the propensity to avoid taxes and the level of corruption in the country concerned. Since the implementation of CSR requires the adoption of anti-corruption values, as well as the introduction of reliable anti-corruption measures, transparency and accountability, it can be concluded that where a business environment is created based on this moral and ethical concept, can be expected higher degree of compliance with current legislation, incl. of tax laws.

2.4 Specific Manifestation of the Principles of Good Governance in the Tax Administration

The Institute of Public Administration (IPA) in Bulgaria has conducted a thorough study of the principles of good governance based on official definitions and opinions of major institutions of the European Union (European Commission, European Ombudsman), international institutions (UN, OECD), global financial institutions (World Bank, European Bank for Reconstruction and Development, European Central Bank, International Monetary Fund), global non-governmental organizations (World Economic Forum, Transparency International) and other institutions of global importance such as the United States Agency for International Development (USAID) and the Department for Human Rights of the United States (Institut po publichna administratsia, 2015a). Based on this, a set of prevailing global principles of good governance is derived, which have been established in practice. An IPA study (2015a) found that about two-thirds of organizations associate good governance with two guiding principles: (1) the rule of law and (2) efficiency and effectiveness. At least half of the organizations also refer to the following traditional principles: (3) Accountability; (4) Sustainability and long-term orientation; (5) Openness and transparency; (6) Civic participation; (7) Human rights, cultural diversity and social cohesion; (8) Ethical behavior. In addition, the following newer principles are set out: (9) Sound financial management; (10) Competence and capacity; (11) Responsiveness; (12) Innovation and openness to change.

As part of the Council of Europe's Strategy for Innovation and Good Governance at Local Level, adopted in 2007, a methodology for a unified assessment of good governance of local administrations was introduced—the Etiquette for Innovation and Good Governance at Local Level. The evaluation allows for comparability of results on the basis of a single, comprehensive indicator, prepared by summarizing a number of indicators in it. The label is awarded by a Commission within each

country. An evaluation mechanism has been developed in two stages for awarding the Label—self-assessment and evaluation by external experts. Self-assessment is based on specific indicators that apply to each of the 12 principles. With regard to external evaluation, a uniform system of indicators is developed and approved, which each external expert follows. This enables each municipality to measure and evaluate its activities according to the relevant indicators, which allows it to identify its strengths and weaknesses. The municipality can also conduct surveys among citizens and municipal employees and determine whether the self-assessment is in line with public opinion. Thus, a municipality can develop an action plan to address weaknesses, for example, to introduce a code of ethics to prevent corruption. Such indicators of good governance and criteria for their evaluation can also be developed and applied in the tax administration. Such an approach may be appropriate given that the collection of local taxes and fees in some countries is left to municipalities, such as Bulgaria.

According to the OECD (2015), trends in tax administration reform have intensified in recent years as governments focus on improving efficiency and reducing costs. The reforms undertaken for this purpose are in the following directions: (1) Institutional reorganization, including the definition of new roles and functions; (2) Consolidation of office networks to achieve greater economies of scale; (3) Elimination of administrative duplication; (4) Major redesign of business processes, supported by better use of information and communications technology (ICT); (5) Strengthening the management capabilities for dealing with fiscal fraud; (6) Implementation of approaches to the provision of complex public services (“whole of government”). These findings (OECD, 2015) are based on a study of the practice in the tax administrations of nearly 40 countries. They show a perceived need to improve the performance of revenue agencies. In this regard, in addition to the above-mentioned guidelines for reforms, it may be recommended to adopt the principles of good governance in the activities of the tax administration and to periodically evaluate the results of their actual implementation.

Given the above, it can be concluded that the tax administration in each country, regardless of its specific name and the adopted organizational structure, is a public sector institution with specialized activities related to the accumulation of tax revenues and control in this regard. Like any public institution, a modern revenue agency should strive to operate in accordance with the principles of good governance. In order to improve the activity of tax revenue administration and tax control (audit), it is necessary to apply a system of criteria and indicators for each of the principles of good governance in order to ensure their effective application, and not only their inclusion in strategic documents and periodic reports on the activities of the revenue agency.

2.5 Managing Tax Administration Performance in Line with the Sustainable Development Goals (SDGS)

The initiatives of the administration in the public sector, incl. Sustainable development revenue agencies should be linked to the adoption of the principles of good governance and the application of quality management methodologies aimed at improving administrative performance. Modern administrative practice around the world uses quality management systems (QMS), which combine management philosophy, approaches and tools for managing organizations. Among the most recognizable methodologies for quality management are the systems ISO (standards of the International Organization for Standardization), EFQM (Model for Organizational Excellence of the European Foundation for Quality Management), CAF (Common Framework for Assessment/Self-Assessment, adopted as a QMS standard for public administration in EU countries), Baldrige (QMS, popular in the US). These are conceptual models for managing organizations, based on the ideas of Total Quality Management (TQM). These systems contain a number of common characteristics (Institut po publichna administratsia, [2015b](#)).

An example will be the European Foundation for Quality Management's (EFQM) Model of Organizational Excellence, which is widely used in European administrative practice. This model takes into account both the benefits for the organization (institution) and the society, and thus, through its application, a balance is achieved between the economic and non-economic indicators of the activity of the respective administration. According to the EFQM Model, the perfect organization strives for sustainable development by managing its processes and resources so as to achieve useful results not only for itself but also for society. The EFQM model can be used to diagnose organizational resilience (Serban & Ghenta, [2009](#)).

The EFQM excellence model was included in the Strategic Plan of the National Revenue Agency (NRA) in 2004 and has actually been applied in the tax administration of Bulgaria since 2008. Periodically, every 2–3 years, self-assessments are made at various levels and structural units in the NRA, and the identified areas for improvement are a source of information about the strategic plan and operational programs. As a result of the implementation of the EFQM Excellence Model in the NRA, examples of measures, initiatives and concrete benefits derived from it can be given (Getov, [2015](#)):

- 1. Measures and initiatives in the NRA, resulting from the implementation of the model of excellence:**
 - (a) A structured approach has been introduced to review, prioritize, update and improve (including new) the NRA's partnerships with other organizations, incl. Taking into account the mutual benefits for achieving the goals of the state administration.
 - (b) The planning process, the indicators for measuring the results of the NRA and the target values have been improved.

- (c) Higher degree of transparency and accountability of the territorial directorates and the central management regarding decisions, tasks and deadlines.
- (d) Actions have been taken to develop plans for the development of the main functions of the NRA in implementation of the overall strategic plan of the agency.
- (e) Additional forms for surveying the opinion and satisfaction of customers, partners and employees have been introduced.

2. Benefits of implementing the EFQM Excellence Model in the NRA:

- (a) From managers and in the structures where the model is accepted as a management tool, the Model contributes to a better understanding by managers of the principles of good governance.
- (b) It allows conclusions to be drawn about common strengths and areas for improvement that are systemic in nature and valid for the whole organization.
- (c) Allows the discovery of good practices at the regional level;
- (d) Conducting self-assessments is linked to strategic and operational planning in the NRA.
- (e) The benefits of continuous monitoring, development and improvement are confirmed.
- (f) There is a change in the thinking of managers and experts as an attitude to the goals of the organization and the way of working.
- (g) Partnership, which allows by sharing information and expertise to achieve a real result for both parties.

A study of the annual activity reports of the National Revenue Agency (NRA) of Bulgaria for the period 2007–2017 shows that the application of this methodology for quality management (EFQM Excellence Model) gives significantly improved results from the operation of the Revenue Agency, including: there is increased efficiency—the collection of public revenues increases at a lower level of administrative costs; electronic services are being developed; information exchange, cooperation and interaction are expanding; the reputation and public trust in the tax administration increases (Nikolova, 2019). In addition to the results of this study, data from the Revenue Agency, published on the website of the Institute of Public Administration (IPA) in Bulgaria, which indicate that the introduction of the EFQM Excellence Model as a management tool in the NRA, contributes to a better understanding of the principles of good governance in the tax administration system (Getov, 2015).

The European Foundation for Quality Management (EFQM) has been developing and developing the EFQM Excellence Model since 1992. The model is the most popular organizational management framework in Europe and has become the basis for determining the winners of national quality awards in many countries. Based on the IPA study (2015b) on quality management systems in public administration and the implementation of good governance, the main advantages of implementing the EFQM Excellence Model can be systematized:

- **Provides a comprehensive philosophy of good governance:** Summary of good practices and appropriate implementation tools.
- **Flexibility:** Easily adapts to the needs and priorities of an administrative structure.
- **Stakeholder relations are improving:** Focus on purposeful building and development of stakeholder relations.
- **Improves the performance of organizations that provide priority services:** Administrations with a great diversity of functions and work processes, such as ministries, agencies, district administrations, municipal administrations.
- **Self-improvement, innovation and improvement:** engaging and motivating managers and employees in administrative structures for continuous development and improvement of implementation.
- **Positive experience gained:** there are favorable results from the use of the model in the administrations of EU member states.

The EFQM model enables organizations across Europe and beyond to develop a culture of improvement and innovation (European Foundation for Quality Management, 2022). It is used as a diagnostic model and serves as a basis for the development of activities with social and environmental responsibility. According to Serban and Ghenta (2009), using this model, organizations can learn to evaluate themselves, to measure their own progress in order to continue their continuous development. The authors point out that the model is based on several main components:

1. **Focus on results:** The goal is to achieve the expected results of all stakeholders related to the organization. Excellent organizations measure and anticipate the expectations of stakeholders, monitor their perceptions, monitor and evaluate the performance of other organizations. Information is collected and used in relation to the requirements, implementation and evaluation of policies, strategies, operational objectives and plans.
2. **Focus on the customer:** Excellence creates sustainable value for customers. Excellent organizations know the needs of their customers and understand them. Excellent organizations monitor and monitor the activities of competitors and identify their competitive advantages. They are able to anticipate the future needs and expectations of their customers and act to meet them and exceed them if possible. When problems arise, excellent organizations respond quickly and efficiently. They create and maintain excellent business relationships with their customers.
3. **Leadership and strategy:** Excellence means visionary and inspiring leadership. Excellent organizations have leaders who set a clear direction for the organization and communicate this with stakeholders. They will develop values, principles and a control structure for the organization to ensure a unique identity and attractiveness to stakeholders. Managers at all levels of organizations will strive for excellence and encourage others to do so.
4. **Process management:** Excellence means managing organizations through a network of interdependent and interconnected systems, processes and facts. Excellent organizations have a management system based on the needs and

expectations of all stakeholders and aimed at meeting them. Decisions are based on facts and reliable information about the current and projected results and capacity of the system, the expectations and experiences of stakeholders, including the representation of other organizations, even competitors. Based on reliable indicators, risks are identified and managed effectively. In this way, the organization is controlled in an extremely professional way. Appropriate preventive measures are being developed and implemented, which create and maintain high trust among stakeholders.

5. **Personal development and participation:** Excellence maximizes employee contribution through their development and participation. Excellent organizations identify and understand the current and future competencies needed to implement the organization's policies, strategies, operational goals and plans. They recognize the growing importance of intellectual capital and use the knowledge and know-how of their employees for the benefit of the organization. They are developing a reward system for employees in order to create commitment and loyalty to the organization. By creating collective values and a culture of trust by supporting personal initiatives, excellent organizations maximize the potential and active participation of their employees and use this capital to generate improvements.
6. **Continuous innovation and improvement:** Excellence uses the creation of innovative training and opportunities to challenge the status quo. An excellent organization constantly analyzes its activities and achievements, makes strict external and internal comparisons to maximize its capacity for improvement. They are trying to protect and take advantage of their intellectual property. Through continuous analysis of the actual status quo, the organization and employees are looking for opportunities to increase the number of innovations and improvements.
7. **Social responsibility:** Perfection means to exceed the minimum requirements of the applicable laws and rules of the organization, to understand and meet all efforts and expectations regarding the social environment. Excellent organizations apply high ethical standards, making their actions transparent and accountable. Social responsibility and environmental sustainability are proactively observed. The social responsibility of the organization is reflected in its values and is an integral part of the organization. Through a transparent and open commitment of stakeholders, excellent organizations are able to meet and exceed the requirements and expectations of the regional and, where possible, the global community.
8. **Partnership development:** Excellence develops and maintains value-added partnerships. In a world of ever-changing and growing demands, great organizations realize that their success depends on the partnership they build. Excellent organizations seek partnerships with other organizations and develop these relationships. In order to achieve common goals, organizations cooperate and help each other with experience, resources and knowledge. They build sustainable relationships based on mutual trust, respect and openness.

The EFQM model is based on a holistic approach to the organization and is a tool that can be used to integrate sustainable development principles into its strategies, plans and programs (Serban & Ghenta, 2009, p. 353). Based on the literature review and the characteristics of this model, it is concluded that its adoption in the practice of revenue agencies creates an opportunity to manage performance in accordance with the Sustainable Development Goals (SDGs). The specific positive effects that can be achieved in accordance with the SDGs are:

- Ensuring healthy and safe working conditions.
- Protection against discrimination.
- Ensuring accountability, transparency and reliable internal control.
- Maintaining integrity and combating corruption.
- Apply high standards of institutional ethics.
- Fair pay, training and human resource development.
- Satisfaction and commitment of staff to achieve the goals of the organization.
- Participation in volunteer programs and activities for environmental protection, observance of ecological principles in the implementation of administrative work, for example, rational use of paper documents, consumables for printers and photocopiers.
- Development of cooperation and interaction.
- Development of innovative thinking and desire for progressive change.

This not only improves the working environment in the revenue agency, but also increases public confidence in it, which reflects on increasing tax morale, compliance with the law and improving the reputation of the public administration as a whole. All this creates preconditions for increasing the voluntary fulfillment of tax obligations. This ensures regular revenues to the state budget for the provision of quality public services and goods, for the implementation of government policies and programs, which is a prerequisite for maintaining social stability and harmonious development.

2.6 Solutions and Recommendations

Based on a study of systematized practical rules for good governance in European public administration (Institut po publiczna administratsia, 2015a) and regulatory principles for the activities of the Revenue Agency in Bulgaria (Danachno-osiguriteln protsesualen kodeks, 2020), Table 2.1 sets out the principles of good governance, which can be adopted in the revenue administrations, together with criteria (indicators) for their implementation.

Trends in tax administration reforms in recent years aimed at improving efficiency and reducing costs can be complemented by adopting the principles of good governance and periodically evaluating the results of their actual application in this area. In this way, on the one hand, the implementation of administrative and control activities can be improved, and on the other hand, confidence in revenue agencies,

Table 2.1 Principles of good governance in revenue agencies and evaluation criteria

Principle	Characteristic	Indicator
Rule of law	<ul style="list-style-type: none"> • The revenue authorities shall act within the limits of their powers established by law and shall apply the laws accurately and equally to all persons. • Revenue authorities comply with the law and court decisions. 	<ul style="list-style-type: none"> • The Revenue Agency complies with all applicable laws and regulations (by-laws). • The Revenue Agency publicly announces all sanctions (contested acts and court decisions) for the offenses committed by it. • The rules and procedures in the Revenue Agency shall be adopted in accordance with the provisions provided by law. • The rules and regulations are applied impartially.
Efficiency and effectiveness	<p>The goals of the revenue agency are achieved through economy, efficiency and effectiveness of activities, including:</p> <ul style="list-style-type: none"> • Effective staff management and maintaining the level of competence. • Creating an appropriate organizational structure for effective implementation of obligations. • Reporting and verifying the activities of the organization to evaluate the results of operations on their effectiveness and efficiency. 	<ul style="list-style-type: none"> • The Revenue Agency plans its activities and budget in accordance with its plans at strategic and operational level. • Performance information is regularly collected and analyzed. The Revenue Agency shall take action to address the differences between expected and actual performance. • The Revenue Agency shall develop and implement a performance management framework that covers all its objectives, services and functions, as well as appropriate indicators, reporting regularly on its performance and progress. • The Revenue Agency exchanges good practices and experience with other public institutions and foreign tax administrations, using this information to improve its own efficiency and effectiveness. • The revenue agency's procedures, implementation reports and information systems are subject to independent evaluation and the results are reported to the supervisory authority. • All key services and functions are evaluated periodically at appropriate intervals to assess their performance and impact. • The revenue agency shall keep appropriate documentation to ensure that trends can be identified and efficiency and effectiveness increased.
Accountability	Adopting rules that require revenue authorities to motivate their actions,	<ul style="list-style-type: none"> • All decision-makers are aware of their individual and collective

(continued)

Table 2.1 (continued)

Principle	Characteristic	Indicator
	<p>take into account criticism or demands made on them, and take responsibility for non-compliance with laws or commitments. Reliable reporting concerns:</p> <ul style="list-style-type: none"> • Levels and deadlines for reporting. • Types of reports to be submitted to the management and supervisory bodies of the Revenue Agency. • Forms of reporting the detection of errors, irregularities, fraud or abuse. 	<p>responsibilities, which are outlined in the legal framework and in their job descriptions.</p> <ul style="list-style-type: none"> • The Management Board prepares regular public reports to report on the decisions taken. • The legislation of the revenue administration includes regulations for reporting, motivation and implementation of decisions that are understandable to management, employees and citizens. • Citizens have access to reports, procedures, projects and other documents/without classified information/ concerning the activities of the Revenue Agency. • The Revenue Agency has a transparent audit system defined in the regulations. The inspection rules are observed and applied objectively. • It is clear to the auditors who is responsible for each decision, and the relevant decision-making bodies are willing to provide information for public scrutiny. • The Revenue Agency has clear and definite procedures established in the regulations for dealing with bad management and actions of revenue authorities that violate civil rights, which procedures are applied in accordance with regulated rules and best practices.
Sustainability and long-term orientation	<p>Strategy for carrying out the administrative activity in accordance with the SDGs, including:</p> <ul style="list-style-type: none"> • Accumulation of planned tax revenues to ensure the stability of government, policies and programs. • Implementation of socially responsible activities and commitments to reduce the harmful impact on the environment. 	<ul style="list-style-type: none"> • The Revenue Agency researches the leading practices for ensuring sustainable development and applies them in its activities. • The needs of future generations are taken into account in the process of planning the activity. • There is a clear demonstration of the commitment of the top management bodies of the Revenue Agency to achieve sustainable development, which is an integral part of developing policies and strategies, planning actions and setting goals in all departments, functions and services provided.

(continued)

Table 2.1 (continued)

Principle	Characteristic	Indicator
		<ul style="list-style-type: none"> • An approach of broad public participation in decision-making related to sustainable development is applied.
Openness and transparency	<ul style="list-style-type: none"> • Requires mechanisms to ensure access to non-confidential information. 	<ul style="list-style-type: none"> • The Revenue Agency has a clear and well-understood legal framework that is widely publicized. • The revenue agency's regulatory framework includes a clear scheme of delegation of decision-making powers, which identifies those responsible for each decision and the way in which decisions are taken, implemented and published. • The Revenue Agency shall take and implement decisions in a manner that is open, transparent, accountable and timely, in accordance with applicable rules and regulations, and that complies with international standards of good administrative practice. • There is a procedure for appealing against decisions that is widely accessible and understandable. • The Revenue Agency actively informs the population. • The Revenue Agency is open to the public and the media.
Civic participation	<ul style="list-style-type: none"> • It creates greater confidence in the final result of the revenue agency and in the conducted tax policy. 	<ul style="list-style-type: none"> • Degree of civic participation and commitment in the public debate.
Human rights and social unity	<ul style="list-style-type: none"> • Respect for human rights and assistance in building a coherent society. 	<ul style="list-style-type: none"> • The Revenue Agency ensures that its services are available to all social groups and its communication does not create preconditions for social exclusion. • The Revenue Agency takes action to protect employees and citizens from discrimination and isolation.
Ethical behavior	<p>Ethical behavior is related to:</p> <ul style="list-style-type: none"> • The quality of the provided services and the availability of mechanisms for their improvement. • The degree of development of e-government and the use of e-services. • The degree of manifestation of unethical behavior and the existence 	<ul style="list-style-type: none"> • Codes of ethics set ethical standards that revenue authorities are expected to comply with; they include a requirement to disclose interests, gifts, and hospitality. • Specific decision-making procedures have been adopted in areas vulnerable to corruption, including public procurement. • An annual review of anti-corruption

(continued)

Table 2.1 (continued)

Principle	Characteristic	Indicator
	of mechanisms to oppose such behavior.	<p>measures is carried out, for example through audits.</p> <ul style="list-style-type: none"> • Policies for employees who are recruited, promoted and re-appointed and/or punished are in accordance with established standard procedures. • Revenue authorities are required to declare potential conflicts of interest that may affect decision-making and to refrain from participating in any such decisions. • The Revenue Agency ensures efficient and effective procurement and uses pre-set selection criteria. • The Revenue Agency shall provide free access to public procurement documents and procurement decisions.
Sound financial management	• Ensures sustainability and long-term orientation of strategic management.	<ul style="list-style-type: none"> • Special documents set out the financial responsibilities that apply to all employees of the Revenue Agency. • The Financial Management and Control System (FMS) in the public sector is implemented and regularly updated. • Internal audit examines financial transactions to ensure compliance with approved internal procedures. • Regular reports are presented to financial controllers and supervisors comparing actual revenues and expenditures with the budget. • The accounts are audited by persons who are independent of the revenue administration. • The approved budget and the annual report on its implementation shall be made public.
Competence and capacity	• Requires the existence of mechanisms for continuous maintenance and development of the competence and capacity of the tax administration, adequacy and timeliness of the response and quality of services provided.	<ul style="list-style-type: none"> • The Revenue Agency identifies the skills needed for effective service delivery and conducts an audit of those skills in order to identify any gaps as part of the strategic human resources development plan. • The revenue agency implements a system for the implementation of personal development plans of employees. • A system is applied to motivate

(continued)

Table 2.1 (continued)

Principle	Characteristic	Indicator
		<p>employees, to reward the good performance of duties and to improve the bad.</p> <ul style="list-style-type: none"> • The Revenue Agency has recruitment and selection policies and procedures that are public and consistently applied. • A training plan has been developed, implemented and monitored to ensure that training needs are fully met and professional skills are continuously developed in order to improve the quality of services provided. • The Revenue Agency analyzes the implementation and results of the recruitment, training and promotion procedures and makes the necessary improvements based on the analysis. • The selection criteria are defined for each position and are public. They reflect the basic requirements for work and do not allow discrimination. • Employees receive regular evaluations of their performance and development as part of a systematic approach to certification and career development.
Responsiveness	<p>Responsiveness (customer care) is directly related to the applied ethical standards and refers to:</p> <ul style="list-style-type: none"> • Administration focused on achieving results and meeting consumer expectations. • Development of e-government and e-services in the public sector. • The scope of the service group and the services offered. • Reliable anti-corruption. 	<ul style="list-style-type: none"> • There are clear guidelines and procedures for employees and revenue authorities in all decision-making processes. • The Revenue Agency ensures that all its employees and bodies work in the interests of the citizens. • A special procedure for complaints with a fixed response time has been developed, related to the administrative services provided and the actions of the revenue authorities, and there is evidence that it is being implemented. • Information regarding the complaints submitted to the Revenue Agency and the response to the complaints, including the resulting changes, shall be made available to employees, revenue authorities and citizens. • If changes in strategy and services

(continued)

Table 2.1 (continued)

Principle	Characteristic	Indicator
		are needed, they are the result of surveys, reports, consultations, complaints and other methods of surveying citizens; the changes made are disclosed. <ul style="list-style-type: none">• The Revenue Agency provides good customer care by ensuring that services are provided by educated and well-trained staff who understand the needs of citizens.
Innovation and openness to change	<ul style="list-style-type: none">• Introducing improvements and launching new projects, participating in partner networks of institutions in the field of financial control and audit, in order to respond to changes in the environment.	<ul style="list-style-type: none">• The Revenue Agency applies innovations in its activities.• The Revenue Agency takes action to identify and implement good practices and new solutions.• The Revenue Agency has been involved in a good governance and innovation project for the past three years.• Revenue authorities and staff are clearly committed to taking action to ensure the benefits of innovation.

Source: The author according to the data of the Institute of Public Administration (2015a)

such as public institutions operating in accordance with the Concept for Sustainable Development, can be increased. All this should have a positive effect on raising tax morale and law enforcement in society.

2.7 Future Research Directions

In recent years, the role of integrated accountability in achieving transparency in line with the holistic approach to organizations and institutions, which is based on the Concept for Sustainable Development, has increased. In this regard, the possibilities for development and regulation of integrated reporting, such as the unity of financial and non-financial information, can be explored, so as to require mandatory disclosure of tax issues that are important to stakeholders.

Research and promotion of tax transparency practices, as well as empirical research on the relationship between tax transparency and tax morality, could help increase tax compliance.

2.8 Conclusion

The implementation of CSR in the company's business ethics and culture provides an opportunity to achieve both business goals and contribute to the development of society as a whole, which in turn creates a favorable environment in which business thrives not only in the short term but and in the long run. Recognizing the role of taxes and taxation in modern society for the provision of quality public services and goods, as well as for achieving the SDGs, business organizations that have adopted behaviors to be accountable to society should—along with specific commitments to protect environment—to pay their taxes in real amounts on a regular basis so that they can increase the welfare of society. Given the tendency to apply a holistic approach to the disclosure of information about the activities of companies, it can be expected that integrated reporting will continue to develop and expand, so as to give an increasingly adequate reflection on the performance of corporations, including. The taxes paid, the applied tax strategies, the impact on tax regulations and tax morale.

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Chapter 3

Cross-Border Tax Fraud as a Barrier to Sustainable Development



3.1 Introduction

This chapter aims to broaden the understanding of tax fraud that goes beyond the jurisdiction of a jurisdiction, distinguishing between “tax avoidance” and “tax evasion”. In this regard, issues related to the genesis of cross-border tax fraud have been studied and the main prerequisites for their implementation have been identified. Factors that give rise to risks of tax evasion in related party transactions have also been studied. The chapter examines the indicators that can be used by the competent authorities in exercising control in the field of cross-border taxation, in the following aspects: (1) basic indicators of tax fraud; (2) indicators of cross-border fraud with value added tax (VAT); (3) indicators for deviations in taxation in transactions with related parties. Another set of issues explored in this paper relates to the possibilities for effectively and efficiently combating cross-border tax fraud. In this regard, the stages that form the modern strategies for combating financial crimes, which are inextricably linked to tax fraud, as well as the applicable models for their investigation, are considered. The main ways of committing tax fraud have been studied, as well as the OECD-regulated principles for combating tax crime, which provide an internationally recognized framework for this purpose. Attention is paid to the applicable tools for international cooperation, for successful fight against tax crimes. The purpose of this chapter is to explore the possibilities for effective and efficient control impact to tackle cross-border tax fraud.

3.2 Background

Cross-border trade fraud to avoid customs duties, VAT and excise duties has important implications for public revenues for both developed and developing economies (Kitsios et al., 2020). For example, the Missing Trader Intra Community Fraud (MTIC) fraud, also known as the carousel fraud, is expected to cost between 45 billion euros and 60 billion euros a year in tax losses for the EU.

Torgler (2008, p. 1240) presents the views of Allingham and Sandmo (1972) on the behavior of taxpayers, according to which they make rational decisions in a situation of uncertainty. Thus, tax fraud is a kind of “gambling”, which will either be paid with lower taxes, or, with the probability of detection and will end in sanctions. Willingness to evade taxes depends on the level of tax fraud of others in a society. Therefore, a person’s willingness to be corrupt depends on the behavior of other citizens in society. The more others perceive themselves as corrupt, the greater the willingness to be corrupt. He emphasizes the importance of social norms and trust in institutions to curb tax fraud (Torgler, 2008). Luttmer and Singhal (2014) conclude that tax morality significantly improves compliance with tax legislation, but the main factor in the implementation of tax obligations is law enforcement.

Alm (1999) examined non-economic factors affecting tax compliance and concluded that if taxpayers place more weight on the probability of an audit than usual, then tax compliance will be higher. Alm and McKee (2006) examine the impact of the likelihood of tax audits and the productivity of tax audits on the level of tax compliance. Thus, they conclude that only if higher audit productivity is combined with a greater likelihood of tax audits can a positive effect on compliance with tax laws be expected. According to other authors (Torgler, 2008; Nuttin & Greenwald, 1968), rewards, rather than just penalties, can have a positive effect in curbing tax fraud. For example, South Korea, which is considering allowing regular business taxpayers to use airport VIP rooms, provide certificates or free parking in public places.

Kitsios et al. (2020) argue that the use of digital technologies offers the opportunity to reduce fraud and increase government revenue. They explore how digital tools can improve the collection of information on goods traded at the border. Believe that digitalisation can improve compliance with tax laws by increasing operational efficiency and the quality of information in commercial transactions. Digital information facilitates collection of authentic, accurate and complete information about the traded goods, improving the ability of borderline agents to collect trade taxes. The information is crucial for the collection of taxes and duties at the border, in particular information on the classification of the product, the volume and the value of the goods traded. This information is usually provided by importers and exporters, who have an incentive to misreport transactions in order to avoid customs duties or taxes. To verify the information provided by importers and exporters, customs officials need access to third party information. Digitalisation allows tax authorities to offer electronic filing of tax returns, pre-filing of tax returns and verification of customs and business activities. Compliance with tax laws and tax

compliance could be improved by monitoring real-time revenue collection and settling differences, conducting electronic audits and using Big Data technology to assess taxpayer risks. Kitsios et al. (2020) conclude that there is a lower incidence of trade fraud when governments improve the collection and processing of information through digitalisation. The results of their study indicate significant potential gains from digitalization as they reduce trade fraud. However, they recognize that digitalisation itself may offer new opportunities for fraud. Individuals and companies can take advantage of new technologies to hide sensitive information and avoid taxes.

3.3 Preconditions and Indicators for Cross-Border Tax Fraud

Combating cross-border tax fraud requires first defining it. Tax avoidance is sometimes used to indicate a legal reduction in taxes, while evasion refers to tax reductions that are illegal. In addition, many activities, especially of corporations, which are often referred to as tax avoidance, can in fact be classified as tax evasion. For example, transfer pricing of intermediate goods, in which companies charge low prices for the sale of low-tax affiliates but pay high prices for purchases from them. If these prices are set artificially in order to reduce the total taxes paid, this activity can be considered as evasion. Concealment is often a problem of lack of information and remedies may include resources to improve information exchange, while avoidance is more likely to be remedied by changes in tax laws (Gravelle, 2009).

Common methods of corporate tax avoidance related to profit-shifting (Gravelle, 2009, p. 732), are:

1. **Debt and Profit Allocation:** A method of borrowing more in high-tax jurisdictions and less in low-tax jurisdictions.
2. **Transfer pricing:** A method by which firms can change their profits by pricing goods and services sold between affiliates. In order not to manipulate income, the prices of goods and services sold by related companies must be the same as the prices applied between unrelated parties. By deliberately lowering the prices of goods and services sold by subsidiaries in high-tax jurisdictions and by tendentiously raising the prices of their purchases, profits can be offset by high-tax jurisdictions.
3. **Hybrid objects and hybrid instruments:** The tax entity is structured in such a way that the enterprise can be recognized as a corporation by one jurisdiction and a partnership in another. This allows the use of foreign tax credits without recognizing the basic income.

Tax evasion by individuals can take many forms and is facilitated by growing international financial globalization and the ease of online transactions. With minimal or no reporting, individuals can buy foreign investment directly from abroad,

such as stocks and bonds, or hold money in foreign bank accounts without income. They can also use structures, such as trusts or corporations, to evade investment income taxes, taking advantage of tax laws (for example in the United States) that exempt non-residents' interest income and capital gains. The passive income of individuals is easily concealed, as there is no multilateral reporting of interest income. Even bilateral agreements for the exchange of information have limitations, as they only apply to criminal cases.

Ferrantino et al. (2012) study the fraud in trade between the United States and China. They found that since the late 1990s, reported US imports from China and Hong Kong have regularly exceeded reported Chinese and Hong Kong exports to the United States. They found strong statistical evidence of insufficient reporting of exports at the Chinese border to avoid paying value added tax (VAT). The value of VAT evasion is estimated at \$6.5 billion for the period 2002–2008. Approximately \$2 billion of US customs revenue was lost at the US border in 2002–2008 due to underestimation of import values. They also found weaker and more circumstantial evidence of transfer pricing (i.e. over-reporting the US border to avoid higher corporate taxes for US-based multinationals) and avoiding Chinese capital controls (money laundering control). According to the authors, there are a number of incentives for companies to divert the invoice price of an export-import transaction, such as tax evasion, transfer pricing and avoiding capital controls. These incentives can lead to inconsistencies in trade statistics, as it is possible to present different data to the authorities in different countries. The main purpose of their analysis is to understand why US imports are systematically higher than those reported by China. They argue that avoiding Chinese VAT, corporate taxes in both countries and avoiding Chinese capital controls is a possible factor underlying both: (1) insufficient reporting of Chinese exports or (2) over-reporting of imports on the US border. According to them, in addition to VAT, the Chinese corporate tax, known as the enterprise income tax (EIT), also provides an incentive for insufficient invoicing of exports. Incorrect reporting of trade data is also one of several methods of moving capital in and out of the country. Another factor in the lack of reporting on Chinese exports may be smuggling.

Ferrantino et al. (2012) believe that insufficient and over-invoicing of exports can be used to cover up capital transactions related to “hidden money” that flow in and out of China. When the true value of exports is higher than that reported to the authorities (ie exports are insufficiently invoiced), the difference can be deposited in a foreign account as a method of undeclared capital exports. Similarly, if the true value of exports is lower than that reported to the authorities, the difference can be used to provide a document to contribute additional capital to the country.

According to the authors, there are incentives for imports with insufficient reporting and oversupply accounting for the US border. Insufficient declaration is related to the avoidance of customs duties. They point out that in the transfer pricing model, incentives imply higher values for imports, as corporate taxes in the United States are usually higher than in China. This model, as a rule, is valid only for intra-company trade. However, Ferrantino et al. (2012) found similarities between the behavior of close traders and related parties with the behavior of an integrated

multinational company regarding the incorrect declaration of value in transfer pricing. They note that the large discrepancies observed in the data reported to exporting and importing countries relate to cases where companies do not attach much importance to the likelihood of being sanctioned because the authorities are inconsistent.

Based on the literature review done so far, they can be systematized the main prerequisites for committing cross-border tax fraud:

- Legislative provisions that exempt certain income and capital gains of foreigners.
- The existence of tax regimes that treat differently the taxation of supplies in the country and those for export, such as zero VAT rate on exports of goods or the existence of variations in the VAT discount on exports.
- Limited interaction and exchange of information between jurisdictions.
- Lack of adequate regulations on offshore areas, such as increased transaction reporting and restrictions.
- Lack of reliable sanctions against money laundering and the informal economy.
- The activities of highly qualified intermediaries, such as independent auditors, who reveal the tax intricacies of foreign corporations.
- The burden of proof in large-scale evaded taxes, the effectiveness of the administration of justice and the enforcement of criminal liability.
- Short limitation periods.
- High share of cash payments.
- Limited resources of the Revenue Agency to deal with tax abuses abroad and pressure on the revenue authorities to refuse to resolve difficult cases due to short deadlines.
- Lack of publicity for large-scale tax evasion as a deterrent.
- Limited declaration of foreign bank accounts and large transactions.
- Inadequate provisions on tax havens and banking supervision.
- Inadequate provisions on trade between related parties.
- The level of integrity and corruption in customs control of goods.
- Insufficient sanctions for those who do not provide information on the disclosure of offshore transactions and evaded taxes.
- The likelihood of detecting and punishing tax fraud or negotiating with the control authorities (tax/customs authorities) for milder sanctions if erroneous reports are found.

The main indicators of tax fraud can be considered (Foks & Bergherm, 1998):

- The taxable person does not keep the required books and records or keeps them, but irregularly.
- Attempts have been made to falsify accounting documents and/or entries, two sets of books are kept or the accounting records are kept so badly that the revenue authority has reasonable grounds to believe that the taxpayer is deliberately trying to thwart his efforts to determine taxable income.
- Refusal to show the accounting documentation or destruction of accounting documents has been established.

- Inability to provide the required information, to give explanations or the overall behavior of the taxpayer reveals that he does not want to cooperate with the revenue authorities during the conversation or meeting.
- False, misleading or inconsistent statements are made during the conversation with the tax authority.
- A false document or a notarized declaration shall be submitted in order to substantiate a position in the tax return.
- Concealment of facts or documents.
- Replacement of accounting or other documents.
- Not all revenues from the operating activities of the company are paid into a bank account, and at the same time there are no sufficient grounds to retain part of the cash receipts.
- The taxable person does not wish to relinquish part of the control over the cash receipts of his employees, when the scale of the activity clearly indicates the need for this.
- Engaging in risky activities.
- The personal standard of living, including the costs of maintaining it and the accumulated assets significantly exceed the declared income from the company's activity.
- Property purchased by the taxpayer is recorded in the name of other persons.
- The taxpayer makes allegations favorable to the person and his behavior, but cannot defend them with evidence.
- The taxpayer is constantly late and postpones his business meetings, does not present the required documentation and does not make a benevolent effort to cooperate with the revenue authorities.

When dealing with cross-border tax fraud, special attention should be paid to Value Added Tax (VAT). According to Keen and Smith (2007) The mechanism of taxation with this tax—the deduction of tax credit and VAT refund, provides unique opportunities for abuse, which is a serious concern in the European Union (EU), where the abolition of internal borders at the end of 1992 as part of measures aimed at promoting economic integration between Member States and the single market have created a number of challenges; for example, the risks arising from the zero rate of exports and significant losses from the so-called “Carousel fraud”. The authors believe that VAT fraud attracts the attention not only of countries that apply VAT, but also to those that might consider introducing such a tax.

In the EU, the most common VAT evasion schemes (Microfinance, 2016) are the following:

1. **Phantom Chain:** Also known as “missing trader fraud”. It operates with a chain of several companies engaged in fictitious transactions. One of them is accumulating tax liabilities, and all the others have managed to exercise the right to use a tax credit and recover the tax. Thus, a product is resold several times through the same companies. Some of them are usually registered in other EU countries, where the zero VAT rate applies. The debtor company does not repay its VAT liabilities, and in many cases is subsequently transferred to a landless person.

2. **Carousel fraud:** This fraud takes place in at least two EU Member States. It involves companies with three main roles—“missing trader”, “buffer” and “user”. The “missing trader” has the task of acquiring the goods from another EU member state and selling them in his country without paying VAT. The sale can be made directly to the “user” or, in order to sever the link between them, one or more “buffer” companies are inserted between them. After acquiring the goods, the “user” usually sells them to a company from another EU Member State, where he seeks a refund of the tax credit. In this scheme of fraud, the “missing trader” does not pay VAT, and the “buffer” company balances its results and also does not pay VAT (Traykova, 2013).
3. **Fictitious exports:** Under this scheme, goods are exported only on the basis of documents. This is usually done with the participation of a customs officer. Zero tax rates are applied to exports, and the trader reimburses the tax credit on costs and purchased goods. Later, the goods are sold on the domestic market without invoices. A lighter variant of the scheme is when there are real exports of goods, but with unrealistically high value. Another option is for fictitious transactions to take place within the EU. This is how intra-Community supplies are formed, which are taxed at a zero rate, but in reality they are only on documents, as again the goods remain and are sold on the domestic market without invoices and without paying taxes. At the same time, the seller reimburses the tax credit for the purchases.

The described VAT evasion schemes are well known to the control authorities. But fraudsters are resourceful and often use modified combinations or more sophisticated and difficult-to-trace schemes. For example, newer practices relate to goods that are exported to non-EU countries, most often Dubai or other Arab countries. They are later re-imported into an EU Member State and sold under known schemes. Across the EU, measures to stop VAT fraud are a priority, but have not yet been completely eradicated or kept to a minimum. Therefore, the efforts of the tax authorities need to be supported by the investigating authorities and the court, and the three units must work in sync.

Keen and Smith (2007, p. 12) point out that the most well-known form of deliberate attack on the EU VAT system is “carousel fraud”. It is a specific case of what in the UK is called “intra-Community fraud with missing trader”—it uses the zero rates of exports, combined with the “deferred payment” mechanism to collect VAT on goods imported into the country. With the abolition of the formalities of fiscal borders in the EU in 1992, according to which Member States are not allowed to complete border formalities, including fiscal procedures that may impede the free flow of trade between them—VAT on imports from another country. Member State begins to gather not at the border, but only at the next periodic declaration. The authors (Keen & Smith, 2007) present the “Carousel fraud” scheme in a simplified form as follows:

Step 1: Company A exports goods to Company B in another EU Member State (e.g. England). The export sale has a zero VAT rate.

Step 2: Company “The Missing Trader” buys goods from Company “A” from another EU Member State (e.g. France). He does not pay VAT on the purchase, because the export from “A” has a zero rate. Charges VAT on the sale of company “C”, but disappears without paying VAT to the revenue agency.

Step 3: Company “C” (“Buffer”) buys goods from company “B” at a price including VAT and sells to company “D”, charging VAT. Company C may not suspect that it is involved in fraud. There may be several buffer companies between “B” and “D”, and some or all of them may be honest.

Step 4: Company “D” pays VAT on the purchase from company “C”. Exports goods to company “A” in another EU Member State (e.g. France) and seeks VAT refund on exported goods. In fact, the VAT left unpaid by “B” is refunded.

This type of fraud can be well covered up by using complex buffer operations and routes. Exports from company D, for example, can be in a non-EU country, as this also leads to a VAT refund. Fraudsters mostly use expensive goods, such as mobile phones, computers or luxury cars. Only a small part of the budget losses from VAT fraud are recovered. It takes years to investigate VAT fraud. The main participants in the schemes are rapidly moving their illegal VAT profits to offshore accounts, where money is outside the scope of European legislation (Bosev, 2019).

With regard to cross-border VAT fraud, the following indicators can be systematized (Ferrantino et al., 2012; Terziev, 2013):

- Discrepancies in data from international trade (trade statistics) presented to authorities in different countries, aimed at tax evasion, transfer pricing and avoidance of capital controls.
- Posting less than done. Under this scheme, traders declare only part of the sales, creating false documents, documents with false content or do not post at all the transactions they make. Thus, they declare less sales revenue than actual ones.
- A distinctive feature of carousel fraud is the invalid flow of goods, which finds only documentary expression in successive purchases and sales between the participants in the chain.

Based on a study of applicable audit techniques in tax control (Natsionalna agentsia za prihodite, 2014), the following examples can be given of factors that give rise to risks of tax evasion in related party transactions:

- Complex group structure of taxpayers, such as equity interests, location and number of related parties.
- Complex business model of taxpayers, related to the implementation of multiple and complex transactions with related parties.
- Taxpayers constantly make losses or their financial results vary significantly during the audited periods (from positive to negative).
- Numerous changes in the controlling owner of taxpayers and in the composition of related parties during the audited periods.
- Significant changes in the terms of related party transactions during the audited periods, for which the business need is not clear.

- Use of a common integrated information system by all related parties in the group, in which the accounting of transactions between them is automated and taxpayers cannot give adequate explanations.
- Taxpayers do not apply the usual control procedures to related party transactions as they do to third parties.

Also, the following indicators for deviations in taxation in transactions with related parties can be systematized (Natsionalna agentsia za prihodite, 2014):

- Making sham transactions, i.e. transactions for which the business logic is not clear.
- Related party transactions are subject to conditions that differ from market conditions and lead to significant variations in the financial result.
- The terms of related party transactions are not determined on the basis of offers from third parties for the same subject of the transaction.
- There is no documentation for transfer pricing and transactions with related parties or the available documentation is not reliable.
- Lack of documentation (contracts, protocols, etc.) supporting the actual execution of transactions with related parties.
- Invoices for deliveries and accompanying credit and debit notes from related parties are issued and received with a long delay.
- Changes in accounting policies and/or corrections of errors in connection with the accounting of transactions with related parties during the audited periods.
- The business model of the taxpayer creates preconditions for significant transactions with related parties and tax deviations in connection with the application of transfer pricing.

The OECD Guidelines on Transfer Pricing (2022) offer general guidelines for the development of rules and procedures for documents to be required of taxpayers in the control of related party transactions, as well as guidelines designed to help taxpayers secure documents, with which they will be able to prove that their related party transactions comply with the principle of independent market relations. OECD states that every taxpayer should make efforts to set their transfer prices according to the principle of independent market relations. In this regard, the OECD recognizes the right of the administration to oblige the taxpayer to submit certain documents related to its transfer prices, incl. written documentation attesting to the efforts he has made to comply with the principle of independent market relations. It is in the taxpayer's interest to keep this documentation so that he can present it when necessary for tax control. Taxpayers should be able to justify the special circumstances that affect price determination in conditions of free competition. It is also recommended to have documents disclosing the negotiation procedures for determining or revising the prices of transactions with related foreign companies (draft budget, distribution agreement, etc.).

3.4 Counteracting Cross-Border Tax Fraud

Concealed taxes are causing significant losses to the world economy. Therefore, the aim is to prevent them so that the planned revenues can be collected in full and used to provide quality public services and goods for the benefit of citizens.

Value added tax (VAT) is an important source of revenue in the European Union (EU), accounting for 17.4% of Member States' total tax revenue in 2018 (Bussy, 2021). In some EU countries, such as Bulgaria, the share of this tax is about 1/3 of the total tax revenues. Every year, Member States experience large revenue losses due to VAT fraud and non-compliance with tax laws. According to the European Commission's report on the VAT Gap, EU Member States have lost approximately 134 billion euros in value added tax revenue in 2019 (European Commission, 2019).

When examining ways to combat tax fraud related to international business, special attention should be paid to VAT abuses, as this indirect tax is one of the leading sources of revenue in the budgets of many OECD and EU countries. There are many methods for VAT fraud as well as for avoiding paying it. Some of them are related to other taxes on transactions in goods and services. Thus, tax crime schemes can be differentiated according to whether they concern only VAT or other taxes (Terziev, 2013).

Tackling the shrinking tax base and shifting profits is another aspect of international efforts to combat tax fraud, which is a top priority for governments around the world. In this regard, the updated OECD Transfer Pricing Guide (2020) includes guidelines on aspects of transfer pricing in financial transactions. In order to counteract tax fraud and prevent its recurrence, it is necessary to be identified and ways and schemes of tax fraud. Specific to tax fraud is that it is often linked to other financial crimes, as shown in Fig. 3.1, as follows: tax crimes and money laundering; tax crimes and corruption; tax crime and organized crime (PROTAX, 2020); it can also be added—tax crimes and terrorist financing.

Tax crimes are often closely linked to other financial crimes, as criminals do not report their income from illegal activities for tax purposes. On the contrary, criminals may report excess income in an attempt to launder their proceeds of crime (OECD, 2017). Effective strategies to combat financial crime include several successive stages, as follows: prevention, detection, investigation, prosecution of crimes and

Fig. 3.1 Relationship of tax fraud with other financial crimes. Source: The author according to PROTAX (2020)



Table 3.1 Tax investigation models

Model 1	Model 2	Model 3	Model 4
Australia, Canada, Germany, Greece, India, Ireland, Israel, Japan, Korea, Malaysia, New Zealand, Singapore, South Africa, Switzerland, Uganda, United Kingdom, United States	Austria, Azerbaijan, El Salvador, Estonia, Germany, Hungary, Latvia, Netherlands, Portugal, Serbia, Sweden, Spain, United States	Georgia, Ghana, Greece, Iceland, Turkey	Belgium, Brazil, Burkina Faso, Chile, Colombia, Costa Rica, Czech Republic, Denmark, Ecuador, Finland, France, Greece, Iceland, Lithuania, Luxembourg, Mexico, Norway, Peru, Slovak Republic, Slovenia, Spain, Sweden
17 countries	13 countries	5 countries	22 countries

Source: OECD (2017)

recovery of proceeds of crime. The main state bodies and institutions involved in the fight against financial crime are: the tax administration, the customs administration, the anti-money laundering authorities (including the financial intelligence unit), the police and specialized law enforcement agencies, the prosecutor's office and financial regulators.

The countries apply different models for counteracting financial crimes. For example, four main models are applied in the investigation of tax crimes (OECD, 2017), data for which are presented below in Table 3.1.

First model: The tax administration is responsible for directing and conducting investigations.

Second model: The tax administration is responsible for conducting an investigation under the direction of the prosecutor.

Third model: A specialized tax agency that operates under the supervision of the Ministry of Finance but is separate from the tax administration and is responsible for conducting investigations.

Fourth model: The police or the prosecutor's offices are responsible for conducting investigations.

The PROTAX project has developed The Tax Fraud Investigation Framework (TFIF), a tool designed to support law enforcement agencies to facilitate investigations and prosecutions against tax fraud at national and European Union level. This tax fraud investigation toolkit (PROTAX, 2020) takes into account that tax laws, tax regimes and the criminalization of certain tax abuses are different in each jurisdiction. Therefore, the possibilities that the legal framework may inadvertently offer to criminals are different and it is not possible to list all the potential ways that can be used to commit tax fraud and tax evasion. Beyond the tax legal framework of a jurisdiction, there may also be opportunities arising from—the capacity law enforcement, geographical location, politics, the human factor, technological tools, conditions for doing business, banking secrecy, free movement of people, services, goods and capital that can offer various opportunities for tax fraud. These features of the relevant jurisdiction are well known from tax consultants, chartered accountants,

auditors and tax lawyers, who can help with tax fraud. Despite the great variety of tax frauds, some common ways of committing them can be pointed out (PROTAX, 2020, p. 32):

- **Redirection of goods to jurisdictions through negligent inspections, monitoring and law enforcement practices:** Diligent auditing and accounting practices may allow for false invoices and underestimated sales data to pass through the network without arousing suspicion.
- **Mergers and acquisitions:** Business combinations that create an artificial loss to adjust real income.
- **False foreign addresses:** Used for residence and/or company registration.
- **Consumer behavior:** Expectation and acceptance by consumers of goods and services that are reduced by the amount of VAT.
- **Non-regulated sectors:** For example, virtual assets and e-commerce are used.

A tax system that communicates effectively with stakeholders, within and outside the jurisdiction, can achieve sound compliance with tax laws, improve international cooperation, ensure better detection of tax fraud and recover fiscal damage. In this regard, some examples can be given of agencies—at European Union level, which can be partners in detecting transnational tax fraud: EUROPOL, EUROJUST, EU Financial Units Platform, OLAF, EPPO, European Justice Network (PROTAX, 2020). It is important to achieve high efficiency in combating cross-border tax fraud. To this end, a joint investigation can prevent duplication of effort, strengthen cooperation, exchange information and help develop a common cross-border strategy to combat tax fraud (PROTAX, 2020).

With regard to the modern characteristics of the fight against tax crime, the OECD (2021, p. 11) points out that the COVID-19 pandemic makes tax and other financial crimes more global than ever. If left unchecked, they can undermine the rule of law as well as public confidence in the legal and financial system. Technological developments are also leading to new risks, including the rise of cybercrime, the growing misuse of cryptocurrencies and new types of sophisticated professional tools capable of creating opaque structures and driving increasing real-time cash flows. In these circumstances, the OECD's call is to strengthen international cooperation, but also to improve the work of all jurisdictions, based on sound domestic legal and operational instruments for the effective detection and cessation of tax offenses, as well as the sanctioning of those who commit them. In relation to these objectives, ten global principles for combating tax crime are systematized, which are presented below in Table 3.2. This provides an internationally recognized framework for combating tax abuse, against which countries can compare their situation and to develop. The Ten Global Principles cover the full range of instruments that countries should adhere to: from the introduction of laws that criminalize tax crimes to the formation of a comprehensive strategy for combating tax crimes, incl. detection of threats of criminal activity and implementation of mechanisms for confiscation of the profits from the crime after conviction. The OECD calls for a wide range of powers to be given to tax investigation agencies, while stressing the importance of suspects' rights in the investigation, including the presumption of

Table 3.2 Global principles for combating tax crime

Principle	Characteristic
Principle 1. Ensure tax offenses are criminalized	Jurisdictions must have a legal framework in place to ensure that breaches of tax law are included as criminal offenses and that effective sanctions are applied in practice.
Principle 2. Devise an effective strategy for addressing tax crimes	To ensure the effectiveness of the tax crime law, jurisdictions must have a strategy for dealing with tax crimes. The strategy should be regularly monitored and reviewed.
Principle 3. Have adequate investigative powers	Jurisdictions must have appropriate investigative powers to successfully detect tax crimes.
Principle 4. Have effective powers to freeze, seize and confiscate assets	Judicial courts must be able to freeze and seize assets in the course of a tax investigation, as well as be able to confiscate assets.
Principle 5. Put in place an organizational structure with defined responsibilities	A jurisdiction must have an organizational model with certain responsibilities for combating tax and other financial crimes.
Principle 6. Provide adequate resources for tax crime investigation	Tax crime investigation agencies must have adequate resources.
Principle 7. Make tax crimes a predicate offense for money laundering	Jurisdictions must identify tax crimes as one of the main crimes of money laundering.
Principle 8. Have an effective framework for domestic inter-agency co-operation	Jurisdictions must have an effective legal and administrative framework that facilitates cooperation between tax authorities and other domestic law enforcement and intelligence agencies.
Principle 9. Ensure international co-operation mechanisms are available	Tax investigation agencies must have access to criminal law instruments and an adequate operational framework for effective international cooperation in the investigation and prosecution of tax crimes.
Principle 10. Protect suspects' rights	Taxpayers suspected or accused of committing a tax crime must be able to rely on basic procedural and fundamental human rights.

Source: The author according to OECD (2021)

innocence, the right to a lawyer and access to all incriminating evidence (OECD, 2021).

With regard to Principle 9 “Ensure international co-operation mechanisms are available”, the OECD (2021) states that tax crimes often have an international dimension, for example because foreign jurisdiction has been used to conceal assets or income, or because proceeds from illegal transactions are stored abroad without being declared to the tax authorities. It is emphasized that criminal activity can cross international borders, while investigative agencies have powers that are limited by jurisdictional borders. Therefore, cooperation between investigative agencies is extremely important.

International cooperation can take a number of forms, including information sharing; service of documents; obtaining evidence; facilitating the taking of

testimony from witnesses; transfer of persons for interrogation; execution of orders for freezing and seizure; and joint investigation. In order for such cooperation to take place, there must be a legal agreement setting out the conditions and procedural requirements. These agreements can be information exchange agreements, such as tax information exchange agreements (TIEAs), information exchange and administrative assistance agreements, bilateral tax treaties and other similar instruments (OECD, 2021).

To successfully combat tax crime, it is important that jurisdictions have a large and well-functioning international cooperation network with the following characteristics:

- It has a wide geographical coverage.
- It covers a wide range of tools for cooperation and information exchange.
- It is supported by an internal legal framework that allows the exchange of information.
- A clear operational program for international cooperation.

Examples of instruments for cooperation and exchange of information include: agreements to reduce or eliminate double taxation, agreements for the exchange of tax information (TIEA) and administrative cooperation in tax matters, agreements for international cooperation in tax matters Convention on Mutual Administrative Assistance in Tax Matters, EU directives and regulations on international cooperation in the field of taxation (Council Directive 2011/16/EU of 15 February 2011 on Administrative Cooperation in the field of Taxation), internal regulations that allow tax authorities to exchange information with certain countries on a unilateral basis (OECD, 2012).

3.5 Solutions and Recommendations

This chapter systematizes the main prerequisites for committing cross-border tax fraud. Their knowledge allows for the formation of a strategy for counteraction in this direction, which includes not only follow-up by the tax authorities and the judiciary—to investigate evaded taxes, but also a proactive approach—to draw the attention of the competent authorities to the genesis and conditions that give rise to fraud. In this regard, it can be recommended not only to improve tax control (audit), justice and the effectiveness of sanctions and penalties for perpetrators, but also: (1) continuous review and improvement of the current regulatory framework related to taxation and applicable tax regimes, as well as regulations for offshore areas, foreign bank accounts and transactions, related party transactions and the activities of tax intermediaries, so that favorable opportunities for abuse do not arise; (2) improving the interaction and exchange of information between jurisdictions; (3) curbing the informal economy and corruption, which are favorable environments for the development of financial crime; (4) achieving real rule of law in a democratic world.

Based on a study on the mechanisms for cross-border fraud with Value Added Tax (VAT), the following possible countermeasures can be proposed in this regard:

- Stricter registration checks, such as on-site visits and background checks.
- Requiring guarantees in doubtful cases.
- Adopt or strengthen joint and several liability rules whereby traders can be held liable for fraud elsewhere in the chain with which they have been acquainted.
- Establish a better and faster exchange of information between national tax authorities so that the importing country can immediately understand that exported goods to it have been reported in another Member State but not shown in its own system for VAT.
- Ensuring broad powers for tax investigators and imposing severe penalties on criminals.
- Introduction of electronic monitoring of real-time trade in risk sectors.
- Introduction of mandatory electronic invoicing, which allows tax authorities to monitor trade in real time.
- Introduction of the so-called Intra-Community (reverse charge) for intra-Community supplies, which shifts the responsibility for charging VAT to the buyer (recipient) instead of the seller (supplier), as a means of tackling chain tax fraud in intra-EU VAT.

In this way, it could contribute to more effective tackling of cross-border VAT fraud, which is a major source of income in the tax systems of many EU and OECD countries, and the mechanism of taxation with this tax—the deduction of tax credit from tax subjects and the refund of VAT from the budget, creates favorable opportunities for abuse.

3.6 Future Research Directions

In order to remove barriers to the implementation of a modern tax policy aimed at achieving the goals of sustainable development, it is important to achieve effective and efficient control impact to combat fraud both within national tax systems and to combat cross-border tax fraud. To this end, the study of the factors favoring cross-border tax fraud related to the diversion of profits and income, as well as value added tax (VAT), could be deepened. In this regard, it will be useful to focus on achieving the rule of law in democratic systems and reducing corruption and the informal economy on a global scale, as they create favorable conditions for the development of financial crime.

Also, scientific efforts could focus on modeling possible interactions between competent authorities and institutions in OECD countries so as to improve—information exchange, sharing of experience and good practice, as well as joint investigations by control and judicial authorities in different jurisdictions to tackle cross-border tax fraud.

3.7 Conclusion

The study of issues related to tax avoidance and cross-border tax fraud provides an understanding of the role they play in the erosion of the global economic system, as they undermine the rule of law with all the resulting negative consequences for modern tax policy at national and international level. Increasing the efficiency, the results of the work and the trust in the tax administration and the administration of justice in the respective jurisdictions are prerequisites for a reliable counteraction to tax crimes. With regard to tackling cross-border tax fraud, the focus should be primarily on improving opportunities for cooperation and interaction, exchange of information, good practices and experience. Thus, the synergy of control effects can be generated, which—based on the implementation of modern IT (for example, “Big Data” technology) in the activities of financial control authorities—to reduce cross-border tax fraud to a level that does not threaten sustainable development.

The results of the study make it possible to characterize the following characteristics of cross-border tax fraud: (1) are complex in nature and often accompany other financial abuses and criminal activity, such as money laundering, terrorist financing, corruption, organized crime; (2) engage more participants, ie. the schemes for their implementation are more complex; (3) are assisted by highly qualified experts who know the vulnerabilities of the tax legislation and the tax system; in most cases the tax frauds are realized with the knowledge of the accountants who perform the accounting, and in many cases with the assistance of specially engaged accounting firms or law firms; (4) develop best in the face of poor communication between supervisors in different countries (e.g. lively trade relations between the United States and China with weak cooperation and exchange of information between financial and fiscal supervisors in both countries); (5) rely on weaknesses in administrative capacity and a thriving corruption environment. Therefore, the effective and efficient fight against cross-border tax fraud requires strengthening the rule of law, development of cooperation and interaction between control bodies at national and international level, including increasing information exchange, sharing experiences and good practices.

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Part II
Opportunities for Improving the Tax
System in Connection With Sustainable
Development

Chapter 4

Design of Sustainable Tax System



4.1 Introduction

This chapter examines the taxes that form the modern tax system, and in this regard the relevant classifications and characteristics of individual types of taxes are made. Particular attention is paid to the advantages and disadvantages of applying direct and indirect taxes, as well as income taxes, consumption taxes, property taxes and environmental taxes. Issues related to tax breaks, tax reductions and tax rates, as well as their role in shaping the tax burden, efficiency and fairness of taxation, their impact on employment, economic growth and investment, were also explored. The effects of the application of different taxation systems—progressive, flat and regressive taxes are also studied. These issues are related to the challenges of forming a sustainable tax policy related to finding a balance between economic efficiency and social justice of taxation. This chapter examines the problems and solutions related to increasing tax compliance in two areas: stimulating the voluntary fulfillment of tax obligations and improving the control impact, as a guarantee for the accumulation of planned tax revenues in the budget. In this regard, special attention is paid to the implementation of administrative liability, the imposition of fines and sanctions on perpetrators in cases of tax violations.

4.2 Background

An overview of the leading economic doctrines in the period from the late 1930s to the 1970s years of the twentieth century shows that the main influence on US stabilization and fiscal policy was exerted by Keynesian theory (Davies, 1986). Keynesian views and policies have then been challenged by monetarists, rational expectations theorists, and supply-side theorists. According to monetarists, proper

control of money supply will help promote the conditions necessary for the growth of a healthy economy. Davies (1986, p. 1) refers to Meiselman (1982) and points out that, in the short term, changes in cash are crucial in determining fluctuations in real output and employment. In the long run, however, the amount of money can only affect the nominal gross national product (GNP). Real income is largely influenced by factors such as the supply of labor, raw materials and capital, the state of technologies, the amount of human capital, health and the ingenuity (intelligence) of individuals, a stable legal framework, and a stable and constructive public policy, which contains the necessary incentives for efficient use of productive resources.

Since the mid-1970s, the study of the tax structure and its impact on the economy has been deepening. The goal is to clarify the link between taxes and the efficiency of the economy. According to Davies (1986, p. 6), although most modern neoclassicists and representatives of supply theory understand Keynesian analysis, the theory of rational expectations and monetarist theories, they do not focus on any of them and consider problems over a longer period of time than neo-Keynesian economists and politicians. These economists focus their research on economic efficiency and growth. They see positive incentives for production as a driving force in a stable, healthy and growing economy. Their analysis deals with the assessment of incentives and their impact on human behavior and the resulting supply of goods and services. In order to achieve the goals of efficiency and growth, most economists-supporters of the theory of supply give recommendations that are related to tax issues.

Davies (1986) considers that the most serious threats to production incentives are government policies on inflation, government benefits and taxation. Modern neoclassicists and supply-side economists believe that the impact of inflation, with its enormous distortions, due in part to historical cost accounting procedures, is hampering savings and investment. Their empirical studies show that in some cases the effective rates of taxation on capital gains and profits exceed 100%, which implies a reduction in capital. Inflation is also leading to an increase in personal income tax, so that without legal changes in tax rates, they will have to pay the state ever higher proportions than their real wages and salaries.

The tax system is the main component of the financial system and an essential part of the socio-economic system as a whole, which is why its rationality, justification and efficiency are extremely important. It can be defined (Stoyanov, 2000, p. 55) as a set of applied taxes and their organization and includes: types of taxes, methods of taxation, collection, reporting and control of taxation, bodies and institutions that carry out taxation, collection, tax reporting and control.

The following basic requirements for the tax system have been established in scientific knowledge: economic efficiency, administrative simplicity, flexibility, political responsibility and fairness. Their characteristics are presented in Table 4.1.

When forming the tax system, the following classical principles of taxation are taken into account: uniformity of the tax, certainty of the tax, convenience of the tax, profitability of the tax and neutrality of the tax. Their characteristics are presented in Table 4.2.

Table 4.1 Requirements for the tax system

Requirement	Characteristic
Economic efficiency	<ul style="list-style-type: none"> • The tax system must not impede the efficient allocation of resources.
Administrative simplicity	<ul style="list-style-type: none"> • The tax system can be easily applied and the costs associated with its operation are minimal.
Flexibility	<ul style="list-style-type: none"> • The tax system to react quickly to changing economic circumstances.
Political responsibility	<ul style="list-style-type: none"> • The changes in taxes should be the result of a dialogue with civil society on government spending. • Limit the possibilities for abusing the tax system so that it is not used in the interests of one or another minority group, instead of in the interest of society as a whole, for its general well-being. • To discuss publicly not only who should pay the individual taxes, but also what they will receive from the state against them.
Justice	<ul style="list-style-type: none"> • The tax system should be fair in treating individuals in two respects: horizontal justice, which requires people with the same wealth and income to be taxed equally, and vertical justice, which requires individuals with greater opportunities to pay higher taxes.

Source: The author based on Stoyanov (2000)

Table 4.2 Principles of taxation

Principle	Characteristic
Tax uniformity	<ul style="list-style-type: none"> • Taxation should cover all taxable items in proportion.
Definiteness of the tax	<ul style="list-style-type: none"> • Clear and precise definition of the main components of the tax, the term of payment, the method of payment, the amount of payment.
Convenience of the tax	<ul style="list-style-type: none"> • To be collected at a time and in a way that is convenient for the payer. It is determined by the technique and deadlines for tax payment.
Profitability of the tax	<ul style="list-style-type: none"> • Possible higher net budget revenue from taxation, which requires simplification of tax laws and taxation techniques, as well as optimization of the structure and number of revenue agencies in order to reduce the cost of tax administration.
Tax neutrality	<ul style="list-style-type: none"> • This is a principle that is similar to the requirement of horizontal fairness of taxation, according to which taxpayers with the same tax subjects should pay the same taxes.

Source: The author based on Stoyanov (2000)

Tax policy is aimed at addressing the following main issues: the number and type of taxes applied, the organization of individual types of taxes, the burden of the tax burden and its social and sectoral distribution (Stoyanov, 2000). Through the components of the tax system and in accordance with the principles of taxation, the state seeks to pursue a targeted tax policy by deciding on two competing goals—economic efficiency and social justice. The shape of tax policy is determined by the characteristics of the state and society as a whole, the ratio of social forces in it, its democratic traditions, the scale and nature of the market. Modern tax policy cannot be defined as neutral, because along with its main purpose to provide revenue to the budget, taxes perform a number of other functions, such as—regulating employment

and economic growth, balancing supply and demand, solving certain social and environmental issues.

According to the European Commission (2017), compromises between the goals of efficiency and justice are sometimes needed, but the two are not in conflict. It is important to take into account the social impact of tax systems so as to strike the right balance between the efficiency and fairness of the tax model, in line with national preferences. Tax and social systems can be a reliable means of alleviating income inequalities through redistribution. The key characteristics that determine the fairness and efficiency of a tax system are the following: the extent to which it encourages investment, supports job creation and employment, corrects inequalities, and achieves high levels of compliance.

Modern countries are focused on achieving various economic and social goals that require public spending, which must be financed through taxation. Therefore, attention should be focused on three main issues related to taxation:

- **Taxation affects incentives:** It can change the economic behavior of consumers, producers and workers in a way that reduces economic efficiency. These effects must be taken into account when estimating the public expenditure that will be financed by taxes.
- **Distribution of the effects of taxation on the population:** Equality and fairness issues arise, which need considerable attention.
- **Practical applicability of tax regulations and costs arising from their compliance:** Considerations to be taken into account when designing tax systems to ensure a high level of tax compliance.

According to the OECD (2001, p. 17), the main challenge in tax policy-making is to find the best possible balance between these three issues.

4.3 Types of Taxes, Tax Reliefs and Rates

The taxes that form the modern tax system are numerous and varied and difficult to characterize individually. It is therefore useful to classify taxes. Official data (European Commission, 2021, p. 21; Evropeyska komisija, 2017, p. 2) show that the structure of taxation differs significantly and there are large differences in the levels of general taxation in EU countries. Tax rates, the method of determining the tax base and the level of compliance with tax legislation are the main factors determining the economic consequences of taxation.

According to Burman and Slemrod (2012), it is important to distinguish between impersonal and personal taxes. In the first type (impersonal taxes), how much taxes are generated does not depend on who takes some action that triggers the tax. For example, the usual U.S. retail tax is an impersonal tax, as each consumer generates a \$1 tax liability when purchasing a \$20 item in the state with a 5% sales tax, regardless of who sold it or who sold it. has bought. According to the authors, impersonality simplifies the process of tax collection, as it does not take into account

the characteristics of the buyer, such as income, wealth, age, marital status, etc. On the other hand, this aspect of sales tax limits the extent to which the tax liability can be linked to people's solvency (income and wealth), which is unfavorable from the point of view of fairness in the distribution of the tax burden. Income tax is a personal tax, as the tax liability depends on the level of income—higher-income households tend to have higher tax liabilities, as well as other characteristics such as marital status, charitable contributions, medical expenses (Burman & Slemrod, 2012).

Taxes may come to the revenue of different budgets, on the basis of which they are differentiated into: (1) state or federal taxes, the revenues from which are provided to the central state budget; (2) taxes which are paid into the revenue of the budgets of states, provinces, cantons, republics, etc., when the state is of the federal type; (3) local or municipal taxes that are paid into local budget revenues; (4) distributable taxes, the proceeds of which are provided to the individual budgets according to certain proportions.

According to Stoyanov (2000, p. 46), the majority of taxes are general purpose and serve to cover budget expenditures in general, but there are also such taxes that are used to finance specific expenditures—they are targeted taxes. The author also distinguishes between taxes on major and minor, according to their fiscal importance, pointing out that in recent decades there has been a tendency to differentiate taxes in this way on another basis—depending on their potential for large-scale and significant impact on the economy. In this way, the so-called functional taxes.

From the point of view of modern theory and practice, the most important is the distinction between direct and indirect taxes, as well as their differentiation according to the object of taxation—income taxes, consumption taxes, property taxes and environmental taxes (Stoyanov, 2000). Direct taxes have as their object of taxation: property, wealth, factors of production, which are potential carriers of income or the income itself in its realization or receipt. While indirect taxes cover and tax the income when it is spent on the purchase of goods and payment for services, in the prices of which they are included in advance and lead to their increase. The object of taxation and the nature of the indirect taxes give rise to other names of the same, such as taxes on consumption or consumption, taxes on expenses or turnover taxes.

The attitude to the taxation of indirect taxes is not unequivocal—they have both ardent supporters and strong opponents. Usually the criticism of indirect taxes is that they are regressive and unfair, but there is also the opposite opinion that they are rational and fair, because through them the tax burden is distributed in proportion to the quantities of goods and services consumed. Proponents of indirect taxes believe that the burden of individuals with taxes should not be based on property owned or income (as in direct taxation), but on the amount of goods consumed: who consumes—he pays, not one who owns property or earns income (Stoyanov, 2000).

Opponents of indirect taxes point to their unfair nature: the lower an individual's income, the greater the relative share of indirect taxes seized from him, so they act regressively and are unfavorable to low-income social groups. In this regard, since the time of Adam Smith, it has been considered socially justified to tax indirectly

mainly on luxury and unhealthy goods. Modern economists usually assume that significantly high taxation of these goods is justified from a fiscal and moral-ethical point of view, but can not bring significant revenues to the budget; only the taxation of consumer goods can provide significant financial returns (Stoyanov, 2000, p. 51).

Criticisms of direct taxes are that they limit initiative, hard work, risk, thrift and, as a result, undermine overall well-being. According to some authors (Stoyanov, 2000), from a fiscal point of view, indirect taxes have certain advantages over direct taxes:

- They are included in the prices of small parts (amounts) and are paid by the population in the form of increased prices of goods and services, sometimes without even suspecting their existence, which makes them easier to bear.
- These taxes are more cost-effective because it is easier to cover indirect taxation sites than to establish income.
- Control over the sites and payers of indirect taxes is easier and more efficient.
- Revenues from these taxes are more secure for the budget because they are not affected by profitability or profitability, and their payment is related to the production and sale of goods and services in the prices of which they are included.

In the conditions of the modern market economy the characteristics of the indirect taxes are well known and valued, and the revenues from them occupy a significant part of the total tax revenues. For example, according to the European Commission (2021, p. 22) on tax trends in the European Union, in 2019 the share of indirect taxes (i.e. VAT, import duties and excise duties) in total tax revenues for the EU-27 is an average of 34, 2%.

According to the object of taxation, taxes are divided into four main groups—income taxes, consumption taxes, property taxes and environmental taxes, the characteristics of which will be discussed below.

Property taxes: These taxes are levied on the real estate and movable property of individuals. Such taxes are the land tax, the real estate tax, the inheritance tax, the vehicle tax. It is characteristic of property taxes that there is a discrepancy between the object of taxation—a certain type of property and the source of their payment—the realized income. By presumption, property is a mark and bearer of economic power and solvency, but this is not always the case. Therefore, there is no proportional relationship between property—income—solvency, so the burden of property taxes, other things being equal, may be different (Stoyanov, 2000, p. 47).

Income taxes: These taxes are a traditional part of the modern tax system. They form a significant share of revenues in the state budget. Income is gradually becoming a symbol of economic power and solvency. Therefore, taxation is redirected from property (wealth) to the income of individuals and legal entities, and income taxation is introduced and widely applied. Income taxes increase budget revenues when revenues (tax base) increase without changing tax rates. They are not an element of the prices of goods and services, so they do not directly affect the price level, but only indirectly by changing supply and demand. These taxes are often used as a tool for macroeconomic stabilization, stimulating economic growth and

attracting foreign investment. They are clear and easily applicable because there is a unity between the tax base and the source of tax payment—income. This reduces the cost of collecting them and makes them cost-effective for the budget. Income taxes can affect the behavior of businesses, for example, the choice between work and leisure, between taking and avoiding economic risk, on consumer behavior and propensity to save, on the duration of training.

This group of taxes mainly includes personal income tax (personal income tax) and corporate income tax, also called corporate tax or profit tax.

Consumption taxes: Nowadays, sales, sales and trade turnover are mainly levied on the sale of goods and services, and these taxes are included in their prices and thus lead to their increase. Taxed goods are usually objects of consumption or consumption, which is why these taxes are also known as taxes on consumption or consumption. They are also found under the name of taxes on expenses, as they are taxed on the expenses of the population in the purchase of goods and use of services. As far as the indirect taxes are related to the realized turnovers, there are grounds to call them turnover taxes. This group includes excise duties, sales tax, turnover tax, value added tax.

Environmental taxes: They aim to reduce the harmful effects on the environment, for example—to reduce the use of pesticides or to use less toxic and harmful to the environment and health pesticides, to reduce harmful emissions into the air, in connection with which the introduction of so-called “Carbon tax”. This group includes taxes—energy, transport, taxes on pollution and the use of natural resources. The main branches of application of environmental taxes are—energy, transport, extraction and processing of natural resources. Economic instruments that regulate the price of pollution (including the “green tax”) aim to reduce pollution to the point where the marginal cost of mitigating pollution is equal to the tax rate.

Based on an assessment of revenues from environmental taxes and fees, decisions can be made to reduce other taxes by the same amount without increasing the overall tax burden. Thus, “green” tax reforms are being carried out, which increase environmental taxes and fees, combined with a reduction in personal income taxes, social security contributions and corporate income taxes. Such an approach performs several functions simultaneously—it stimulates production, employment and environmental protection.

According to the European Commission (2021, p. 47) Revenues from environmental taxes represent 2.4% of GDP and 5.9% of the total tax revenues of the EU-27 countries in 2019 Environmental taxes are introduced as a tool mainly in order to influence the behavior of environmental protection, also, they have a certain contribution as a source of revenue in the budget. These revenues are the result of changes in environmental tax rates and tax bases. Thus, zero increase in tax revenues may arise when the tax base (eg fossil fuel consumption) has decreased and the corresponding tax rate has increased. The dynamics of revenues from environmental taxes must be interpreted with caution—always through the prism of environmental policy, ie. from an environmental point of view.

Štreimikienė (2015) points out that the main priorities set by the European Commission to be addressed by EU Member States in their National Reform

Programs include the tax system, which must be designed to be more growth-friendly. By shifting the tax burden from labor to taxes related to consumption and the fight against pollution. The author concludes (Štreimikienė, 2015, p. 19) that the energy sector is the main source of environmental pollution, which is why the increase in environmental taxes is expected to have a positive impact on sustainable energy development. However, the process of greening national tax systems in the European Union has significant differences. For example, the analysis in the three Baltic States and the Czech Republic shows very different rates of energy and pollution taxes, as well as quite large differences in the share of environmental tax revenues as a percentage of GDP in these countries.

In connection with the study of the tax system, in addition to the characteristics of individual types of taxes, attention should be paid to issues related to tax relief and tax rates that affect the tax burden. The tax base is formed by deducting tax reliefs and reductions from the gross income. For the purposes of personal income taxation, this deduction takes into account the social status of individuals or social groups in order to achieve greater fairness in income taxation. This pre-tax adjustment of the income is aimed at achieving effects in several aspects—economic, social, political and demographic. Tax breaks are a non-taxable amount for taxpayers. Through them, the tax burden can be adjusted to the number of family members and to compensate families with more children. Tax treatment of childcare costs is an important issue, especially for countries with low birth rates and problems with the emigration of young people of reproductive age. Tax breaks or non-taxable amounts are usually significantly less than a person's household allowance, but they should take into account the subsistence level or poverty level and thus protect the lowest income people.

The introduction of a non-taxable minimum in personal income tax is related to the implementation of the principle of fairness of taxation. Even in the classical economic theory (John Stuart Mill) the notion is accepted that income taxation should not affect the income that ensures the satisfaction of only the minimum human needs. Determining the non-taxable minimum is in line with the country's poverty line criteria (Kotsev et al., 2008a).

Tax reductions are also exempt from the recognition of amounts related to the recognition of various household expenses, such as: mortgage interest expenses, housing loan interest, medical expenses, charitable expenses, contributions to private pensions and social security contributions, funds, etc. Recognized reductions in different countries are generally linked to ensuring a certain welfare of taxpayers. They raise many questions about the effectiveness and fairness of taxation (Kotsev et al., 2008a), such as: (1) whether part of these household expenditures should be covered by budget transfers, ie. through the social assistance system and thus affect only households in need; (2) the extent to which personal income tax should be charged to social functions or be borne by social assistance; (3) whether the costs of education and training should be exempt from taxation, as they are a personal investment; (4) whether the many tax preferences do not create preconditions for tax violations and abuses; (5) is it not very difficult for the tax administration to deduct various reliefs and reductions.

In the 1980s, a wide range of tax rebates was introduced in developed countries, leading to income evasion and hindering the tax administration, as well as transferring too many uncharacteristic social functions. Therefore, at the beginning of the twenty-first century, there is a tendency to limit tax preferences, recognizing that their complete abolition also has a negative effect, as the tax burden cannot be reduced depending on the characteristics of taxpayers. Tax breaks and reductions in income taxation allow the state to influence the exercise of additional labor, the level of consumption and economic growth, the stimulation of savings, charity, education and training, the creation of conditions for raising more children in the family and others favorable socio-economic effects. Kotsev et al. (2008a, p. 189) conclude that tax preferences must be carefully dosed and tailored to the socio-economic challenges facing each country. The authors point out that tax reliefs and reductions are crucial for the burden of the tax burden on income tax because they determine the amount of the effective tax rate, i.e. the ratio between tax and total income. According to them, it is not possible to compare the tax burden between individual countries, based only on the amount of tax rates, as the formation of the tax base is very important in this regard.

The tax liability depends not only on the tax rate, but also on the amount of the tax base, as it is established as a product of the tax base (the number of taxable units) and the tax amount. The tax base is the number of taxable units on which the tax liability is calculated. When the tax base does not cover all tax units, it means that certain tax units are deliberately exempt from taxation. The tax amount is the tax with which a taxable unit is taxed and is most often determined as a percentage or in an absolute amount.

One of the main issues in the implementation of tax policy is related to the size of the tax quota and the level of the tax burden, as a relative share of income and GDP. According to the Adolf Wagner Act, popularized in the late nineteenth and nineteenth centuries, there is a tendency to continuously increase government spending as a result of expanding the functions and role of the state in modern life, leading to an increase in the tax burden. In this regard, proponents of neoliberal economic doctrine believe that it is necessary to reduce the tax burden to about 40% based on the release of the modern state from unnecessary functions, tasks, institutions and costs.

The main motive for reducing government spending and reducing the tax burden is economic—stimulating economic activity and increasing its efficiency, as a basis for economic and social prosperity. The relationship between the tax burden and economic activity was studied by the American economist Arthur Laffer and expressed graphically by the so-called Laffer curve. According to her, taxes to a certain level generate economic growth and budget revenues, but after that level their impact is reversed—they limit economic development, which leads to a reduction in budget tax revenues. There is an optimal tax rate (rate) at which economic growth is achieved and tax revenues are accumulated in the budget. Some economists (Stoyanov, 2000, p. 64) believe that with lower tax rates, tax revenues in the budget may increase due to the influence of two main factors: (1) stimulating and expanding economic activity, which is the basis for taxation and (2) reduction of resistance to

taxation—reduces the desire for income evasion, which leads to the reduction of the gray economy.

Davies (1986, p. 7) considers the importance of high marginal tax rates from the standpoint of economists who support supply incentives (so-called “Incentive economists”) and motivate that in order to obtain increase real income, production must increase. They are pushing for tax cuts, but not to boost aggregate demand, but to boost production. Reducing the tax rate allows people to keep a larger share of their income. This in turn affects the choice between work and leisure, savings and investment, and therefore the level of production.

High marginal taxes encourage people to reduce their production efforts in favor of leisure time. Davies (1986, p. 7) refers to Gwartney and Stroup (1980), according to whom a high marginal tax rate reduces the motivation for economic activity of individuals. When personal returns are significantly reduced, opportunities for overtime or night work are missed, retirement may occur at an earlier age, there may be more sick leave and absences, leave and time between jobs (when changing) to become more long and risky investment projects to be avoided.

Slemrod (1990) points out that the cost of administering each tax system increases with the number of different tax rates that are imposed, so that only a small number of tax rates can be desirable. According to Dasgupta and Stiglitz (1972), cited by Slemrod (1990, p. 163), the optimal solution to the tax on goods must take into account the income elasticity of goods and the social burden of redistributing wealth through the fiscal system.

Corporate and personal income taxes affect growth and investment. Corporate taxes affect both the location of enterprises and domestic and foreign direct investment. Differences in corporate taxes can lead to diversion of profits by multinational companies from high-tax countries to low-tax ones. Investment decisions are influenced by the effective marginal tax rate (EDP), i.e. the tax burden on the last euro invested in a project (similar to other currencies). The smaller the SPD, the more investment-friendly the tax system. Some ways to reduce the ENPD and create a tax system that supports investment are: providing schemes for faster depreciation or immediate recognition as an expense, allowing capital costs to be deducted, improving the conditions for carrying forward losses, offering tax incentives for research and development (Evropeyska komisija, 2017, p. 4).

The tax burden on labor income affects the decisions of individuals on whether to work and how much to work, as well as the decisions of employers on whether to hire workers, as it leads to an increase in labor costs. The supply of labor by some groups of the population, such as low-skilled workers, young people, older people and second working household members, is particularly sensitive to the level of compulsory social security contributions. However, these decisions also depend on the available social benefits that individuals receive when they do not work or work part-time, i.e. the effect of the “inactivity trap” is manifested. According to the European Commission (2017), the composition of the tax burden is important in the short term, as the various components may affect labor supply or demand. The tax burden per worker is determined by the following components: personal income tax, employer’s social security contributions, employee’s social security

contributions and family allowances, which reduce the overall tax burden in some countries, such as France and Denmark.

4.4 Effects of Taxation: Progressive, Flat and Regressive Taxes

The construction of a sustainable tax system raises the question of the optimal level of tax rates and finding a balance between economic efficiency and social justice of taxation. Therefore, fiscal considerations are not the only ones in building the tax system. In the following presentation, a description of the main income tax systems will be made.

1. **Progressive system:** In the case of the progressive tax, the tax rate changes according to a pre-selected progression, and the tax liability increases progressively with the increase of the tax base. This system of taxation leads to a change in the income ratio established before taxation. Progressive income taxation is defined as more favorable for low incomes than for high ones.
2. **Proportional system:** In the case of proportional (flat) tax, the amount of the tax rate remains the same, and the tax liability changes proportionally with the change of the tax base. This type of taxation does not lead to a change in the ratio of income before and after taxation. This system is considered acceptable for both high and low income taxation and seems objective and fair.
3. **Regression system:** In addition to the two main systems of taxation described above, a regressive tax is applied, in which the tax rate decreases with increasing income. The patent tax has the character of a regressive tax, as its amount is known in advance and does not change regardless of the size of the turnover. Thus, the higher the turnover, the lower the effective tax rate.

More attention will be paid to patent tax as a representative of the regressive system of income taxation, as its characteristics are not presented in sufficient detail in the specialized literature related to taxation. The final annual (patent) tax is a way of taxing small businesses, related to the implementation of mostly craft and other services to the local population (such as cosmetics, knitting, carpentry, hating, shoemaking and upholstery services, etc.), and retail. Patent tax revenues usually go to the local municipal budget, not the state budget. Patent tax replaces personal income tax with final tax, which does not determine the tax base, but it is fixed and differentiated depending on the type of services provided and the place where they are provided. Thus, the amount of patent tax does not depend on the realized income, which is considered a major shortcoming and injustice of this tax. For example, in Bulgaria a patent tax is applied to individuals, incl. sole traders, (1) who perform so. "Patent activities" specified in the Local Taxes and Fees Act, (2) whose turnover for the previous year does not exceed BGN 50,000 and (3) are not registered under the VAT Act. Patent tax is paid in four equal installments. In 2021, the patent tax for

trade in precious metals is in the range of BGN 500 to BGN 2500, depending on the location of the site. Thus, with an annual patent tax of BGN 500, the effective tax rate will decrease with the increase in turnover: it will be 5% for a turnover of BGN 10,000, 2.5% for a turnover of BGN 20,000 and BGN 1.25% with a turnover of BGN 40 thousand.

Some advantages of patent taxation can be pointed out (Kotsev et al., 2008b, p. 199):

- A clear and simplified way of paying a fixed tax when performing activities specified by law, which allows precise planning of revenues from these taxes in the municipality.
- The patent tax brings to light a number of activities and services, the taxation of which is characterized by low collection.
- The administration of this tax and tax control is very economical and efficient, especially when it is regulated as a local tax.
- In general, the patent tax is beneficial for the craftsmen themselves, as it facilitates the keeping of accounting records.
- Encourages taxpayers to realize higher incomes in order to reduce the effective tax rate.
- This tax reduces the risk of declaring incorrect reporting data, as it is determined in absolute amount and does not depend on the amount of income received.

As a basis for the introduction of patent taxes by municipalities, it is stated that taxpayers benefit from the aggregate demand in the municipality. In this sense, the patent is a kind of purchase of the right to offer a particular good or service in the municipality, which is why these taxes were once in the form of license fees. A patent is a payment for income earned by individuals, which is why it is defined as a type of income tax. In determining the optimal amount of this tax, the net income from the respective patent activity (ie the total income less the total costs) should be used as a basis, which should be taxed at the current tax rate and thus form the amount of patent tax in absolute amount. In this way, the principle of horizontal fairness in income taxation can be observed (Kotsev et al., 2008b, p. 200).

As soon as the idea of income taxation arose, it was associated with the progression in establishing the tax liability. Kotsev et al. (2008b, p. 190) point out that according to the German economist and financier Adolf Wagner, taxes should affect the distribution of national income and wealth in the name of greater justice. Thus, progressive income taxation, which began to be widely used in the early twentieth century, is associated with expectations of reducing large disparities in income and wealth.

The main argument in favor of progression in personal income taxation is that in this way social justice is achieved—the state, through constructed progressive scales of taxation, has the opportunity to redistribute income from higher paid individuals and households to poorer ones. Opponents of progressive income taxation believe that progressive taxation scales bring inefficiency to the economy because high marginal rates for higher income groups hinder the incentives for business and entrepreneurship. However, this thesis is refuted by the results of some studies,

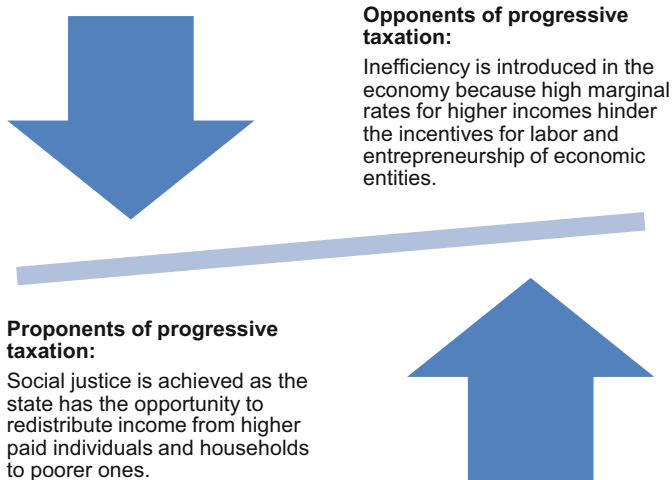


Fig. 4.1 Effects of progressive income taxation. Source: The author based on researched literature sources

according to which, given that people are more interested in their income status than their free time, they will devote much of their time to work (Corneo, 2000). Other scholars have concluded that lowering personal tax rates actually leads to a reduction in entrepreneurial activity, which is an important source of innovative ideas and economic growth, as it makes it pointless to take business risk and engage in self-employment (Cullen and Gordon, 2002). In addition, it is noted that often poor countries have minimum taxes on personal income. Figure 4.1 shows the main positive and negative effects of progressive income taxation, which are highlighted, respectively, by supporters and opponents of the system of progressive income taxation.

Meghir and Phillips (2010, p. 222) pay attention to the behavioral effects of taxation. According to them, people with higher incomes are likely to have more opportunities to redirect their income and consumption to forms that are more favorable from the point of view of taxation. Therefore, their main response and labor supply as a result of changes in taxation cannot be measured directly by working hours, but rather by changes in taxable income.

According to the proponents of proportional income taxation (flat tax), justice can be achieved not only through the system of government revenues, but also through the system of government expenditures, which has less distorting impact on incentives for work and economic growth. In this sense, all income is taxed at the same rate, but in order to compensate, some low-income individuals are provided with state transfers in the form of social benefits, allowances, vouchers and other preferences. In response, critics of the flat tax point out that the redistribution of income through government spending has negative effects, as any redistribution outside the market mechanism creates distortions and inefficiencies. In addition, redistribution through the expenditure system involves significant administrative costs.

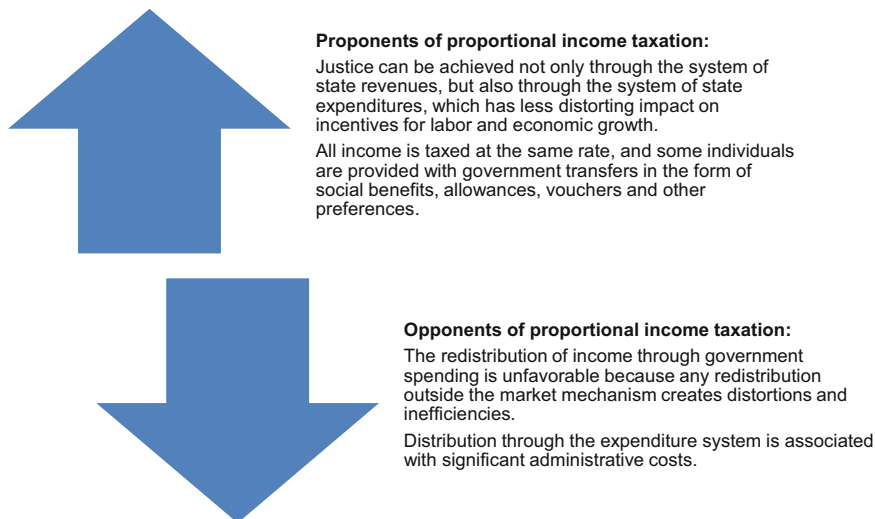


Fig. 4.2 Effects of proportional income taxation (flat tax). Source: The author based on researched literature sources

The fairness of flat taxation (with an exemplary tax rate of 10%) can be judged by comparing the marginal utility of the deducted part, through personal income tax, of wealthy individuals and those with low incomes, as a result of taxation they would not be deprived of the same share of consumption. Thus, a tax of BGN 100 (10% of income of BGN 1000) is much more burdensome than a tax of BGN 1000 (10% of income of BGN 10,000). This is because what is deducted from low-income taxpayers, although less in absolute value, has a greater marginal utility for them. Conversely, the higher a person's income, the lower the marginal utility that is deducted from the 10% tax rate. Although they contribute more to the budget, in absolute terms, high-income taxpayers are left with enough money after income tax to meet their basic necessities and even consume luxury goods. Lower-income individuals do not have this purchasing power and consume mainly basic necessities. Therefore, proportional taxation takes away a relatively small part of the income of the rich and their disposable income remains much higher than that of lower-income individuals. Thus, the burden of the tax burden shifts to low-income and middle-income groups. For this reason, there are critical views that the application of flat income taxes exacerbates income inequality (Nikolova, 2021). Figure 4.2 depicts the main positive and negative effects of proportional income taxation, which are pointed out, respectively, by the supporters and opponents of the flat taxation system.

Usually, in order to mitigate the effect of the flat tax and make it more socially acceptable, a basic relief (non-taxable minimum) is introduced, and often additional targeted relief, such as for families with children. In this way, a fairer transformation of the traditional progressive personal income tax into a proportional personal

income tax can be achieved and the lack of a larger number of tax rates in the income tax scale can be compensated for.

A number of factors must be taken into account when designing the tax system and choosing the method of income taxation, such as budget needs, the level of tax collection, the cost of tax administration and the level of the informal economy. The main arguments of the countries that have introduced a flat tax are related to the possibility of increasing income tax revenues in this way. It is considered that the simplicity and clarity of taxation, as well as the reduced tax rates, which are characteristic of flat taxation, strengthen the voluntary fulfillment of tax obligations, help to reduce hidden taxes, increase revenue collection and the effectiveness of income taxation. Research data (Nikolova, 2021) show that the main positive effects of the introduction of the flat tax are related to the fact that tax revenues in the budget remain relatively constant. Therefore, the flat tax can serve as a counter-cyclical instrument of fiscal policy (a kind of budget stabilizer), which will partially compensate for the reduction in budget revenues from other taxes in the financial crisis. The reasons for this positive fiscal effect of the introduction of the flat tax are the result of the fact that it leads to the declaration of the real amount of income of workers. However, the flat tax does not completely solve the problem of tax compliance on the part of those who generally do not declare their income at all.

Maintaining low levels of income taxes for citizens and businesses, social security contributions and wage costs is typical of the export-oriented growth strategy, in which the focus is on achieving the so-called “Cost competitiveness” and attractiveness to external investors. According to some authors (Vladimirov, 2015), such a policy, in which the level of wages lags behind labor productivity, and the level of income taxes and social security contributions is low, leads to a reduction in budget revenues, and hence public spending. All this leads to an increase in income inequality and social tensions. In addition, it can cause the emigration of young people and skilled professionals in search of better pay and social comfort abroad.

Therefore, when maintaining low incomes and social security contributions is used as evidence of attracting foreign investment, it should be borne in mind that this creates a number of negative effects that limit domestic demand and its role as a driver of economic development and growth (Nikolova, 2021). Therefore, if you want to stimulate economic growth and foreign investment, in order to avoid these negative effects, the model of so-called “Dual income tax”, combining proportionally low taxation of corporate income with progressive taxation of personal income (Galabov, 2009).

Theoretical assumptions suggest the existence of an optimal level of taxation, consistent with the economy of each country, ensuring an effective volume of quality public services (Vladimirov, 2011). Excessively high levels of income taxes have a retarding effect on growth because they reduce incentives to work, provoke attempts to evade taxes and evade income, reduce the level of savings and investment, slow down the development of all factors of production. Tax levels in today's conditions of mobility of goods and services, people and funds have the ability to direct labor and capital to countries with lower levels of taxation. On the

other hand, account should be taken of the fact that not only excessive levels hold back economic growth, but also too low levels of taxation.

Stantcheva (2015) points out that investing in human capital, in the form of time and money, plays a key role in most people's lives. Children and young people receive education, and the accumulation of human capital continues throughout life through on-the-job training. According to her, there is a bilateral interaction between human capital and the tax system. On the one hand, investment in human capital is influenced by tax policy. Taxes on labor income discourage investment by taking away some of the return on human capital. On the other hand, investments in human capital directly affect the tax base and are a major factor in the distribution of pre-tax income. Human capital incentive policies, which vary considerably from country to country, affect the distribution of workers' skills. According to the author, this two-way feedback requires a joint analysis of optimal income taxes and optimal policies for human capital over the life cycle.

Saez and Stantcheva (2016) explore the possibilities for assessing tax reforms related to public welfare, equal opportunities and poverty reduction. In this regard, they come to the conclusion that family background influences people's opportunities and results and is a prerequisite that cannot be tied to choice. According to the authors, this explains why equality of opportunity has a broad regulatory appeal among both liberals and conservatives. Therefore, policies are being pursued directly aimed at reducing such inequalities, such as public education and inheritance taxation. However, public education and inheritance taxation cannot completely erase inequalities based on family background. Therefore, the role of taxes and income-related transfers is emphasized, which aim to correct inequalities in opportunities.

Comparative analyzes are made between the tax systems of individual countries, corporate taxes are the most important, as they are decisive for tax competition. According to Kalendienė and Pukelienė (2011, p. 66), inappropriate changes in corporate taxation can damage the resilience of the economy. They point out that governments compete on tax rates to attract foreign investment to the country and to boost economic growth. On the other hand, the reduction of tax revenues in the public budget leads to an increase in public debt and damage to the economy.

A thematic information document of the European Commission (2017, p. 1) related to taxation states that taxation has a central role in achieving a just society and a strong economy. Taxation can help alleviate inequalities by supporting social mobility and correcting unequal distribution of market incomes; can have a major impact on employment, investment and expansion decisions, leading to greater growth. In this regard, tax policy should be assessed in the following four aspects: encouraging investment, supporting employment, reducing inequalities and ensuring compliance with tax laws.

4.5 Increasing Tax Collection: Incentives Against Sanctions

Modern tax policy aims to increase collection through voluntary fulfillment of tax obligations and compliance with tax legislation. There are many definitions of tax compliance in the literature, but despite some nuances in them, all relate to voluntary compliance with tax laws. For example, Hassan et al. (2021) point out that tax compliance is defined as the ability and willingness of taxpayers to comply with tax laws, declare the correct income for each year and pay the exact amount of taxes on time. According to these authors, tax compliance is the degree to which a taxpayer complies with tax rules and regulations, as well as tax compliance, is the willingness of individuals and other entities to comply with tax laws without the use of any law enforcement.

Three indicators can be used to assess the degree of voluntary compliance with tax legislation (Pashev, 2006):

- **Filing compliance:** Voluntary fulfillment of the obligation to submit a declaration.
- **Reporting compliance:** In accordance with the declared with the actual due.
- **Payment compliance:** With the degree of payment of the declared obligations.

In order to increase the collection of taxes from voluntary fulfillment of obligations, various *discounts* are usually introduced from the amount of the tax liability for taxpayers, such as: to pay the tax together with the filing of the return electronically and to pay the full amount of tax in the term for the first installment, when the annual amount of the tax is paid in several parts. In addition, taxpayers can be encouraged to meet their tax obligations properly by providing them with a range of electronic services, guidance and guidance from the tax administration. This saves time and effort in taxation for both parties—taxpayers and tax authorities. Also, various information campaigns are conducted to acquaint taxpayers with the changes in tax legislation and to form an attitude in society conducive to compliance with tax obligations. In order to simplify the taxation system, reduce the costs of determining tax liabilities and administering taxes, promote the declaration of actual income/profits and limit the gray economy—in some countries, proportional income taxation is introduced, etc. “Flat tax”.

It is important to use a complex (multi-channel) strategy to combat tax fraud and tax evasion. To this end, on the one hand, it is necessary to achieve better administrative activity and strengthened tax control, and on the other hand, great importance is attached to building trust and developing a culture of compliance with tax legislation. In this regard, tax authorities need to review existing policies and legal frameworks or develop new strategies to ensure that taxpayers meet their obligations, giving preference to voluntary compliance (Evropeyska komisija, 2017, p. 13).

Internal Revenue Service in the mid-1990s launched its electronic filing program to enable taxpayers to file their returns in a new way, with plans to increase electronic

income tax returns by 2007, individuals up to 80%. Some taxpayers use their home computers for electronic filing, but most work with tax professionals who file their returns electronically. The advantages of online filing are ease and convenience, new ways to pay taxes and receive refunds. Through electronic banking, payments can be made from the bank accounts of individuals, as well as a choice can be made to deposit the refunded amounts directly into their bank account. The use of electronic filing is not limited to individuals. Business owners also use electronic filing to meet their tax obligations. Various online options help them by simplifying the filing and filing of tax returns and the fulfillment of payment obligations (Weltman, 2002).

The high costs of complying with tax legislation have a particularly large impact on small and medium-sized enterprises. The costs of tax compliance are primarily due to the time spent, not the direct costs of paid accounting services. The time spent includes the hours needed to meet corporate income tax, value added tax and employee taxes, including payroll taxes and social security contributions. According to the European Commission (2017, p. 18), the time it takes for these companies to comply with tax obligations can serve as a good guide to how high the costs of complying with tax laws in a country are. To improve the business environment, tax systems could be reformed in three ways:

- Simplification and reduction of tax liabilities, especially for those wishing to start a business and smaller businesses.
- Expanding the scope of electronic services and providing them at one counter.
- Raise awareness, inform and train corporate taxpayers to help them adhere to tax rules using social media channels.

Although raising tax morale, providing concessions and incentives to taxpayers have a positive effect on the collection of planned tax revenues, these measures cannot fully address the issue of tax fraud and tax evasion. Tax compliance cannot be significantly improved as long as the benefits of income tax evasion far outweigh the expected sanctions and tax controls are weak (Galabov, 2009). Therefore, the degree of conscientious fulfillment of tax obligations is a function of the effectiveness of tax control and sanctions, i.e. the brakes on tax evasion. It is considered that the imposition of administrative fines and sanctions for tax-related violations are most effective when they are tied to the amount of hidden income or tax (Pashev, 2006). When administrative sanctions are set in absolute amount, in the range of lower and upper limits, when imposing them, the sanctioning body assesses the gravity of the violation, the motives for its implementation and other mitigating and aggravating circumstances, and on this basis determines the amount of the fine or property sanction (i.e. the administrative penalty is individualized), which creates preconditions for subjectivism and corrupt practices.

When conducting tax audits, it is possible for revenue authorities to focus only on charging tax liabilities and interest, but to omit the finding of administrative violations (e.g. failure to file declarations, non-declaration of certain data and non-preparation of accounting documents), thus the imposition of fines and property sanctions will be omitted. In this way the effect of the control impact is reduced, as no administrative penal liability is realized. Administrative penalties are imposed in

order to warn and re-educate the offender to comply with the established legal order and to have an educational and warning effect on other citizens. Therefore, during inspections and tax audits, it is necessary, along with tax obligations, to establish the committed administrative violations and to impose adequate fines and property sanctions.

The administrative penal provisions provide for more severe sanctions for a number of cases in which the relevant violations have been committed repeatedly, in order to thus have an educational effect on violators, by applying more serious measures to comply with legislation and established administrative ed. The possibility of rehabilitating offenders and deterring future offenses is greatly undermined if the recurrence of the offenses is not monitored and if the heavier penalties provided for in these cases are not imposed.

Revenue authorities usually resort to a number of sanctions for various violations that are found in the day-to-day operation of the tax system (OECD, 2015). Sanctions aim to achieve three main objectives: (1) to act as a deterrent to non-compliance; (2) to punish those who do not follow the rules; (3) to enforce strict compliance with a special provision of the law, such as filing a tax return and paying taxes on time. The most common violations in practice are: non-compliance with the deadlines for filing tax returns, non-payment of taxes on time and improper fulfillment of tax obligations.

In the presence of the provided prerequisites for the incriminated tax violations, criminal liability should be realized by the judicial authorities. Otherwise, the control impact on compliance with tax legislation will be limited and will not have the deterrent effect that limits tax abuse to a level where they do not endanger the financial security of society. In connection with the implementation of criminal liability for tax violations, the scope of the incriminated acts is important, incl. whether the Penal Code provides for penalties for all cases of non-payment of taxes or only for those in which no tax returns have been filed at all. This issue is important as it can lead to the release from criminal liability of those who have declared their obligations without, however, having entered them in the budget.

Alm (1999) explores the theoretical foundations of the individual decision related to tax compliance and examines non-economic factors influencing it. In this regard, he reached the following conclusions:

- If taxpayers give more weight to the likelihood of an audit than usual, then tax consent will be greater.
- Because some individuals classify any tax payment as a loss, they are likely to declare less income than expected (planned).
- The social norm and social customs matter—the individual will comply, while he believes that tax compliance is the social norm. Conversely, if noncompliance becomes pervasive, then the social norm of compliance will disappear.

Alm and McKee (2006) examine the impact of the likelihood of tax audits and the productivity of tax audits on the level of tax compliance. Thus, they conclude that only if higher audit productivity is combined with a greater likelihood of tax audits

can a positive effect on tax compliance be expected. Torgler (2007) conducted a study of tax compliance and tax morality, related to the existence of a negative correlation between tax morality and the size of the informal economy. He concludes that, compared to other variables, tax morale has a more significant impact on the size of the informal economy. Torgler (2007, p. 5) aims to identify the factors that affect tax morale and, in this regard, he studies social attitudes, and he concludes that compliance with laws, in general, has a positive effect on tax morale.

An information document (Evropeyska komisija, 2017, p. 25) on taxation in the EU states that enforcement is a crucial tool for making full use of the power of the public authority to force taxpayers to comply with the rules. Cross-border cooperation, effective audits, access to information and intelligence, and speedy collection procedures are also important in achieving this goal. In addition, it is essential to promote trust, transparency and a culture of compliance with tax legislation through various means, such as: (1) disclosure of the value of tax revenues, supervision and transparency of tax administration performance; (2) encouraging taxpayers to behave ethically in the performance of tax obligations, using communication and education campaigns to explain why it is important to pay taxes; (3) Cooperation with business for better compliance with tax legislation, using information on the behavioral economy in order to encourage taxpayers to perform their duties adequately and in a timely manner.

4.6 Solutions and Recommendations

Although in the implementation of modern tax policy the voluntary fulfillment of tax obligations is preferred and encouraged, and the goal is to constantly increase its share, the accumulation of planned tax revenues cannot be achieved entirely on a voluntary basis. Therefore, in addition to fostering taxpayers' good faith and creating comfort in meeting tax obligations, the control impact should be constantly improved. This requires not only the detection of tax violations and fraud, but also a deterrent effect on other cases and individuals. The main measures that can be recommended for this purpose are the following:

- Imposition of administrative fines and sanctions for tax violations, which are most effective when tied to the amount of hidden income or tax.
- Reimbursement of fiscal damages from evaded taxes, together with legal interest.
- When establishing concealed income, when the acts are incriminated, to initiate proceedings to seek criminal liability from the perpetrator.
- Building a public culture for voluntary fulfillment of tax obligations and intolerance to tax violations and fraud.
- Initiation of legislative changes to improve tax norms and tax policy related to income taxation.

In order to improve the control impact in the field of taxation, measures should also be taken to increase the integrity and ethics of financial control institutions, as high levels of corruption lead to erosion of tax compliance and compliance in general.

4.7 Future Research Directions

Modern tax policy is oriented towards achieving the goals of sustainable development through the implementation of tax functions. In this regard, in order to increase its efficiency, the short-term, medium-term and long—term effects of the application of different taxation systems—flat, progressive and regressive taxes—could be studied. In order to expand the scientific knowledge in the field of taxation, it may be useful to thoroughly study the factors (economic and non-economic) that influence the perception of one or another taxation system.

4.8 Conclusion

Tax revenues provide funds that the state uses to maintain infrastructure, research, technical progress and others, ie. to finance public spending that stimulates smart and long-term economic growth. If tax levels are below their optimal level, they cannot provide sufficient funds to finance government spending that stimulates potential economic development. The low level of taxation is the reason for the deterioration of the budget balance, which leads to an increase in the deficit and an increase in government debt, which in turn is an unfavorable condition for maintaining stability in public finances. Therefore, the goal of modern tax policy is to apply an optimal taxation system that strikes a balance between the principles of economic efficiency and social justice, so as to ensure sustainable economic growth and prosperity of the nation.

In modern conditions it is recognized that inequality leads to increased social tensions and causes conflicts in society. Therefore, taxation, as a means of transferring resources and wealth, must take into account not only economic efficiency but also inequality and equity issues. The aim is to find a balance between economic efficiency and social justice of taxation in order to achieve an optimally balanced tax system. The specific design of the tax system depends on the dominant values in society: egalitarian ideas, equal opportunities, minimal state intervention in the economy, etc., but in all cases its optimization should be aimed at solving socio-economic problems not only in the short term, but also in the long run.

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Chapter 5

Integrated Reports in the Field of Tax Control



5.1 Introduction

This chapter addresses issues related to the presentation of non-financial information by revenue agencies to stakeholders, based on the introduction of an integrated reporting system for ongoing tax administration and control activities. In this regard, the prerequisites for the disclosure of financial and non-financial information were studied—the adoption of the principles of good governance in public sector institutions and the need to take into account the achievements related to their implementation and the introduction of quality management systems in revenue agencies based on a holistic approach to the organization and its activities. On the other hand, the possibilities and specific aspects related to the disclosure of information from integrated reporting by revenue agencies for the purposes of stakeholders, such as—international organizations (UN, OECD, IMF, World Bank, etc.), politicians and governments, businesses, civil society organizations, individual citizens. Special attention is paid to the presentation of the European Foundation for Quality Management (EFQM) model of organizational excellence, which is widely used in European administrative practice, and the relevant tools for total quality management, known as The Common Assessment Framework (CAF), which is related to the holistic approach in the analysis of organizational performance and aims to achieve the so-called “Organizational excellence” oriented towards sustainable development. Data on the results achieved in some revenue agencies of European Union countries that have practical experience with the implementation of the EFQM model are also presented.

Another set of issues addressed in this chapter concerns the possibilities for applying the data from the integrated reports of business companies in the field of tax control, for example: when selecting cases for tax audit or audit and assessment of the risk of tax violations and fraud; when planning, preparing and conducting tax audits to form an understanding of the activities of the enterprise and its environment

by the revenue authorities. In this regard, the practice of independent financial auditors related to risk assessment, understanding of the company, its activities and business environment is studied, based on which a set of appropriate guidelines for research and analysis in these aspects are presented by the revenue authorities—for tax audits.

The purpose of this chapter is to explore the possibilities of implementing integrated reporting in revenue agencies and to make proposals for the disclosure of non-financial information for the benefit of stakeholders, as well as to offer systematic guidelines for examining non-financial information from corporate accounts by revenue authorities for tax control (audit) purposes.

5.2 Background

The concept of sustainable development affects both the private sector through the adoption of CSR and the public sector through the adoption of the principles of good governance (Nikolova, 2021). Thus, in modern conditions, the Sustainable Development Goals (SDGs) become an integral part of the strategy for competitiveness and growth of enterprises, as well as the strategic documents of public sector institutions. In this regard, sustainable development reporting, also called “integrated reporting”, is being actively developed and the disclosure of non-financial information as part of the financial statements or as a separate report is expanding. As each country’s tax administration is a public institution, it follows the general trends in the public sector regarding development strategies, accountability and disclosure of performance.

Sustainability is described as the main moral and economic imperative of the twenty-first century and one of the most important sources of both opportunities and risks for business (Marx & Van der Watt, 2011). Companies are expected to protect, improve and invest in the well-being of the economy, society and the natural environment in which they do business. This makes it necessary for stakeholders to have accurate, reliable and reliable reports from organizations on their economic, social and environmental results and achievements. An effectively functioning audit committee, as part of the organization’s internal control (audit) system, can help provide accurate and reliable sustainability reports and disclosures that are integrated with the company’s financial statements. Integrated reporting can contribute to building an “integrated thinking” system that takes into account both financial and non-financial aspects, based on a holistic approach to creating value for stakeholders. The main problems related to integrated reporting relate to the audit and analysis of internal control (audit) systems and their role in integrated reporting. It is stated (Oprisor, 2015) that there is a need to develop a set of standards and regulations that can ensure the level of security and comparability of data reflected in all components (financial and non-financial) of integrated reports.

The integrated report could be seen (International Integrated Reporting Council, 2021, p. 10) as a brief communication on how organizational strategy, management,

implementation and prospects, in the context of the external environment, lead to the creation, maintenance or erosion of value in the short term, medium and long term. The integrated reporting framework is designed mainly in the context of private sector companies, but can also be adapted and implemented in the public sector and by non-profit organizations. Cohen & Karatzimas (2015, p. 453) point out that in recent years, the United States and Canada have developed the production and publication of reports specifically aimed at the profile of citizens. These reports contain easy-to-understand financial information about government organizations and are called “popular reporting”. They relate to the production of short, easy-to-read and user-friendly financial statements, focused mainly on the needs of citizens, but can also be useful for a wider audience, including politicians, public sector employees, the media and community groups. The information included in them comes from the official financial statements and the official financial systems. The authors believe that it will be useful to present integrated popular reports as well. For example, providing additional information on human or intellectual capital is considered to be very important in the public sector from a strategic perspective and can lead to more useful, holistic and meaningful reporting. In this way, two goals can be achieved: on the one hand, citizens will be encouraged to engage in public affairs and on the other hand, the relevant public organization will fulfill its reporting obligations by providing citizens with a “holistic” picture of its status. Cohen and Karatzimas (2015, p. 455) conclude that integrated reporting is appropriate for both the private and public sectors.

The main information needs of citizens are—the use of resources in the public sector and the management of government programs, the cost of services provided, future tax aspects, the financial situation at state and local level; all these aspects have been studied and cited by Cohen and Karatzimas (2015, p. 452). Despite the growing focus on integrated reporting and its increasing application, there is still no common mandatory reporting standard. It is an area that is developing dynamically, but at present the requirements of most countries for integrated reporting are applied on a voluntary basis (Jeroe, 2016, p. 9). The global financial crisis becomes an occasion for careful consideration of traditional accounting models and leads to calls for the integration of financial and non-financial disclosures, thus boosting the development of integrated reporting (De Villiers et al., 2017).

The complex role of companies in modern society can be assessed by improving transparency in reporting on their activities. This can have a positive impact on the development of integrated reporting, also called sustainable development accounting, sustainable development reporting, “The Triple Bottom Line” (the three “P’s”—profit, planet, people). This statement aims to present a comprehensive view of the company, as a combination, in one document of financial and non-financial information about the relationship between economic, environmental, social and managerial performance of the company. Thus, a holistic approach is realized in the disclosure of information about the company’s activities, which is necessary to achieve the goals of sustainable development. The International <IR> Framework

has been approved by The International Integrated Reporting Council—a global coalition of regulators, investors, companies, standard setters, accountants, academics and NGOs (International Integrated Reporting Council, 2021).

According to the International Integrated Accounting Framework (International Integrated Reporting Council, 2021, p. 2), the purpose of integrated reporting is to achieve:

- Improving the quality of information available to financial capital providers, with a view to its more efficient and productive distribution.
- Promote an interconnected and effective approach to corporate reporting based on the full range of factors that significantly affect an organization's ability to create value over time.
- Increasing the responsibility and management of a wide base of capital (including financial, production, intellectual, human, social and natural), as well as promoting understanding of their interrelationships.
- Support for integrated thinking, decision-making and actions aimed at creating value in the short, medium and long term.

Integrated reporting is not intended to replace financial reporting. There are no strict requirements for the presentation of the integrated report. It can refer to more detailed information: if it is on paper it may include applications, and if it is web-based it may have hyperlinks to other information. The results of integrated reporting are presented in an integrated report, which aims to give an idea of the organization's resources and the relationships between them that are used in its activities or related to it. Resources are called capitals that increase, decrease or transform from one species to another (Peycheva et al., 2016, p. 140). The integrated a report may be submitted as a separate report or to be included as a distinguishable part of another report or disclosure of information; for example, may be included at the beginning of the statement, which includes the financial statements of the organization (International Integrated Reporting Council, 2021, p. 12).

In the International Integrated Accountability Framework (International Integrated Reporting Council, 2021, p. 18), individual capital (resources) are categorized and described as follows:

1. **Financial capital:** The set of funds that an organization has available to produce goods or provide services and is obtained through financing, such as debt, equity or grants, or generated through operations or investments.
2. **Production capital:** Manufactured physical objects (excluding natural physical objects) that are available to the organization for use in the production of goods or provision of services, including buildings, equipment, infrastructure (such as roads, ports, bridges and water and waste treatment). The capital produced is often created by other organizations, but also includes assets created by the reporting organization for sale or for own use.
3. **Intellectual capital:** The intangible assets of the organization, incl.—intellectual property, such as patents, copyrights, software, rights and licenses; “Organizational capital”, such as specific knowledge, systems, procedures and protocols.

4. **Human capital:** People's competencies, abilities, experience and motivation for innovation, including—bringing the management framework in line with the risk management approach and supporting ethical values, ability to understand, develop and implement the organization's strategy, and loyalty and motivation to improve processes, goods and services; also, people's ability to lead, manage, and collaborate.
5. **Social capital and relationships:** Refers to institutions and relationships in and between communities, stakeholder groups and other networks, and the ability to share information to improve individual and collective well-being. This capital includes—shared norms, generally accepted values and behavior, relationships with key stakeholders, as well as the organization's willingness to cooperate and partner with them, incl. in defense of their interests; also intangible assets related to the brand and reputation of the organization.
6. **Natural capital:** All renewable and non-renewable natural resources and processes that provide goods or services that support the past, present or future prosperity of an organization, incl.—air, water, land, minerals and forests, biodiversity and ecosystem health.

Not all capital is equally relevant to organizations. Interactions with individual capital may be insignificant or so indirect that they are not significant enough to be included in the integrated statement. Organizations can categorize capital differently. Regardless of how the organization categorizes capital for its own purposes, the categories set out in the integrated reporting framework should be used as a guideline to ensure that the organization does not miss capital that uses or affects its activities (International Integrated Reporting Council, 2021, p. 20).

5.3 Submission of Non-financial Information by the Tax Administration

In connection with the implementation of sustainable development policy, the term “good governance” has come to be used to denote the understanding that public institutions must make their decisions, manage public resources and guarantee human rights without tolerating abuse and corruption, observing the rule of law. As early as the 1980s, international financial institutions, such as the International Monetary Fund and the World Bank, began tying their aid and loans to developing countries to good governance (Ombudsman na Republika Bulgariya, 2009). The United Nations Human Rights Council (UN Human Rights, 2022) defines the main characteristics of good governance as follows: transparency, accountability, accountability, participation and responsiveness.

Although there is no uniform classification of the principles of good governance, a set of principles for effective governance and sustainable development developed by the UN Committee of Experts on Public Administration (CEPA) has gained popularity. They are designed to help stakeholders, on a voluntary basis, build

effective, accountable and inclusive institutions at all levels, in relation to the 2030 Agenda for Sustainable Development. The principles are focused on achieving the desired effects in three aspects: effectiveness, accountability and inclusiveness (UN Department of Economic and Social Affairs, 2022):

1. **Principles related to efficiency are:** Competence, Sound policymaking, Collaboration.
2. **Principles related to accountability are:** Integrity, Transparency, Independent oversight.
3. **The principles related to inclusion are:** Leaving no one behind, Non-discrimination, Participation, Subsidiarity, Intergenerational equity.

In accordance with the Concept for Sustainable Development, modern public institutions, incl. Revenue agencies should respect the principles of good governance. In order to assess the extent to which this is actually the case, it is necessary for public sector administrations to submit detailed reports on both the financial results and the non-financial aspects of their activities, i.e. they need to apply an integrated approach to take into account the effects achieved by complying with the principles of good governance.

Trends in tax administration reform have intensified in recent years as governments have focused on reforms to improve efficiency and reduce costs. An OECD study (2015) states that there have been huge changes in the governance of public sector agencies over the last two decades. These include: committing to so-called “Open government” and increased accountability, a more formalized approach to planning (both at strategic and operational level), increased focus on implementation (e.g. performance management and budgeting systems), institutional and organizational restructuring, the use of market-based mechanisms and modern techniques for managing employees, bringing them more in line with trends in the private sector (OECD, 2015, p. 105). The main characteristics of “open government” include:

1. **Transparency:** His actions and the people responsible for them should be exposed to public scrutiny.
2. **Accessibility:** Keep information accessible to servants and their activities.
3. **Responsiveness:** To respond to new ideas, requests and needs.

According to the OECD (2015), in connection with these trends for reform in public sector institutions, the revenue agencies are observed:

- Growing practice of preparing and publishing official strategic business plans, many of them contain strategic goals for implementation, focused on results and indicators for the implementation of key goals and objectives.
- The emergence of customer/service charters defining the nature and standards of services that taxpayers can expect.
- Increased exposure to oversight and review by external bodies (e.g. national audit bodies and the ombudsman).

- Preparation and publication of detailed annual reports on implementation, including taking into account the implementation in accordance with the planned goals and objectives.
- A more structured and systematic approach to resource allocation, monitoring resource use and performance evaluation.
- The introduction of modern approaches to human resource management.

In order to improve the performance of the public sector, most OECD countries have introduced performance management and budgeting. In 2005, over 70% of them included non-financial performance data in their budget documentation (OECD, 2005, p. 64).

Modern institutions in the public sector are oriented towards the application of the principles of good governance and the introduction of quality management systems (QMS) in order to improve administrative activity. Among the most common QMS in practice are ISO (International Organization for Standardization standards), EFQM (European Foundation for Quality Management Organizational Excellence Model) and CAF (Common Assessment/Self-Assessment Framework, adopted as a QMS standard for public administration in EU countries), Baldrige (QMS, popular in the US). All these QMS are based on conceptual models for organizational management, which are based on the ideas of Total Quality Management (TQM), and therefore contain a number of common characteristics (Institut po publicna administratsia, 2015).

The Common Assessment Framework, which is a tool for overall quality management based on the European Foundation for Quality Management (EFQM) Model of Organizational Excellence, is widely used in European administrative practice. The model takes into account both the benefits for the organization (institution) and the society, and thus, through its implementation a balance is achieved between economic and non-economic indicators for the functioning of the respective administration. The Common Assessment Framework (CAF) is based on the idea that excellent performance in the work of organizations, citizens/consumers, people and society is achieved through leadership that manages strategies and planning, people, partnerships, resources and processes. The model considers the organization simultaneously from different aspects, i.e. applies a holistic approach to the analysis of organizational performance. The structure of the CAF model is presented below in Fig. 5.1.

According to the EFQM Model, the perfect organization strives for sustainable development by managing its processes and resources so as to achieve useful results not only for itself but also for society. The EFQM model could be used to diagnose organizational resilience (Serban & Ghenta, 2009, p. 348). This model is based on a holistic approach to the organization and is a tool that can be used to integrate sustainable development principles into its strategies, plans and programs (Serban & Ghenta, 2009, p. 353). Given the characteristics of the EFQM model, its application in revenue agencies could create an opportunity to manage the implementation of administrative and control activities in accordance with the objectives of sustainable development.

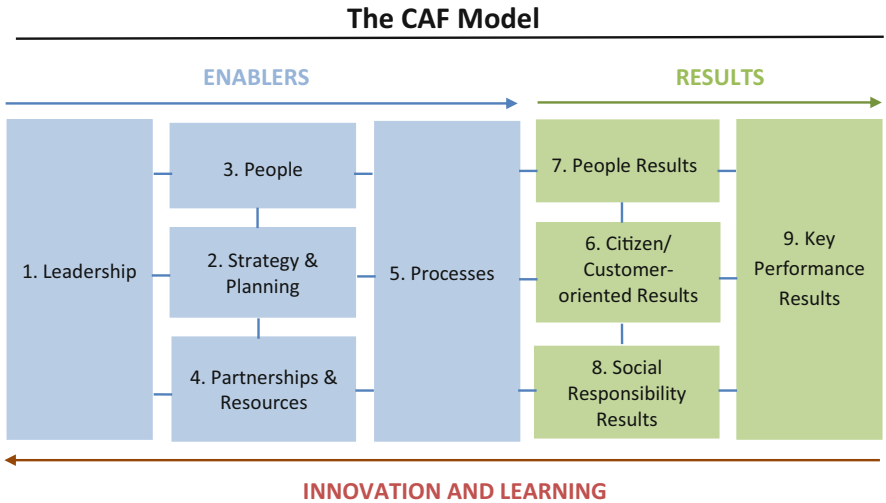


Fig. 5.1 Structure of the Common Assessment Framework (CAF). Source: European public administration network (2020)

The structure of the CAF consists of nine elements (9 evaluation criteria), identifying the main aspects that require careful consideration in any organizational analysis. The first five criteria (1–5) form the so-called “Enablers”, which determine what the organization does and how it approaches its tasks in order to achieve the desired results. The other criteria (6–9) are related to the so-called “Results” achieved in terms of citizens/consumers, society, social responsibility and key performance targets. The holistic approach of TQM, which underlies the CAF, requires that all aspects of the functioning of an organization be carefully assessed and that all components be interconnected and interact. In addition, it is necessary to analyze: the causal relationships between the elements on the left side of the model (enablers—causes) and the elements on the right side of the model (results—consequences); as well as the holistic connection between the enablers themselves.

CAF is aligned with the fundamental concepts of organizational excellence, which are adapted to the specifics of the public sector, in order to improve the efficiency of public organizations. In this regard, a distinction is made between the traditional bureaucratic public organization and the public organization oriented to the total quality on the basis of observance of the so-called “Principles of perfection”. The essence of the CAF model is related to the self-assessment of the organization, as a starting point for the overall process of improving its activities. The guiding principles of excellence are presented in Table 5.1.

These principles of excellence are integrated into the structure of the CAF model. Their compliance, as well as the process of improvement under the nine evaluation criteria (structural elements of the CAF), imply the implementation of integrated reporting in the organization, which includes both financial data and significant non-financial information.

Table 5.1 Principles of excellence according to the CAF model

Principle	Characteristic
Orientation to results	• The organization focuses on achieving results that satisfy all stakeholders of the organization (authorities, citizens/users, partners and people working in the organization), in relation to the set goals.
Focus on citizens/consumers	• The organization focuses on the current and potential needs of citizens/consumers.
Leadership and consistency of goals	• Leaders establish a clear mission, vision and values of the organization, and also create and maintain an internal environment in which people can participate fully in achieving the goals of this organization.
Management through processes and facts	• The desired result is achieved more efficiently when related resources and activities are managed as a process and decisions are based on data and information analysis.
Human development and participation	• At all levels—they are the essence of the organization and their full participation allows their abilities to be used for the benefit of the organization. The contribution of employees must be optimized through their inclusion, development and creation of a working environment of shared values, a culture of trust, openness, empowerment and recognition.
Continuous learning, innovation and improvement	• Perfection is a challenge to the status quo and requires change through continuous learning to create innovation and opportunities for improvement. Continuous improvement must be a constant goal of the organization.
Development of partnerships	• To achieve their goals, public sector organizations need other organizations. Therefore, they need to develop and maintain useful partnerships. An organization and its partners are interdependent, and their fruitful relationships increase the ability of both parties to create value.
Social responsibility	• Public sector organizations must take their social responsibility, respect environmental sustainability and strive to meet the main expectations and requirements of the local and global community.

Source: Institute of Public Administration (2020)

According to the characteristics of the fourth structural element of the CAF “Partnerships and Resources”, presented in Fig. 5.1:

- Public sector organizations need different types of resources to support the implementation of their strategies and plans, as well as the effective functioning of their processes. Resources can be tangible or intangible and should be carefully managed.
- Public sector organizations develop and manage partnerships with other public organizations, non-governmental and educational organizations, and private service providers.
- Working together with citizens and civil society organizations is a type of partnership that is increasingly appropriate for public sector organizations.

- In addition to partnerships, organizations must manage the relevant resources—finance, knowledge, technology, facilities. Effective, innovative and transparent resource management is key for public organizations to ensure stakeholders accountability and legal use of available resources.

Therefore, the management of resources and partnerships in a public sector institution presupposes the existence of adequate accountability in order to be able to assess the results of its activities. This also applies to the revenue agency of each country. In order to achieve the goals of sustainable development and in accordance with the holistic approach that underlies the CAF, this reporting should provide an overview of all aspects of public administration, providing financial and non-financial data systematized in an integrated report.

EFQM's model of organizational excellence has been adopted in a number of EU public sector institutions, including some revenue agencies. For example, the EFQM model was included in the Strategic Plan of the National Revenue Agency (NRA) in 2004 and has been implemented in fact since 2008 in the Revenue Administration of Bulgaria. Data published on the website of the Institute of Public Administration in Bulgaria show that the introduction of the EFQM Excellence Model as a management tool in the NRA contributes to a better understanding of the principles of good governance in the tax administration system (Getov, 2015). A study of the annual activity reports of the NRA for the period 2007–2017 shows that the application of this methodology for quality management gives significantly improved results from the operation of the Revenue Agency in Bulgaria in several main aspects: increasing the collection of public revenues; development of electronic services, information exchange, cooperation and interaction; engaging in environmental causes and volunteering; conducting information campaigns and trainings; improving accountability and transparency; disclosure of non-financial information about the activity of the tax administration. All this leads to an increase in the reputation and public confidence in the revenue agency (Nikolova, 2019).

In view of the above, it is concluded that the implementation of good governance in the public sector, oriented towards achieving the goals of sustainable development, can be improved by introducing a system of integrated accountability in public administrations, incl. in the revenue agencies, to provide in one report both financial and non-financial information about the activity.

5.4 Analysis of Integrated Reports in Tax Audits

The Reflective Paper on Sustainable Europe 2030 (European Commission, 2019) pays special attention to issues related to responsible business behavior, corporate social responsibility and new business models. It states that enterprises have an important role to play in the transition to sustainable development. They realize that responsible business can lead to more sustainable profits and growth, new market opportunities and shareholder value in the long run. In recent decades, more and

more companies have integrated the Sustainable Development Goals (SDGs) into their competitiveness and growth strategies, with 78% of the world's leading companies including corporate social responsibility issues in their annual reports in 2017.

There are many definitions of corporate social responsibility (CSR), but the definition in ISO 26000: 2010 of the Working Group on Social Responsibility (International Organization for Standardization, 2010) has gained popularity, according to which: "Social responsibility (e)—the responsibility of the organization for the impact of its decisions and activities on society and the environment through transparent and ethical behavior that is consistent with the sustainable development and well-being of society; takes into account the expectations of stakeholders; complies with applicable law and international standards of conduct; based on this broad definition, it can be concluded that CSR requires business to be conducted in compliance with the law and generally accepted norms of conduct. Thus, regardless of the specific context and area CSR is inextricably linked to ethics and integrity. The implementation of the principles of CSR in the strategy and corporate culture of an organization is a prerequisite for carrying out transparent activities in accordance with applicable law and moral and ethical standards.

Venter et al. (2016) conducted a study that found a natural link between two global corporate developments, namely integrated thinking and transparency of tax disclosure. They surveyed 45 large companies and found, through regression analysis, that there was a positive relationship between the transparency of corporate tax reporting and integrated thinking. With an established corporate culture based on social responsibility and a transparent business environment, the likelihood of tax violations and abuses thriving is significantly lower. Therefore, when conducting a survey of an audited entity by the revenue authorities, in relation to the applicable standards for gaining an understanding of the entity and its environment and assessing the risks of material misstatement, deviations and inconsistencies—must be taken into account whether the business is socially responsible and to what extent the principles of CSR have been adopted.

In specialized studies (Wood, 2010, p. 27) as users of information from integrated reporting are identified—in the first place, investors and corporations, as well as policy makers, society, advocacy groups and consumers. In view of the specialized studies carried out on the subject, it should be noted that at this stage the possibilities that integrated reporting can provide to revenue authorities in the planning and preparation of tax audits have not yet been explored.

The assignment of a tax audit is preceded by the so-called "Selection", which analyzes various data on the tax subject, financial and non-financial, to which the revenue authorities have access in order to assess whether the case has a high or low potential for adjustments in the amount of tax that will affect tax revenues. The aim is to analyze various data concerning: doubtful expenses and revenues that seem to be underestimated, inflated or uncharacteristic of the activity of the tax subject; the presence of unusual records in the disclosed reporting data compared to previous years or with other companies with similar activities; the presence of risk factors, as some industries/industries are known for tax violations that are constantly identified,

such as oil and gas companies, producers of alcohol and cigarettes, trade in materials, construction, agriculture, etc. (Foks & Bergherm, 1998).

In connection with the implementation of tax audits, the revenue authorities also analyze various data related to taxpayers in order to study their activities and establish the real results of it. Thus, a thorough analysis is performed before the audit itself, as part of the preparatory procedure of the team of tax authorities in order to implement an effective and efficient audit. In this regard, a variety of information about the taxpayer's enterprise, its history and the environment in which it operates is studied. This makes it possible to form the specific guidelines of the audit and control hypotheses, which will be subject to verification by the revenue authorities in order to establish the reliability of the reported and declared data related to tax liabilities. After gathering the initial information about the activities of the audited entity, the auditor prepares an audit plan and identifies issues for consideration that serve as guidelines. At this stage, the auditor can begin to prepare his working papers and identify all issues from the declarations and reporting of the taxpayer that raise doubts—resources, receivables, liabilities, estimates, costs, revenues, potential opportunities for undeclared sales, income, profits (Foks & Bergherm, 1998).

The team of tax authorities that conducts an audit seeks to gain an overview of the state of the enterprise, including: understanding of the activity of the enterprise and its specifics, the reliability of the accounting system used, what specific resources are used in the activity, with what taxes the taxpayer is subject to taxation and with what tax rates, whether he carries out import or export, the change in the personnel and the labor costs, the deductions from the salary, etc. (Foks & Bergherm, 1998).

In the practice of all financial control bodies there is a need for a study of the economic activity of the controlled enterprise, which is carried out at the stage of planning and preparation of control activities. For example, the independent financial audit applies a comprehensive methodology to form an understanding of the specific aspects of the enterprise and the economic (industry) environment in which it operates, which is the basis for determining the level of so called “Intrinsic risk” and the implementation of an adequate audit strategy in response to the assessed risks. This methodology is presented in ISA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment (International Auditing and Assurance Standards Board, 2016).

The existence of technological similarities between the independent financial audit and the tax audit gives grounds to adapt the methodology established in the field of independent financial audit for risk assessment and formation of understanding of the enterprise and its environment to be applied in the practice of approach bodies.

The adoption of such an audit approach to the formation of understanding of the activities of the enterprise and its environment by the revenue authorities may contribute to:

- Effective planning and conducting of the tax audit—selection of appropriate tools and information sources, anticipation of the need for experts, more members of the audit/inventory team, longer audit period, expansion of the scope, etc.

- Identification of the specific issues (problem areas) to which the attention of the revenue authorities should be directed, as it is expected to reveal tax violations and frauds of fiscal significance, i.e. basis for the formation of adequate control guidelines and hypotheses of the audit.
- Formation of correct and reasoned conclusions and findings.
- Timely taking measures to secure receivables and evidence.

It should be borne in mind that despite the technological similarity between the independent financial audit carried out by chartered accountants and the tax audit carried out by revenue authorities, there is still a significant difference in the purpose of the audit. In a tax audit, unlike an independent financial audit, the purpose is not to verify the audited entity's accounts. Revenue authorities check the reporting, but in order to gain an understanding of the taxpayer's real income and profits, so they will study and analyze information to determine whether tax laws have been complied with and whether the required taxes have been paid. Therefore, tax audits focus on the tax aspect of the problems and not on the proper accounting of business operations.

5.5 Solutions and Recommendations

In order to achieve good governance in the public sector, oriented towards achieving the goals of sustainable development, it could be recommended to public institutions, incl. of revenue agencies to introduce integrated reporting systems. In this regard, they could disclose non-financial information in the following aspects:

- Ensuring healthy and safe working conditions.
- Protection against discrimination.
- Ensuring accountability, transparency and reliable internal control.
- Maintaining integrity and combating corruption.
- Apply high standards of institutional ethics.
- Fair pay, training and human resource development.
- Satisfaction and commitment of staff to achieve the goals of the organization.
- Participation in volunteer programs and activities for environmental protection, observance of environmental principles in the implementation of administrative activities, such as the rational use of paper documents, printer consumables and photocopiers.
- Development of interaction, cooperation and partnership.
- Development of innovative thinking and desire for progressive change.

Such non-financial information obtained from the introduction of an integrated reporting system in revenue agencies could be useful for a wide range of stakeholders who pay attention not only to the fiscal aspects of tax revenue accumulation, but also to the non-financial effects of implementation of tax administrative and control activities, including: international organizations (UN, OECD, IMF, World

Bank, etc.), the governing body's and policymakers, business, civil society organizations, individual citizens.

Based on specialized publications related to independent financial audit (Erofeeva et al., 2012; Defliz et al., 1997; Hubbard et al., 1991; Whittington et al., 1992), as well as the guidance given in ISA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment (International Auditing and Assurance Standards Board, 2016), Table 5.2 summarizes the main guidelines that could be used by revenue authorities to study and analysis of the economic activity and economic environment of the enterprise, in connection with the analysis and assessment of risk, preparation, planning and performance of tax audits.

Various information sources can be used for research and analysis of the economic activity and the economic (business) environment of the audited enterprise, such as the data from the tax file and the available electronic databases with tax-insurance data, and in perspective, etc. "Big data", data from official registers and statistical data, data from integrated reporting, incl. financial and non-financial data.

5.6 Future Research Directions

Given the opportunities that integrated reporting can provide to revenue authorities for effective planning, preparation and implementation of tax audits in order to improve tax control, it will be useful to develop and approve an integrated reporting framework that meets the needs and needs of revenue authorities (tax auditors). In this regard, an in-depth empirical study of the needs of revenue authorities for integrated reporting data is needed. Also, an empirical study could be done on the information needs of stakeholders related to the possibilities of introducing an integrated reporting system in revenue agencies.

5.7 Conclusion

The development of integrated reporting and the disclosure of non-financial information by the tax administration can lead to increased confidence on the part of taxpayers and serve as a good example for other institutions in the public sector. This could improve the reputation of the public administration as a whole. Higher trust in public sector institutions is a prerequisite for compliance with the law, effective governance and sustainable development. In particular, with regard to the tax system—trust in revenue agencies is the basis for increasing the voluntary fulfillment of tax obligations and a guarantee for regular collection of planned tax revenues. All this creates favorable conditions for the implementation of the developed policies and programs, incl. to achieve the goals of sustainable development

Table 5.2 Guidelines for research and analysis of the economic activity and economic environment of the enterprise by the revenue authorities

Guidelines for research and analysis	
Macroeconomic factors	<ul style="list-style-type: none"> • Current economic conditions and phase of the economic cycle (recession or growth). • Increase or decrease in customs duties (duties and taxes) if the company is engaged in foreign economic activity. • Change in taxation. • Dependence on foreign markets. • Exchange rate fluctuations. • Inflation, currency regulation. • Interest rates and access to finance.
Industry (branch) conditions	<ul style="list-style-type: none"> • Geographical distribution and segmentation of the industry. • Market and competition, incl. demand, capacity and price competition/regulation, main competitors and distribution of market shares. • Cyclicity or seasonality of the activity—impact on the business of the audited entity. • Stage of economic development (start-up phase, market entry phase and rapid growth, “business maturity” phase or decline). • Development of technologies related to the activity of the enterprise. • Channels and strategies for sales in the industry (internet, retail, through a distribution network, etc.). • Industry customer profile—whether there is a concentration of sales to an individual customer or group of customers, as well as types of sales agreements in the industry. • Profile of the suppliers in the branch—key suppliers and subject of the deliveries, types of agreements with the key suppliers, regularity of the deliveries, dynamics in the prices of the deliveries during the checked periods. • Gross margins in the industry. • Energy supply and price. • Wage level in the industry. • Shortage or surplus of workers in the industry.
Legislation and regulations	<ul style="list-style-type: none"> • Accounting standards, concepts and specific practices. • Regulatory body and requirements for a specific activity or industry (licensing/permitting regime, regulated prices/market, requirements for compliance with certain financial indicators, deadlines, etc.). • Special tax registrations and tax regimes. • Identified cases of non-compliance with applicable laws and regulations during the audited period by control and regulatory authorities. • Legislation and other regulations that have a significant impact on the activities of the enterprise. • Direct supervision activities. • Applicable taxation (direct and indirect taxes). • Government policies affecting the business of the enterprise, incl. currency controls, fiscal policies and incentives (e.g. government aid programs), tariffs, trade restrictions.

(continued)

Table 5.2 (continued)

Guidelines for research and analysis	
	<ul style="list-style-type: none"> • Environmental requirements affecting the industry and business of the enterprise.
Business, organization and management	<ul style="list-style-type: none"> • Features of the management process (decentralization). • Organizational structure. • Business strategy (e.g. planned market expansion). • Nature of the sources of revenue (e.g. manufacturer, wholesale undertaking, undertaking offering banking, insurance or other financial services, import/export, utility undertaking, transport undertaking and undertaking for technological products and services). • Nature of cash flow. • Products or services (range) and markets (e.g. large customers and contracts, payment terms, profit margins, market share, competition, exports, pricing policy, product reputation, guarantees, order register, trends, marketing strategy and objectives, production processes). • Conducting the activity (e.g. stages and methods of production, business sectors, supply or products and services, detailed information on dying or expanding activities). • Associations, joint ventures and other activities exported from the enterprise. • Participation in e-commerce, including online sales and marketing activities. • Location of production facilities, warehouses and offices. • Main clients, occasional contracts and long-term contracts. • Sources and methods of delivery of materials, dependence on suppliers, key suppliers of goods and services (e.g. long-term contracts, stability of supply, payment terms, imports, delivery methods, such as “just in time”). • Marketing and methods of realization. • Methods of production and distribution. • Staff (e.g. location, availability, qualifications and experience of key staff, pay levels, trade union contracts, retirement benefits and other post-employment benefits (on retirement), stock options or incentive bonus arrangements and government regulation, related to staff). • Cost. • Duration of the production cycle. • Research and development and costs. • Guarantees on liabilities to third parties. • Related party transactions. • List of shareholders/partners.
Investments	<ul style="list-style-type: none"> • The investment policy. • Acquisitions, mergers or disposals of business (planned or recently implemented). • Investments and disposal of securities and loans. • Capital investment activities, including investment in machinery and equipment and technology and any recent or planned changes.

(continued)

Table 5.2 (continued)

Guidelines for research and analysis	
	<ul style="list-style-type: none"> • Investments in non—consolidated enterprises, including associations, joint ventures and special purpose vehicles.
Financing	<ul style="list-style-type: none"> • Sources of funding. • Capital structure. • Structure of the group—main subsidiaries and associates, including consolidated and non-consolidated entities. • Structure of borrowed capital, including clauses, restrictions, guarantees and off-balance sheet financing agreements. • Leasing of property, plant and equipment for use in the business. • Beneficiary owners (local and foreign). • Related party transactions. • Use of derivative financial instruments.
Financial reporting and statements	<ul style="list-style-type: none"> • Standards in the field of accounting and audits that deserve special attention. • Accounting principles and industry-specific practices. • Revenue recognition practices. • Accounting for fair values. • Inventories (e.g. locations, quantities). • Foreign exchange assets, liabilities and operations. • Industry-specific essential categories (e.g. bank loans and investments, receivables and inventories for manufacturers, research and development for pharmaceutical companies). • Accounting for unusual or complex transactions, including those in disputed or emerging areas (e.g. accounting for share-based compensation). • Presentation and disclosure of financial and non-financial statements (financial and integrated statements). • Account balances, groups of business operations and atypical relationships between accounts.
Goals and strategies and related business risks	<ul style="list-style-type: none"> • Developments in the industry (potential business risk, for example the company does not have staff or expertise to deal with changes in the industry). • New products and services (potential business risk, such as increasing product responsibility). • Business expansion (potential business risk, for example demand is not accurately assessed). • New accounting requirements (potential business risk, such as incomplete or inappropriate application or increased costs). • Regulatory requirements (potential business risk, e.g. increased legal exposure). • Current and future financing requirements (potential business risk, such as loss of financing due to the company's inability to meet the requirements). • Use of IT (potential business risk, for example systems and processes are incompatible). • Effects of the implementation of a strategy, especially effects that lead to new accounting requirements (potential

(continued)

Table 5.2 (continued)

Guidelines for research and analysis	
	business risk, such as incomplete or inappropriate application).
Review and evaluation of the results of the enterprise	<ul style="list-style-type: none"> • Change in activity. • Basic ratios and operational statistics. • Main indicators for the results of the activity, such as level of profit, profitability, etc. • Measures of employee performance and motivational compensation policy. • Trends. • Use of forecasts, budgets and analysis of deviations. • Analyst reports and credit rating reports. • Competitor analysis. • Financial results by periods (revenue growth, profitability, indebtedness).

Source: The author, based on Nikolova (2014)

locally and globally. In addition, the ability of tax authorities to interpret and use integrated reporting data, which is being disclosed by more and more companies and organizations from different fields of activity, can significantly improve the process of risk analysis and assessment by revenue authorities, as well as the preparation, planning and performance of tax audits. In this way, limited audit resources will be able to focus on the cases with the highest fiscal potential and achieve the best results in the control impact against tax violations and fraud.

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Chapter 6

Improving Prevention and Diagnostics in Tax Control



6.1 Introduction

This chapter examines the possibilities for proactive control actions related to taxation and counteraction to tax violations and fraud in their genesis or in a timely manner at the time of their implementation, when major fiscal damage has not yet been caused. In this regard, the content of the control process was clarified, emphasizing, on the one hand, the diagnosis and prediction of the condition of the object of control and on the other hand—the related monitoring and evaluation of the external and internal environment, and the conditions that cause deviation from the set norms (i.e. non-compliance with the tax laws).

Attention is paid to the applicable methods for monitoring the controlled objects and establishing indicators for tax fraud, as the characteristics of the methods “Monitoring” and “Survey” are clarified and examples of their application by the revenue authorities are given. The advantages of the innovative Big Data technology and its possibilities to be used in the activity of the revenue agencies are considered, incl. for monitoring and risk assessment in the field of tax control. The main indicators for the presence of tax violations and fraud are presented, which can be detected by the revenue authorities through monitoring and research of the activity. These issues are related to the possibilities for raising tax morale and compliance with tax legislation in order to implement a holistic approach to control impact in the field of taxation, based not only on audits and sanctions, but also on understanding the behavior of taxpayers related to tax compliance.

Special attention is paid to the identification and assessment of risks in the field of taxation, based on financial and non-financial information, as well as the risk management process. In this regard, a description of the analysis as a method of control is made and examples of its application by the revenue authorities are given. The appropriate control methods, information sources and means for forming an understanding of the activity and business environment of the audited enterprise by

the revenue authorities are clarified. For this purpose, the possibilities for application of the basic SWOT-matrix and analysis of—Strengths, Weaknesses, Opportunities and Threats—by the revenue authorities in tax audits are considered. Attention is paid to the developed modern methodologies for identification and risk analysis in the field of law enforcement related to tax crimes. The purpose of this chapter is to contribute to the improvement of tax control by expanding its preventive functions and limiting tax non-compliance and tax gap.

6.2 Background

From a theoretical point of view, management can be considered as a set of separate functions that are related to planning, organization, management, control and regulation. In this regard, in relation to a specific object, the control function can be presented as a process consisting of the following elements: (1) establishing the norm of behavior with its quantitative and qualitative parameters, (2) determining or forecasting the expected state, (3) measurement and assessment of the actual condition, (4) comparison between the norm, the actual and the expected condition and (5) regulation of the behavior as a result of the performed control (Dinev, 1999, p. 19).

Determining or forecasting the expected condition of the object of control requires an assessment of the external and internal environment, as well as the conditions that give rise to deviations from the norm of behavior. This is how control is realized before the event, not after it, i.e. diagnostics of the system or the object of control is performed (Dinev, 2014, p. 10). Therefore, the full implementation of the control function implies the diagnosis of the object of control, i.e. anticipation of the condition or behavior. Dinev (2014, p. 11) points out that the current crisis of growth, preceded by the global financial crisis, poses the need for a new type of control—one that anticipates and anticipates events, and which in cooperation with a wide range of experts offers appropriate solutions. He emphasizes the need for reliable control over risk-generating factors, which are usually complex and integrated, in order to be able to achieve a pre-emptive control effect. According to him, in modern conditions it is necessary to “Research” control, which studies, researches, evaluates and proposes effective solutions, as well as the implementation of diagnostic and prognostic control (audit). To this end, not only the traditional forms of control—inspection and audit—should be implemented, but also monitoring and research, as well as partial and thematic inspections should be applied (Dinev, 2014, p. 12). Therefore, in order to achieve a comprehensive control impact, it is necessary to perform not only ex-post controls, but also ex-ante and ongoing controls.

The preliminary tax control aims to establish the legality of the forthcoming processes, activities and actions, as well as the fulfillment of the conditions for their lawful course. This control has the highest degree of prevention (compared to other forms), because it creates an opportunity to prevent possible tax fraud and tax

evasion. For example, revenue authorities carry out ex-ante tax controls in order to prevent tax fraud by revealing their genesis and counteracting the moment when the conditions for their implementation are created before they become a reality. In connection with this, early control diagnostics is carried out, the prognostic possibilities of the tax control are realized and it is proactive.

The current tax control is carried out in parallel with the development of processes and the implementation of actions, which is why it is operational in nature. For example, when the tax authorities carry out inspections at retail outlets for the presence of fiscal devices, the issuance of a fiscal receipt, the registration of sales, etc., operational tax control is carried out. To be effective, it should be systematic, permanent, and not just campaign, sensational. In modern conditions, with the widespread use of IT, operational tax control is most often performed remotely by making a permanent connection between the fiscal devices in retail outlets, gas stations and others with the revenue agency. Continuous monitoring makes it possible to identify deviations in the objects of control from the normal or expected state in a timely manner.

The current tax control is carried out by the operational control bodies, through partial and thematic inspections, in order to identify and correct the tax violations in a timely manner, at the time of their implementation. Current control stops the negative development and prevents further accumulation of negative effects. In this way, it helps to limit the fiscal damage from tax violations. Therefore, prevention finds its own expression in the current tax control, but after the development of negative phenomena has already begun (Tomov, 2002, p. 74). However, prevention can only be considered an immanent feature of ex ante control.

The subsequent tax control is focused on the processes and actions after their completion, which is why it is ascertaining. However, in order for tax control to be effective, it must be aimed at correcting deviations from the norms and the expected situation, and not only at their establishment and ascertainment. In this way a reliable counteraction to the violations and frauds in the field of taxation is realized. Prevention can also be sought in this form of control, as the results of its implementation have a deterrent effect and help prevent future deviations from the norms (Tomov, 2002, p. 74).

6.3 Monitoring of Taxable Activities and Indicators of Tax Fraud

The monitoring of the object of control and the establishment of indicators of tax fraud is associated with the application of two main methods of control—monitoring and research (Nikolova, 2019, p. 63).

The observation represents a systematic purposeful perception of the researched object, as a whole or of its individual parties, in which the researcher does not intervene, but only fixes behavior, properties, characteristics, etc. This method can

be used in operational tax control in relation to the property or object of the audited entity. The aim is to form a perception and to record data that will be used to assess and compare assets, income, living expenses, operating income, production and trade costs, parameters of deliveries, characteristics of customers and suppliers. Monitoring of a specific system or object of control can also be done in order to prevent emerging tax fraud and prevent tax evasion.

The study provides an opportunity to study a certain event, phenomenon, process or result related to the rights and obligations of persons arising from tax law, examining the relevant facts and circumstances, the factors that influence it, the conditions under which it takes place, and related to it persons. For example, in the field of tax control, various facts and circumstances related to the business activities carried out by tax entities are studied. In this way, an understanding of the activity and the environment in which it is carried out is formed, and also, indications or data about fraud, the mechanism of execution, the persons involved, etc. can be established.

The study can also be used to study the trends and patterns of controlled phenomena, processes and results by examining certain periods (past states) or data on other systems and objects (operating under similar conditions) and making comparisons. This makes it possible to establish indicators of tax violations and fraud or to anticipate deviations in the studied object and to carry out adequate control impact. For example, the data on the declared VAT for import and refund, on the declared financial result, etc. can be studied. In this way, atypical and illogical data can be identified to which control actions can be directed. The survey is applied by the tax authorities during the selection of tax subjects, inspections and audits to establish indicators of deviations and fraud, to gain an understanding of the environment in which the audited entity operates and to assess the risk of deviations and fraud.

This method is widely used in the field of tax control. In practice, control over compliance with tax legislation involves the study of certain events, phenomena, processes and results that are relevant to tax obligations or rights on the faces. In this regard, various sources of information are studied—integrated reporting (financial and non-financial information), accounting, commercial and tax documents, official registers, statistical bulletins, off-reporting information (for example, in connection with the establishment of undeclared income, can be done research of data on the Internet and social networks). The aim is to achieve a comprehensive acquaintance with the information relevant to the system or object of control.

The OECD (2001, p. 3) points out, as a strategic goal for revenue authorities, the need to address the challenges posed by the globalization of economic processes, as the administration of tax systems in an open global economy is more complex. In such circumstances, taxpayers are more sensitive to differences in inflation, tax treatment, exchange rates, tax rates and the ability of tax authorities to monitor trade and income flows. The significant increase in the amount and type of income earned abroad due to globalization also reduces the ability of revenue authorities to verify the accuracy of declared data.

For the purposes of monitoring economic activity and establishing indicators of tax fraud, in today's digital environment, opportunities are being sought for the application of Big Data technology. It provides opportunities to create new tools that help the tax administration provide proactive services to citizens, better manage and identify tax risks related to fraud, tax evasion, income evasion, income, profits and tax evasion turnover, and as a result to increase tax collection. Big data is a vast and complex, often unstructured data set collected from a wide variety of sources, including the Internet, social networks, sensors, text messages, video images and audio files, and other often unstructured sources.

Public sector administrations are looking to apply big data flows to their work, for example to crime prevention and public safety, to facilitate disaster response and to improve social services. Revenue authorities could also focus on the opportunities offered by the use of big data technology for tax administration and revenue collection. Combining Big Data with modern analytical technologies, such as geospatial analysis, network analysis, text and voice analysis, click-flow analysis, operational information on business turnover, based on constant remote connection with revenue administration and real-time analysis, can significantly expand the ability of revenue authorities to detect tax fraud and tax evasion in their genesis and counteract them in a timely manner before their development. The availability of such data in real time will create opportunities for revenue authorities instead of capturing and analyzing transactions that have taken place in the past, to make real-time or timely tax assessments, provided that their information systems are integrated with the natural environment taxpayers (OECD, 2016). Therefore, this will increase the preventiveness of tax control and its ability to limit deviations from tax rules to the extent that they do not endanger the financial security of society.

Combining Big Data technology with filing tax returns electronically will have a significant effect on tax administration in the future. Thus, revenue authorities will be able to monitor business activity in real time or in a timely manner, assess compliance with norms and expected status, as well as identify risks of evasion of income, income, profits and tax evasion. Combining Big Data technology with advanced analysis of the facts and circumstances related to taxation creates opportunities to counter tax fraud and curb the informal economy. As part of this approach, big data can help revenue authorities research and understand taxpayers' historical activity and behavior (OECD, 2016).

As most tax liabilities arise in connection with taxpayers' business transactions, it is expected that over time it will be possible for revenue authorities to move taxation to the point of transaction through the application of big data technology, eliminating the need to file a large proportion of tax returns. Big data technologies can also allow revenue authorities to review all transactions in the wider economy, group and compare, and not just analyze the risks of specific taxpayers. Thus, the perspective for revenue authorities is to move from an analysis of historical transactions to a state in which they can view the activities of taxpayers in real time (OECD, 2016).

The application of big data technologies provides opportunities to improve many aspects of the work of revenue authorities. The aim is to make a digital transformation aimed at a transition from a tax administration that extracts most of its data from

declarations and other information provided by taxpayers to one that extracts information from third parties to use it for optimizing the interaction with the taxpayers, monitoring the activity, risk assessment and provision of modern tax services (OECD, 2016, p. 64).

In order to carry out effective and efficient tax control, it is necessary to monitor the activities of taxable entities on an ongoing basis in order to identify the risks and indicators of violations and fraud of tax legislation. The violations are related to deviations from the norms for which administrative sanctions are imposed—most often fines for individuals and property sanctions for legal entities. They may be established during tax audits or in the course of tax audits, along with the determination of actual tax liabilities and the accrual of interest thereon. Fraud, in the sense in which this term refers to the filing of tax returns, is a repeated, systematic or deliberate violation of tax law. Characteristic of the fraudulent behavior in the preparation and filing of tax returns is that the taxpayer has deliberately and deliberately tried to reduce the amount of tax due by him through some pre-conceived plan. From the point of view of the practical implementation of tax control, it is important to assess the fiscal potential of tax fraud and the means for its reliable proof, so that limited audit resources are not directed to insignificant or impossible to prove cases. Many tax administrations have set up separate departments to investigate tax fraud. They are responsible for selecting cases of fraud, as well as for obtaining evidence to be presented to the court in criminal proceedings (Foks & Bergherm, 1998, p. 53). There is no standard definition of cases that are treated as tax fraud. The provisions in different jurisdictions differ in their scope, for example, in some countries only non-declaration of taxable income, profits, trade turnover, transactions, and property is considered as tax fraud; thus, if tax liabilities are declared even though they have not been paid, this is not treated as tax fraud; while in other countries, all cases of non-payment of taxes are criminalized.

The monitoring of taxable activities allows the revenue authorities to detect illegal behavior, deviation from the normal or expected state, i.e. to establish certain indicators and pattern of fraud. According to Foks and Bergherm (1998, p. 54), indicators (signs) of tax violations and fraud can be considered:

- The taxpayer does not keep or keeps irregularly required books and records.
- Attempts have been made to falsify accounting documents and/or entries, two sets of books are kept or the accounting records are kept so badly that the revenue authority has reasonable grounds to believe that the taxpayer is deliberately trying to thwart his efforts to determine his taxable income.
- Refusal to show the accounting documentation or destruction of accounting documents has been established.
- Inability to provide the required information, to give explanations or the overall behavior of the taxpayer indicates that he does not want to cooperate with the revenue authorities during the conversation/meeting.
- False, misleading or inconsistent statements are made during the conversation with the tax authority.

- A false document or a notarized declaration shall be submitted in order to substantiate a position in the tax return.
- Concealment of facts or documents.
- Replacement of accounting or other documents.
- Not all revenues from the operating activities of the company are paid into a bank account, and at the same time there are no sufficient grounds to retain part of the cash receipts.
- The taxpayer does not wish to relinquish some of the control over the cash receipts of his employees when the scale of the activity clearly indicates the need for it.
- Engaging in risky activities.
- The personal standard of living, including the costs of maintaining it and the accumulated assets significantly exceed the declared income from the company's activity.
- Property purchased by the taxpayer is recorded in the name of other persons.
- The taxpayer makes allegations that are favorable to his personality and behavior, but he cannot defend them with any evidence.
- The taxpayer is constantly late and postpones his business meetings, does not submit the required documentation and does not make a benevolent effort to cooperate with the revenue authorities.

Indicators of violations and fraud are only signs, not evidence of their existence. Reliable evidence should be gathered from revenue authorities so that violations and fraud can be proven in court. Cases that raise reasonable suspicions of fraud are best directed to specialized criminal tax investigation departments. For example, data on significant amounts of hidden income or other taxable items for more than 1 year have been established, as well as cases where reliable evidence can be provided that the taxpayer has deliberately tried to reduce the amount of his tax. Administrative fines and penalties should be imposed on taxpayers who have committed minor offenses once and can give a reasonable explanation for their mistakes.

6.4 Comprehensive Risk Assessment Based on Financial and Non-financial Information

Traditionally, revenue authorities have implemented a strategy to ensure compliance with tax laws, based on combating violations and fraud through conducting audits and imposing sanctions. Gradually, however, a holistic view of the control impact in the field of taxation is being developed, including an understanding of the risks and applying integrated approaches (OECD, 2015, p. 123). The Center for Tax Policy and Administration at the OECD (2004) presents a framework for risk management and counteraction, which is based on the analysis of taxpayers' behavior. Another OECD Center for Tax Policy and Administration study (2010) aims to improve understanding of the motivation of taxpayers for compliance with tax legislation.

Investigating taxpayers' behavior can help revenue authorities form and implement effectively strategies for compliance with tax laws, which contributes to the sustainability of tax systems. In this regard, the most important drivers of individual behavior of taxpayers in compliance with tax legislation are systematized in the following main categories:

- **Deterrence:** About children and inspections, risk for detection of deviations from the norms and severity of sanctions.
- **Norms:** Personal and social norms of behavior.
- **Opportunities:** To comply with laws, for example, low costs of compliance, clear and easy rules, as well as non-compliance with the law—opportunities to avoid.
- **Justice:** In terms of results and procedures.
- **Confidence:** V the actions of the government, the tax authority and other taxpayers.
- **Economic factors:** General economic factors, business factors and the amount of tax liabilities.
- **Interactions:** Determinants of compliance behavior interact with each other.

By better understanding taxpayers' behavior, revenue authorities can use their limited resources more efficiently so that they implement strategies that have a real and systematic impact on tax compliance behavior. This will ensure stable tax revenues for the implementation of policies by governments (OECD, 2010, p. 7).

An OECD study (2013, p. 7) presents some opportunities for raising tax morale and compliance with tax legislation:

1. **Build a profile of taxpayers:** Based on the analysis of the attitudes of individuals and their perceptions regarding tax issues. Thus information can be obtained, for example, which groups of people are most resistant to paying taxes and which groups would be the easiest and for convincing not in the benefits of taxation. Understanding the various social, economic and institutional factors that influence tax morale can also contribute to the development of literacy among taxpayers and the preparation of appropriate educational campaigns.
2. **Understanding the informal sector better:** Efforts to better understand the profile and perceptions of retailers, for example, can help establish a dialogue with them on tax issues, which to contribute to the formation of a culture of compliance with tax laws.
3. **Simplification of tax regimes and wider use of information technology:** The aim is to reduce opportunities for corruption (to demand or expect to pay bribes), as well as to meet the expectations of taxpayers to provide better and more timely electronic administration services.
4. **Coordinating the efforts of the various bodies that enforce tax laws:** Taxpayers 'perceptions that tax authorities' approaches are overly controlling can reduce trust in them and provoke non-compliance with tax laws.

An important element of the risk management process is the compliance measurement framework, which provides revenue authorities with a set of compliance

indicators that could be used to monitor and assess compliance results (OECD, 2015, p. 127). The compliance monitoring framework should include a set of measures and indicators for the main types of risks associated with registration, timely submission of documents, regular payment and proper reporting of administered taxes (OECD, 2008).

The main goal of the revenue authorities is to collect the taxes due in a way that maintains confidence in the tax system and the tax administration. It is recognized that cases of non-compliance with the law are inevitable due to the actions of taxpayers, due to ignorance, carelessness, negligence or intentional concealment, as well as due to weaknesses in the tax administration, such as insufficient capacity, corrupt practices, etc. Therefore, the tax administration should implement strategies to ensure that non-compliance with tax legislation is minimized. The OECD points out that revenue authorities have a leading role to play in ensuring that taxpayers and other countries understand their obligations to comply with tax laws. The specific obligations of taxpayers are different in different jurisdictions and, but can be grouped as follows: (1) registration in the system, (2) timely submission of the necessary tax information, (3) reporting of complete and accurate information and (4) payment of tax liabilities on time. Compliance refers to the extent to which the taxpayer meets these requirements (OECD, 2004, p. 7).

It is characteristic of tax administrations in general that they have limited resources. As a result, revenue authorities need a methodology for determining the most rational allocation of their resources to ensure tax compliance. Tax risk management is a structured process for the systematic identification, assessment, classification and treatment of compliance risks, such as non-declaration or incorrect reporting of tax liabilities (OECD, 2004, p. 8).

Following the model of the Center for Tax Policy and Administration at the OECD, the compliance risk management process includes:

Step 1: Risk identification.

Step 2: Risk assessment and prioritization.

Step 3: Behavior analysis—economic and non-economic factors that influence the behavior of taxpayers regarding compliance with the law are studied.

Step 4: Defining a strategy for risk management.

Step 5: Planning and implementing strategies.

This model also pays special attention to the measurement of compliance in four aspects—registration of data, filling in the data in the reports/declarations, submission of the reports/declarations and payment (OECD, 2004, p. 9).

Risk assessment is closely related to the performance of research and analysis of various data and information related to the object of control. The use of financial and non-financial data from integrated reporting makes it possible to obtain a comprehensive risk assessment in relation to a specific object of control.

In its essence, the analysis is a mental division of a whole into its simple constituent parts, in order to study these parts separately, as elements of a complex whole. By dissecting the whole (object, system, process, phenomenon, etc.) the aim is to study the functions, structure, organization, hierarchy, relationships,

relationships, interaction of its components. Thus it becomes possible to find the constituent parts in the whole, the simple elements in the complex, the possible causes in the consequence, etc. The analysis provides two possibilities for research: from the cause—to the investigation (i.e. when the analysis starts from the primary documents, passes through the accounting records and reaches the financial statement) and vice versa, from the investigation—to the cause (i.e. when the analysis begins with the “reading” of the financial statement, those articles are selected that will be examined until the details are reached, the data in the primary documents).

In tax control, this method is widely used in the selection of taxpayers for audit, in the performance of inspections and tax audits. The methodology of tax control requires to form models of the behavior of the object of control, to make logical analysis, analytical comparisons and to analyze the causal relationships in order to establish deviations from the norms and the expected state, and to form adequate control impact. In addition, tax control analyzes an interrelated quantity, such as: the relationship “income and livelihood (subsistence)”; the relationship “costs-revenues”, “purchases-sales”, etc. Modern IT is actively used to perform electronic audits, as a result of which the opportunities for timely detection of deviations and fraud increase significantly (Nikolova, 2019, p. 66).

OECD (2001, p. 3) states that where compliance with tax laws is not achieved voluntarily, revenue authorities must be able to identify the specific risks associated with tax evasion. Effective revenue authorities identify and assess risks to tax compliance and develop strategies to address those risks. These strategies include: education, service, marketing, risk profiling, auditing, key deterrence measures, prosecution and proposals for legislative changes. It also emphasizes the need for revenue authorities to be strategically focused and responsive to changes in the internal (administration) and external (taxpayer) environment. They should assess the risk of compliance with tax legislation not only at national but also at international level in order to soundly manage the identified risks.

The International Organization for Standardization defines risk in ISO 73: 2009 “Risk management—Vocabulary” (International Organization for Standardization, 2009) as “the effect of uncertainty on the objectives”, and Note 1 to this standard specifies: “The effect is a deviation from the expected—positive or negative”. This definition was developed by an international commission representing more than 30 countries and is based on the contributions of several thousand experts on the subject, in order to satisfy areas that use the term “risk” in different ways. In some areas, the term is limited to negative impacts (“downward risks”), while others include positive impacts (“upward risks”). ISO 31000: 2018 “Risk management—Guidelines” uses a similar definition (International Organization for Standardization, 2018).

In the practice of the bodies for financial control there is a need for research of the economic activity of the enterprise, which is carried out at the stage of planning and preparation of the control activities. Such a study is a prerequisite for the effective and efficient implementation of control, because without the formation of understanding of the controlled object, it is impossible to establish its actual state and whether there are deviations from the norms or the expected state. The more

thorough and credible the idea of the revenue authorities about the controlled object, the more significant can be the control impact on it. For example, the standards for independent financial audit require to examine the object of control and to form an understanding of the enterprise and the environment in which it operates, to assess the risks of significant inaccuracies, deviations and nonconformities or expected status (International Auditing and Assurance Standards Board, 2016).

Before starting the tax audit, the revenue authorities carry out preliminary preparation (analysis before the audit), examining the activity of the audited enterprise and its history. The purpose of tax auditors is to get an idea of the taxpayer's activity and the specific environment in which it takes place (Foks & Bergherm, 1998, p. 21). Data for this analysis can be obtained from:

- **The tax file of the taxpayer:** The data in the submitted declarations are analyzed and a comparison is made between them.
- **Other government agencies or institutions:** Archival documents from court cases, customs documents for import and export, police file, received licenses and certificates, data from the municipality, data on registered vehicles, acquired real estate, land, etc. can be viewed.
- **The taxpayer:** He is required to have a list of pre-defined documents and information or the taxpayer is required to complete a survey with research questions for the purposes of the audit; a conversation with the employees can be held, documents and accounting data can be studied, an idea of the condition of certain assets, inventories, cash, etc. can be gained.

The study and analysis of the audited entity provide an opportunity to identify those issues that raise doubts about the revenue authorities—thus forming audit guidelines and hypotheses that are subject to verification during the audit, select appropriate means, methods and approaches to control to enable effective control impact. In addition to these classic sources of information for research and analysis of the audited company and its environment, in modern conditions, due to the development of IT and digitalization of reporting and control, can also use data from various electronic sources of information, including the databases of the tax administration, other institutions and the taxpayer. As the number of companies compiling integrated reports is constantly increasing, special attention should be paid to the possibilities of extracting valuable financial and non-financial information from them for the purposes of tax audits. The ability of tax authorities to study and analyze the activities of audited entities is constantly evolving and improving, especially in connection with the use of innovative technologies such as “Big Data”.

The existence of technological similarities between the independent financial audit and the tax audit gives reason to believe that revenue authorities can apply a similar approach to forming an understanding of the company's activities and the environment in which it operates as independent auditors (Nikolova, 2014). Based on a study of specialized publications in the field of independent financial audit (Erofeeva et al., 2012; Defliz et al., 1997; Hubbard et al., 1991; Whittington et al., 1992) as well as the guidance given in ISA 315 Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment

(International Auditing and Assurance Standards Board, 2016), the following presentation will present appropriate guidelines, methods, techniques, information sources and tools for research and analysis of the activity and business environment of the audited entity.

The guidelines for research and analysis can be systematized into the following nine groups: (1) macroeconomic factors; (2) branch (industry) conditions; (3) regulations and regulations; (4) economic activity, organization and management; (5) investments; (6) financing; (7) financial statements and reports; (8) objectives and strategies and related business risks; (9) review and evaluation of the results of the enterprise's activities.

A variety of methods and information sources can be used to form an understanding of the activities and business environment of the audited entity.

- **Control methods:** Analysis of the reporting data, incl. data from integrated reporting; visit and inspection of the enterprise; surveying and interviewing the tax entity, employees of its enterprise and contractors; study of financial and non-financial data, various publications on the industry and regulations governing the reporting and business activities of the audited entity, data on production, sources and methods of supply of materials, marketing and methods of implementation, sources of funding, organizational structure, accounting policies and procedures, capital structure, product lines, production methods, distribution, etc.
- **Information sources:** The documents and data from the tax file of the audited entity, incl. from previous control actions related to the enterprise; independent financial audit and internal audit reports; annual statistical surveys; the data from conducted surveys and interviews with the staff (management, internal auditors, associates from the information technology department, etc.), with other auditors, consultants and contractors; official statistics, economic and financial surveys and articles, professional journals, bank reports, etc.; the minutes of the meetings; powers of attorney, lists of shareholders, minutes of meetings of the board of directors; materials prepared for shareholders; advertising literature, publications and brochures of the audited entity; reports on the results of the activity of the enterprise, its competitors or the branch; accounting and auditing guides for various industries; financial statements (interim and annual); the financial statements of key competitors in the same sector; the financial and non-financial data from the reporting, accounting accounts and documentation of the audited entity; management's internal reports; instructions for the accounting system, document flow and internal control; the individual chart of accounts; job descriptions; the marketing and sales plan; important contracts with long performance, etc.

After the data and information relevant to the audited activity have been studied, at the next stage—to analyze the activity and the business environment of the audited enterprise, the basic SWOT-matrix can be used (see Fig. 6.1). SWOT analysis (i.e. Strengths, Weaknesses, Opportunities and Threats) is a strategic planning technique used to help identify strengths and weaknesses, opportunities and threats associated with a project or business venture. This technique is designed for the decision-making process and can be used as a tool to assess the strategic position of

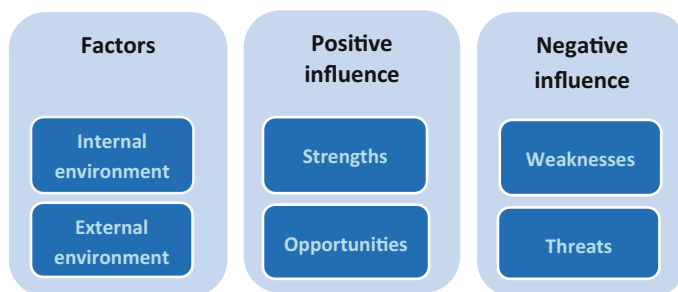


Fig. 6.1 Basic SWOT matrix. Source: The author, based on Todorov (2014)

organizations of different types. The basic SWOT-matrix takes into account the influence of both internal and external factors for the company, which can be favorable (positive) or unfavorable (negative). Internal factors arise from the so-called “Internal environment”. They represent the strengths and weaknesses of the company. External factors are related to the external environment. They are perceived as opportunities and threats (Wikipedia, 2022).

From the nine groups of guidelines for research and analysis of the activity and environment of the audited enterprise, systematized above, as external factors (external environment) can be considered—the relevant macroeconomic, industry (sectoral) conditions and regulatory framework, and as internal factors (internal environment)—the economic activity, the organization and management of the enterprise, the investment activity and the financing, the financial and accounting reporting, the business purposes, the strategies and the results of the activity of the enterprise.

Table 6.1 presents an example SWOT-matrix of a manufacturing plant. In a similar way, SWOT-matrices of enterprises that carry out commercial activity or provide services can be developed.

The basic SWOT-matrix is a convenient tool for illustrating the results of the study of the enterprise and its environment. The SWOT-matrix allows for a comparison of strengths and weaknesses, as well as opportunities and threats to the audited entity in order to perform an analysis in these areas. For the purposes of tax control, it is necessary in this analysis to focus on tax aspects, i.e. to reveal the potential risks of tax violations and fraud to which the attention of the revenue authorities should be directed. For example, if we use the data above from the sample SWOT-matrix of a manufacturing enterprise, we can identify the following risk areas in relation to taxation:

- **Internal environment:** Strengths and weaknesses.
 - The inclusion of fixed assets in the depreciation plan and the formation of tax-deductible depreciation costs, focusing on new production equipment, technological rights, trademark and more.
 - Sources of financing the activity, focusing on loans from individuals, other enterprises and contributions from partners.

Table 6.1 SWOT-matrix of a manufacturing enterprise

<i>Strengths</i>	<i>Weaknesses</i>
<ul style="list-style-type: none"> • New production equipment. • The best technology at the moment. • High quality products. • Registered trademark. • Competitive prices. • High financial autonomy (financing mainly from own sources). • High level of loyalty to customers and distributors (retention of regular customers). 	<ul style="list-style-type: none"> • Lack of sufficiently qualified staff. • Insufficient distribution network. • Ineffective advertising. • Dependence on certain suppliers. • High administrative costs. • High fixed costs. • Low degree of filling of the production capacity.
<i>Opportunities</i>	<i>Threats</i>
<ul style="list-style-type: none"> • Opportunity to export products to the EU. • Expressed interest in establishing a joint venture in third countries. • Probable interest from potential distributors in providing better conditions. • Opportunity to import cheaper materials from Asia. 	<ul style="list-style-type: none"> • Lack of sufficient barriers for other companies to enter the industry, i.e. probability of the emergence of competitors. • Probability of reducing market share in the country. • Probability of occurrence of substitute goods. • Probably an increase in the prices of basic production materials.

Source: Todorov (2014)

- The quality of the accounting work in the enterprise—educational qualifications, skills, experience and qualification, as a prerequisite for making/not making mistakes and inconsistencies in the reported and declared data.
 - The reliability of the costs of advertising, heating and lighting, administrative costs and rents paid.
 - The reliability of the costs of raw materials and labor.
- **External environment:** Opportunities and threats.
 - The use of transfer prices.
 - Cross-border transactions.
 - Related party transactions. The following control means can be used for research and analysis of the economic activity and the economic (business) environment of the enterprise—questionnaires (survey cards), protocols of the revenue authorities for on-site inspection of the audited entity and interviews with employees of the enterprise, as well SWOT-matrices (tables) with systematized non-financial information. The documentation of this study and analysis for the purposes of tax audits, similar to the practice of independent financial audit, should be considered as part of the working documentation prepared during the tax audit by the revenue authorities, which does not need to be applied as evidence to the audit act (unless it contains data on the basis of which corrective findings are made in it), but only to be archived in the tax file of the company to be used in other inspections and audits (Nikolova, 2014).
- In connection with the fight against tax crimes, a research team of the PROTAX project is developing a methodology for risk assessment (PROTAX, 2021, p. 5), which aims to provide practitioners with a model for detecting suspicious behavior

and indicators of tax crime, together with a practical model for tax authorities, politicians and other stakeholders to assess the risks and control of tax crimes in their jurisdiction and in the whole of the European Union. Researchers point out that national and regional risk assessment frameworks are also being developed by major international institutions involved in tax and financial flows, such as the World Bank, the OECD and the Tax Justice Network (TJN). The ambition of the research team of the PROTAX project is to develop a methodological tool for identifying and analyzing uncertainties caused by threats and vulnerabilities in the field of law enforcement in the EU related to tax crimes, modeling them as risks. The expectations are thus to support the development of coordinated control activities and measures. There are two interpretations of risk in this methodology:

- The first type of risk is to commit a tax crime. This applies to suspicious activity and indications, etc. “Red flags”, which are established by answering questions systematized in a specially developed survey, presented in Annex 3 to the risk assessment toolkit.
- The second type of risk is that these indications cannot be read in an optimal way due to various legal, institutional and cultural factors. In this regard, the PROTAX project team (2021, p. 49) points out that the sharing of information across borders, agencies and jurisdictions is crucial for the tax crime investigation environment.

This two-way risk environment—risks of tax crime and risks related to vulnerable aspects of control—is the basis on which the methodology for risk assessment of PROTAX has been developed. Questions indicating suspicious behavior or transaction, etc. “Red flags” are systematized in Annex 3 (PROTAX, 2021, p. 60) in the following groups:

- Questions about types of suspicious activities, arrangements and transactions that may specifically indicate a tax crime.
- Questions assessing compliance with tax requirements, reliability and tax behavior of the company, divided into: questions for establishing and managing a company; questions about a new company or customers; questions related to suspicious circumstances of groups of companies.
- Issues related to potential money laundering, subdivided into: money laundering through accounts; money laundering using cash; money laundering in offshore companies; money laundering with the participation of employees and agents of financial institutions; money laundering through lending.
- Questioning the use of intermediaries—unnecessary or illogical use of an intermediary in a transaction.
- Abnormal and illogical transactions, including: questions about the logic or financial meaning of a transaction.
- Questions of disclosure of suspicious types of secrecy.

The main weaknesses that pose risks, according to the PROTAX team (2021, p. 37), are the following: scope and definition of tax crimes, threshold for tax crimes, sanctions for tax crimes, legal liability for tax crimes, international cooperation in

criminal matters, information sharing, treatment of whistleblowers, obligations to report suspicious financial behavior, obligations to keep the client's financial transactions secret, resource constraints.

Usually, suspicious marks ("red flags") identify only some kind of illegal financial flows and cannot show what predicate crime is behind this illegal flow. The risk assessment of PROTAX aims to warn stakeholders of potential "red flags" indicating a suspicious transaction or financial agreement, and then relies on this risk to be interpreted in a broader context, in terms of possible crimes in the tax system of The European Union. Proceeds from tax crimes are often laundered and can be used for other criminal acts, so that illegal financial flows are inextricably linked to tax crimes (PROTAX, 2021, p. 16).

6.5 Solutions and Recommendations

The use of modern techniques (including remote) for monitoring taxable objects and activities can significantly improve the work of the tax administration and the perception of taxpayers about it. Timely, preventive tax control, which counteracts tax violations and fraud at the time of their inception, will be able to increase taxpayers' confidence in the ability of the tax administration to effectively deal with tax deviations, increase voluntary compliance with tax obligations and to improve collection.

The study and analysis of the activities and business environment of the audited entity, based on financial and non-financial information, could contribute to better preparation and efficient conduct of tax audits, in the following aspects: (1) identification of problem areas in relation to taxation, which have the greatest potential for tax violations and fraud arising from the strengths and weaknesses of the business, as well as from the opportunities and threats faced by the audited entity in order to focus control on them; (2) obtaining an understanding of the unique characteristics and specifics of the audited activity, necessary for testing the control hypotheses, evaluating the evidence gathered and reliably arguing the conclusions and findings of the tax audit team.

6.6 Future Research Directions

In order to strengthen the control impact in the field of taxation, it would be useful to expand risk research to cover not only the conditions and risk factors, but also the detection of indications of abuse and deviations from tax norms, as well as to propose techniques and methodologies for responding to the identified risks, applying a holistic approach to tackling tax inconsistencies and seeking a more synergistic effect of coordination of the efforts of the various control bodies, which observe the observance of the tax laws.

6.7 Conclusion

In its traditional image, tax control is ex-post, i.e. “Post-event control”, as it is carried out mainly through audits (audits) and/or inspections of past activities, completed processes and actions taken, in order to establish their compliance with tax rules, their reliable declaration and to implement properly control impact. However, the adoption of the principles of sustainable development in modern conditions raises the need for development and priority implementation of preventive and operational measures to combat tax fraud and tax evasion. The aim is to minimize fiscal damage and ensure fiscal stability, increase revenue collection by increasing voluntary tax compliance—instead of enforcement, which can only be used as a last resort in a relatively limited number of cases.

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Part III
Sustainable Models for Tax Control
and Taxation

Chapter 7

Taxation for the Purposes of Sustainable Development



7.1 Introduction

This part deals with issues related to tax functions in modern conditions in the context of the Concept for Sustainable Development. In this regard, the possibilities for achieving economic, social and environmental effects through taxation are studied. In each of these areas, attention was paid and specific issues were studied, including: the weaknesses of modern taxation systems and social transfers related to income inequality, social mobility, etc. “Trap” of inactivity, etc.; the short-term and long-term effects of the conducted tax policy with an emphasis on the taxation of personal income taxes and corporate income taxes; the tendencies for shifting the taxation from the labor income to other tax bases, which do not distort the incentives for growth and progress or which create opportunities for the realization of the so-called “Double dividend” from taxation; the impact of taxation on international competitiveness, investment decisions, innovation, diversion of profits from multinational companies, etc. Special attention is paid to the study of the challenges in the implementation of modern tax policy related to increasing investment and innovation as an engine of growth and sustainable development, job creation and employment, reducing inequalities, supporting equal opportunities and social mobility, protection of the environment and reduction of harmful effects on it. Issues related to the relationship between subsidies and investments in education and tax policy related to inheritance taxes and income taxes are addressed. Also, issues of the relationship between ensuring equal access to quality education and health care, on the one hand, and the structuring of the tax and social security system—on the other hand. The characteristics of the main types of environmental taxes are systematized and the tendencies and perspectives for carrying out “green” tax reforms and policies are studied. The purpose of this chapter is to create an idea of current opportunities and trends for simultaneous achievement of—fiscal, economic, social and environmental results through the tax policy aimed at achieving the goals of sustainable

development; and to argue that a balance between economic efficiency and social justice in taxation is possible.

7.2 Background

In addition to the fiscal function, in modern society taxes can also perform an economic function related to the impact on employment, economic development and growth; social function related to the redistribution of income of individual taxpayers and impact on social processes; and an environmental function that can be seen as an instrument for conducting environmental policy and influencing the behavior of taxpayers in order to protect the environment.

The fiscal function has established itself as primary and immanent to the tax. The active social function of the tax dates back to the second half of the nineteenth century, and the economic function from the 1930s. Proponents of the theory of functional taxes consider the economic function of taxes to be dominant in accordance with the postulates of Keynesian doctrine. According to them, the main purpose of taxes is not to provide revenue to the budget, but to have the desired impact on the reproduction process and the national economy (Stoyanov, 2000, p. 26).

Taxation has a central role to play in achieving a just society and a strong economy. It can help tackle inequalities by supporting social mobility and reducing inequalities in market incomes. Tax policy can also have a major impact on employment decisions, the level of investment and the willingness of entrepreneurs to expand their business, leading to greater growth (Evropeyska komisija, 2017a).

In modern socio-economic conditions, it is not enough just to stimulate economic development and growth, as problems such as income inequality, the harmful effects on the environment and the violation of the ecological balance come to the fore. Thus, the efforts of scientists and government are aimed at ensuring conditions for sustainable economic development and growth through the conduct of tax and macroeconomic policy (Nikolova, 2021). What is important in modern conditions is the nature of growth and therefore the goal should be focused on such growth that does not impair human well-being and does not endanger the environment (Stiglitz, 2012). Thus, in connection with the desire to ensure both growth and sustainable economic development—in the formation of tax policy is becoming increasingly important to find a balance between economic efficiency and social justice in taxation.

The key characteristics that should be taken into account when assessing the fairness and efficiency of a tax system are the extent to which it: (1) encourages investment, (2) supports job creation and employment, (3) corrects inequalities, (4) achieves high levels of compliance with the law. It is recognized that compromises between efficiency and fairness are sometimes needed, but the two objectives are not mutually exclusive (Evropeyska komisija, 2017a, p. 11).

7.3 Exploring the Possibilities for Achieving Economic Effects Through Taxation

Taxes and transfers are a powerful tool used to raise revenue, redistribute income and wealth, reduce inequality, improve opportunities and even improve the functioning of markets. Poorly designed tax and transfer systems can discourage productive activity, economic growth and progress (Stantcheva, 2018). The effects of taxes are not only timely and short-lived. Instead, their medium- and long-term dynamic effects, such as their impact on human capital investment, innovation, savings and capital accumulation, must be taken into account (Stantcheva, 2018, p. 2). In this regard, it is appropriate to study mainly the effects of income taxation, incl. personal income taxes and corporate income taxes.

Personal income taxes are a traditional part of any modern tax system. At the present stage it is characteristic of them that their fiscal function decreases and their social and economic function strengthens. This trend is confirmed, for example, by the data on the tax policy of countries in Europe, such as England, Poland, Bulgaria, Romania, Lithuania, etc., with the exception of Belgium, Italy, Germany, France, etc., where income tax is relatively high and still has great fiscal significance (European Union, 2021).

Reducing personal income taxes can be a tool to promote higher employment levels and bring about desired social effects. An information document from the European Commission (2017a) states that reductions in the income tax for vulnerable and more vulnerable groups, such as low-income workers or second working household members, can help increase employment levels, while reducing poverty and social exclusion. As not all countries have enough fiscal space to be able to consider reductions in personal income taxes without adequate compensation, a way must be sought to finance these reductions. In this regard, shifting the tax burden to other tax bases is a possible option. High levels of personal income taxes, together with the relatively low tax burden of consumption taxes, property taxes and environmental taxes, indicate that there is scope for shifting the tax burden from income to other tax bases. From the point of view of economic growth, certain types of taxes are considered less distortive, such as consumption taxes, periodic housing taxes and environmental taxes. In this regard, the existence of different reactions and outcomes, in the short and long term, should be taken into account, from the conducted tax policy (Evropeyska komisija, 2017a).

Piketty et al. (2014) derive formulas for the optimal upper tax rate in a model where people with the highest incomes respond to changes in the level of taxes through three channels—labor supply, tax avoidance and compensation-negotiation. In this regard, they investigated three groups of effects:

1. **Effects of supply-side taxes:** The fall in the highest tax rates leads to an increase in supply, with highly skilled people working and earning more.
2. **Tax avoidance effects:** When tax rates are high, high-income earners find ways to use loopholes and report less of their taxable income.

3. Effects related to compensation-negotiation: Lower marginal tax rates cause the highest earners to bargain more aggressively for higher pay.

These authors examine the effect of tax rates on growth, using data on GDP per capita and the highest tax rates for the period 1960–2010 for 18 OECD countries. They find that reductions in tax rates for the highest incomes do not lead to greater economic growth. As a result of the bargaining effect, lowering the highest tax rates actually generates a shift from lower to higher incomes and an increase in the shares of the highest incomes, but without additional economic activity (Piketty et al., 2014).

Saez, Slemrod and Giertz (2012), quoted by Piketty et al. (2014, p. 231), conduct extensive empirical economic research analyzing the effects of tax rates on pre-tax income, in which they reach two general conclusions. First, higher incomes respond to tax rates whenever tax law offers options for tax avoidance. Such responses can be quite large in the short term. Second, when there are no tax avoidance options, the estimated elasticity labor is not large in the short or medium term. According to these authors, no study to date has shown convincing evidence of high real economic activity of higher-income earners, in response to tax rates, in the short or medium term. However, it is difficult to provide convincing estimates of long-term resilience.

One of the challenges in conducting tax policy is to increase investment. Corporate and personal income taxes affect growth and investment. Corporate taxes affect both the location of enterprises and domestic and foreign direct investment. Differences in corporate taxes can lead to diversion of profits by multinational companies from high-tax countries to low-tax ones. Investment decisions are influenced by the effective marginal tax rate. The lower the effective marginal tax rate, the more investment-friendly the tax system (Evropeyska komisija, 2017a).

According to an information document from the European Commission on Taxation, there are several ways to reduce the effective marginal tax rate and create a tax system that supports investment (Evropeyska komisija, 2017a):

- Providing schemes for faster depreciation or immediate recognition as an expense.
- Allowing deduction of capital costs.
- Improving the conditions for carrying forward losses.
- Offering tax incentives for research and development.

Increasing investment is often a priority in policies, as weak investment means low growth and poor long-term employment and employment prospects. According to the European Commission (2017a), it is important to create a tax system that maintains a low value of the effective marginal tax rate and thus avoids reducing incentives for profitable investments. This does not necessarily mean that tax rates need to be reduced. Instead, faster depreciation schemes, immediate recognition as an expense or provision for the possibility of deducting capital financing costs reduce effective marginal taxation. It also states that legal certainty, stable, predictable and simple tax rules are important for business and investors in decision-making. Taxation is one of the main tools available to governments to promote

entrepreneurship and innovation. Tax policies can help reduce entrepreneurial risk and the cost of doing business (Evropeyska komisija, 2017a).

In connection with the promotion of investment, most corporate tax systems provide incentives for companies to make more commitments by allowing interest payments to be deducted, but do not provide the same treatment for equity. The propensity to borrow leads to higher debt levels, making companies more vulnerable and economies vulnerable to crises. As a result, the risks to financial stability and insolvency increase. Such tax treatment is particularly problematic for young and innovative companies, which often do not have access to external financing. They are at a disadvantage, although they are important for creating growth in the future. The asymmetric tax treatment of debt and equity is used by some multinational companies to organize their debt so as to reduce their overall tax burden. In this regard, the European Commission is proposing a corporate tax deduction for companies that choose to increase their equity capital to finance rather than take on debt. This will ensure that the same tax incentives are applied to equity and debt by creating a more neutral tax environment that encourages investment (Evropeyska komisija, 2017a, p. 14).

Tax incentives to encourage investment in research and development may include corporate taxes, personal income taxes and social security contributions. They can be in the form of tax credits, tax breaks, accelerated depreciation and more. To stimulate investment and innovation in this area, tax credits and tax breaks are recommended based on real R&D spending, not just results.

Tax incentives for venture capital are an important part of the tools related to investment and innovation policies in the European Union and around the world. These investments create jobs and increase productivity, but a number of factors hinder their development. Taxation can play an important role in overcoming these barriers to investment. Tax incentives for venture capital can take the form of a tax credit, tax exemption, tax deduction, loss compensation or a combination of different incentives.

Akcigit et al. (2018) examine the effect of corporate and personal taxes on innovation in the United States in the twentieth century. They conclude that higher taxes have a negative impact on the amount and location of innovation, but not on the quality of innovation. Corporate taxes influence the production of innovation by corporate inventors and mobility between countries. Personal income taxes affect the amount of innovation and mobility of inventors.

Tax incentives could also help reduce the risk of investment in small and medium-sized enterprises and start-ups by providing pre-tax credits, capital gains relief or loss relief. According to the European Commission, there are large differences in the costs of complying with tax legislation between the countries of the European Union. The complexity of tax systems, the high costs of tax compliance and the lack of tax security act as a barrier to business and investment. The high costs of complying with tax legislation have a particularly large impact on small and medium-sized enterprises. Compliance costs are mainly due to the time spent and not to the direct costs of accounting (Evropeyska komisija, 2017a). To improve the business environment, tax systems can be reformed in three main aspects:

- Simplification and reduction of tax liabilities, especially for those wishing to start a business and smaller businesses.
- Expanding the scope of electronic services and providing them at one counter.
- Raising awareness, information and training of corporate taxpayers to help them adhere to tax rules using various channels, including social networks.

Another challenge in the implementation of tax policy is related to job creation and increasing employment. Income taxes and social security contributions affect, on the one hand, the decisions of individuals related to the supply of work and, on the other hand, the decisions of employers related to the demand for labor, as their amount increases labor costs. Labor supply by some sections of the population, such as low-skilled workers, young people, older people and second-employed household members, is particularly sensitive to taxes and social security contributions (Evropeyska komisija, 2017a, p. 5).

Meghir and Phillips (2010) review the extensive literature on taxation and labor supply in the United Kingdom since 1978, focusing on the impact of taxes and benefits on employment incentives. They conclude that hours worked do not respond particularly strongly to the financial incentives created by tax changes for men, but are slightly more impactful for married women and single mothers. Deciding whether to take a paid job at all is quite sensitive to taxation and benefits for mothers and women in general. Deciding whether or not to work for men with low education is relatively more responsive to incentives. For men with a high level of education, the decision to work is quite inelastic (insensitive). The amount of taxable income they earn seems to be sensitive, but this effect is more because their income and expenses are redirected to non-taxable forms than because they reduce their work effort.

According to Meghir and Phillips (2010, p. 206), incentives are certainly important, but their impact varies depending on the demographic and educational characteristics of individuals. For some groups, such as women with young children, taxes and benefits can affect whether or not to work and how many hours they work. For men with low education, tax and social incentives are also important, but only regarding the decision to participate; their working hours are insensitive to changes in taxes and benefits. This group of men either do not work at all or work full time. For highly educated and wealthy men, taxes do not affect whether they work or not and how many hours they spend per week or even per year. However, taxes affect their total number as well as their taxable income. They react by reorganizing their activities to take advantage of the way in which different sources of income are taxed and by redirecting consumption to deductible sources. They can also adjust the amount of effort they put into their work. The authors also point out that although empirical approaches and starting points differ, there is a broad consensus in research on these issues in general.

The effect of taxes and social benefits should be analyzed on a broader basis, not just in relation to labor supply. Meghir and Phillips (2010) link this issue to choices related to education and investment in human capital. According to them, appropriate models in this direction should include decisions on education and labor supply,

as well as wage formation. Individual choice includes switching between jobs when the opportunity arises and between work and unemployment, as well as choosing primary education. They offer a study of the impact of taxes and benefits on: (1) life-cycle learning decisions, as this changes future returns; (2) job mobility, as the benefits of relocating also have an effect on taxation; (3) incentives to work at any given time. The authors emphasize the need for a clear distinction between the short-term and long-term effects of taxes and benefits, which can be very different. They conclude that incentives matter and that taxation can generate significant distortions. Emphasize that taxes and social benefits affect not only labor effort—can affect and other decisions, including those related to the accumulation of human capital. According to them, all groups of the population may be sensitive to taxes and benefits, but to varying degrees (Meghir & Phillips, 2010).

The impact of taxation on labor efforts is considered one of the main sources of inefficiency (Meghir & Phillips, 2010, p. 204). The magnitude of inefficiency depends on how efforts respond to incentives and how the tax and transfer system changes incentives to work and earn. If the goal is to design an optimal system of taxes and benefits, you need to know how people react to taxes and benefits. Knowledge is needed on how sensitive work efforts are to incentives in groups with different backgrounds, as well as in men and women (Meghir & Phillips, 2010).

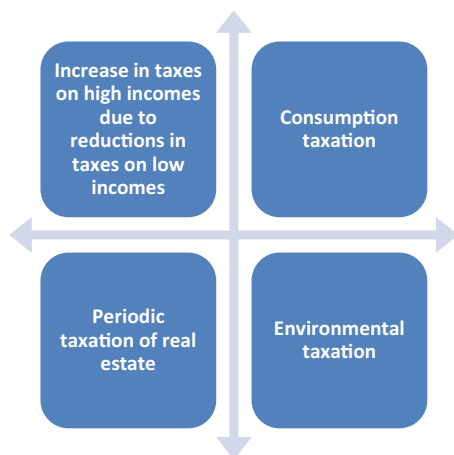
In this respect, the composition of the tax burden is important in the short term, as its various components can affect either the demand or supply of labor. The tax burden for a worker is determined by the following components:

- Personal income tax.
- Employer's social security contributions.
- Employee insurance contributions.
- Family allowances that reduce the overall tax burden, for example in France and Denmark.

The high marginal tax rates for the second working member of the household who switches from inactivity to work or who increases his employment—drive the so-called “Inactivity trap”. According to the European Commission, in most countries, taxation has a high contribution to the “trap” of the second working family member in cases where the main worker receives the average salary (Evropeyska komisija, 2017a). In addition, other factors, such as the availability of affordable and high-quality childcare services and well-planned work-life balance policies, may affect individuals' decisions about whether to return to work and increase their employment time. The indirect tax on the return to work of an inactive person is the part of the additional gross salary, which is deducted as a tax in cases when an inactive person who is not entitled to unemployment benefits but is entitled to income-related social assistance—enters work. Thus, the “inactivity trap” is an indicator that measures the financial incentives for the transition from inactivity and social benefits to employment (European Commission, 2017a, p. 7).

The European Commission points out that reductions in income tax can be a tool to encourage higher levels of employment, especially when high labor costs hamper employment or incentives to take up a job are low and the work is not well paid.

Fig. 7.1 Compensation for the reduction of taxes on labor income. Source: The author, based on Evropeyska komisija (2017a)



Targeted reductions in income tax for vulnerable and vulnerable groups, such as low-income workers or second-employed household members, can help increase employment while reducing poverty and social exclusion (Evropeyska komisija, 2017a, p. 12).

According to the European Commission, in connection with support for job creation and employment, in recent years many European Union (EU) countries have reduced the overall taxation on labor income. Some of them have reduced labor taxes for low-income workers and specific groups, while increasing labor taxes for higher-income groups. Others may have offset the effect of reducing taxes on labor income by shifting to other types of taxation, such as consumption taxation. In this regard, it is pointed out that in such cases it is important to take into account the possible regressive effect of taxes on consumption, as an alternative source of revenue in the budget (Evropeyska komisija, 2017a).

Periodic taxation of real estate is another type of taxation that should be taken into account as a means of compensating for the reduction in income taxes. When recurring property taxes are relatively low, as in most EU countries, then there may be room for an increase. It is considered that in countries where housing taxation mainly involves transaction taxes, an internal shift to periodic property taxes could be useful. Transaction taxes usually restrict transactions that would distribute property more efficiently. These taxes also have a negative impact on labor mobility due to the high transaction costs paid when changing homes (Evropeyska komisija, 2017a).

The next type of taxation that could be used to compensate for the reduction in income tax is environmental taxation. Revenues from environmental taxes are formed from taxes on energy, transport, pollution and resources. Figure 7.1 shows the possibilities for compensating for the fiscal effect of reducing taxes on labor income.

According to Jonė Kalendienė and Violeta Pukelienė (2011, p. 63), although it is strongly believed that countries with lower tax rates have better prospects for future

growth, low tax revenues limit government spending and can cause serious imbalances in the economy. In addition, lower taxes cannot guarantee sustainable economic growth. Their study used a comparative analysis of EU countries, and its results show that low tax rates could undermine the resilience of some European economies. The authors point out that economic growth depends on the accumulation of human and physical capital and that taxes can affect the accumulation of these factors of production. Lee and Gordon (2005) note that lower corporate tax rates, especially on investment, contribute to rapid short-term growth due to increased corporate investment. However, this can be seen as one of the risks to the sustainability of economic growth due to distortions and excessive investment, which can lead to oversupply in the economy in the medium term. Cullen and Gordon (2002) present the results of research that shows that corporate taxes should be lower than personal income tax to encourage private business creation and economic growth.

M. Koethenbueger and B. Lockwood (2010) analyze the relationship between tax competition and growth and conclude that the impact of tax decentralization and competition on economic growth depends on the type of tax and the results may be different in terms of wealth. According to Jonė Kalendienė and Violeta Pukelienė (2011, p. 65), governments compete with tax rates to attract more investment and foreign business to a country and thus promote economic development. In this regard, corporate taxes are most important for tax competition between countries and for comparisons between them. The results of their study show that some EU countries are competing by lowering their corporate taxes, trying to be more attractive to investors. They conclude that inappropriate changes in corporate taxation can damage the resilience of the economy; too low corporate tax rates are detrimental to total state budget revenues and threaten the resilience of the economy.

7.4 Exploring the Possibilities for Achieving Social Effects Through Taxation

Taxation has a role to play in alleviating inequalities and supporting social mobility by pre-allocating, redistributing, correcting or encouraging behavior. Taxation can also play a social role and play a role in building a fairer society, for example, by providing the right mix of revenue to finance public spending; mitigates inequalities; and supports social mobility across generations.

In this direction, one of the leading goals is to correct inequalities and promote social mobility. The problem is related to inequality in disposable income (after taxes and benefits) and the percentage of the population at risk of poverty. According to the European Commission, despite the existence of a stable social assistance system in the EU, there are still some serious inequalities—Lithuania, Romania, Bulgaria, Latvia and Estonia show the highest levels of income inequality after taxes and social transfers (Evropeyska komisija, 2017a, p. 8).

Greater inequality is associated with less social mobility, as inequality affects opportunities. Social mobility can be both within a generation and across generations. Intergenerational mobility refers to the ability to move up or down the scale of income or wealth in human life. Intergenerational mobility refers to the degree to which people's socio-economic characteristics depend on the social status of their parents. Intergenerational mobility is an important indicator of whether people can succeed in a society, regardless of their socio-economic background. It is closely linked to equal opportunities. Taxation has a role to play in supporting social mobility, for example: (1) as a source of funding for quality education, (2) as a means of reducing the transmission of privileges or disadvantages from one generation to the next, (3) through income redistribution and especially wealth by stimulating behavior that increases social mobility.

According to the OECD (2011, p. 40), intergenerational income mobility is low in countries with high inequalities such as Italy, the United Kingdom and the United States, and much higher in the Nordic countries, where income is more evenly distributed. The assumption that higher inequality distorts opportunities and reduces intergenerational mobility is the starting point of a study by Miles Corak (2013). In particular, it focuses on the extent to which growing inequalities in high-income countries, especially in the United States, are likely to limit economic mobility for the next generation of young people. In the context of inequality, based on a comparative analysis of a public opinion poll, Corak (2013, p. 18, 2010, p. 16) points out that US and Canadian citizens value the ideal of equal opportunities and individual freedoms. They recognize the importance of individual responsibilities and have the same level of disapproval of "equality of results" as the ultimate goal.

Brunori, Ferreira and Peragine (2013), cited by Corak (2013, p. 6), found a strong correlation of indices of inequality of opportunity with indicators of mobility across generations of income or education. According to him, the achievements of children in specific moments of their lives are related to the prevailing socio-economic inequalities to which they are exposed. Knudsen, Heckman, Cameron and Shonkoff (2006), quoted by Corak (2013, p. 7), clarify how socio-economic status affects the health and abilities of the child in the early years—even in the womb, which in turn affects the early cognitive and social development and readiness to learn. These results and the family environment (well-being) of children, as well as the quality of neighborhoods and schools, affect the success of primary school, which affects the success of high school and college. Family resources, connections and contacts affect access to good schools and jobs, and the degree of inequality in labor markets determines both the resources available to parents and the return on education that children receive. This whole process then forms the income in adulthood. According to Corak (2013, p. 21), inequality reduces mobility as it shapes opportunities: (1) exacerbates the consequences of innate differences between individuals; (2) changes the opportunities and incentives that form, develop and transmit characteristics and skills valued in the labor market; (3) shifts the balance of power so that some groups are able to structure policies or otherwise support their children's achievements regardless of talent.

Roemer (2004) considers three categories of circumstances through which parents can give preference to their children. First, parents can pass on economic benefits through social connections that facilitate access to jobs, admission to certain schools, colleges, or access to other sources of human capital. Second, parents can influence their chances of living through genetic transmission of characteristics such as innate abilities, personality and certain aspects of health that are valued in the labor market. Third, parents can influence their children's lifelong income prospects in subtle ways, such as through family culture and other monetary and non-monetary investments that shape skills, inclinations, beliefs and behaviors. It identifies four channels of parental influence: (1) providing social connections; (2) developing children's beliefs and skills through family culture and investment; (3) genetic transmission of abilities; (4) formation of preferences and aspirations in children.

Stantcheva (2014, p. 175) points out that investing in their children's education is also a priority for many parents. They often seek to provide their heirs opportunity to attend the best schools you can afford and make savings for college. The author draws attention to the tripartite interaction between education subsidies, inheritance taxes and income taxes:

- Income taxes take away part of the return for individuals from their education, but also redistribute resources to low-income parents, which facilitates their investment in their children's education.
- Inheritance taxes affect the choice between transferring resources through the purchase of education or through financial wills.
- They invest in education directly have an impact on the tax bases of income and inheritance, and are the main determinants of income distribution before taxation. Wills affect work incentives and hence income from income taxes.

In order to strengthen equal opportunities, measures can be taken to ensure equal access to quality education and healthcare. Public expenditure on them is financed mainly through taxation, relying on an appropriate combination of taxes and a high level of compliance with tax legislation. Tax and social systems can be a powerful tool to combat income inequality through redistribution. The overall structure of the tax system can play a role in reducing income inequalities and wealth distribution, as well as in promoting social cohesion. In this connection, account should be taken of the role of income taxation and cash benefits, the nature (progressive, proportional, regressive) of personal income tax and capital gains tax, as well as VAT, real estate tax, tax on heritage. According to the European Commission, it is important to ensure that the overall tax burden on citizens is progressive. At best, this system can help to correct inequalities in market incomes or at least should not increase them (Evropeyska komisija, 2017a, p. 13).

Progressive taxation of personal income provides an opportunity to realize the redistributive function of tax and social security systems. Within the European Union, Ireland, France, the United Kingdom and the Netherlands have the most progressive systems of income taxation, while Hungary, Bulgaria and Latvia have the least progressive systems of income taxation. The corrective effect of tax and social security systems can be assessed by comparing the Gini coefficient of market

income (before taxes and benefits) with the Gini coefficient of disposable income (after taxes and benefits). The strongest redistributive effect in EU countries, expressed in a relative reduction in the Gini coefficient, was observed in Finland, Belgium and Denmark (Evropeyska komisija, 2017a, p. 24).

The driving forces of income inequality vary from country to country. Although unemployment is a major factor in inequality in most EU countries, in some cases such as Bulgaria, Cyprus, Estonia, Lithuania and Latvia, the weak redistributive effect of taxes and social payments plays a leading role (Evropeyska komisija, 2017b, p. 7). This becomes clear when comparing the values of the Gini coefficient, calculated on the basis of gross income before tax and social transfers, and the Gini coefficient, calculated after all direct taxes and social transfers, including pensions.

7.5 Exploring the Possibilities for Achieving Environmental Effects Through Taxation

Environmental taxes are related to four main categories—energy, transport, pollution and resources:

- **Energy taxes:** Includes taxes on energy products used for both transport and stationary purposes.
- **Transport taxes:** Includes taxes related to the ownership and use of motor vehicles. They also include taxes on other transport equipment, such as aircraft and related transport services.
- **Pollution-related taxes:** Includes taxes on measured or calculated atmospheric emissions (excluding taxes on carbon dioxide emissions) and water, on waste management and on noise.
- **Resource taxes:** Includes any taxes related to the extraction or use of a natural resource.

In many cases, there may be environmental and/or economic benefits from combining environmental tax with other regulatory instruments. Environmental taxes are very rarely used in isolation and more regulatory instruments are often used. Revenues from environmental taxes are on average about 2%–2.5% of GDP in OECD member countries, with about 90% of revenues coming from taxes on motor fuels and motor vehicles (OECD, 2006, p. 16).

Environmental taxes can be defined as a mandatory payment to the government imposed on tax bases that are essential for the environment. Relevant tax bases include energy products, motor vehicles, waste, measured or calculated emissions, natural resources, etc. Mandatory payments are also proportional to the services provided (e.g. the amount of waste collected and treated) and can be referred to as fees and taxes (OECD, 2006).

According to the OECD (2006), all Member States impose taxes and charges related to the environment, including: 375 such taxes and about 250 charges related to the environment. The largest number of environmental taxes in OECD countries is levied on energy products and motor vehicles; there are also a significant number of taxes related to waste imposed on certain products, which can cause significant problems in waste management or final disposal of waste, i.e. for incineration and/or disposal. On average, revenues collected from environmental taxes represent about 2%–2.5% of GDP, but there are large differences between countries. For example, in the Czech Republic, Denmark, Finland, the Netherlands, Norway and especially Turkey, revenues accounted for more than 3% of GDP in 2003, while in the United States these revenues accounted for less than 1% of GDP. In the period from 1995 to 2003, there was a tendency for total revenues from environmental taxes to decrease on average over time, even when a number of new taxes were introduced after 1995, which should contribute to increasing revenues. The amount of revenue collected from environmental taxes is an inaccurate criterion for assessing the environmental impact of taxation in individual countries. From an environmental point of view, the aim should be to reduce the size of the tax base by changing the behavior of companies and households, which would cause a decline in income. Thus, a country may have low revenues from environmental taxes either because it applies low tax rates to the relevant taxes, or because it applies very high tax rates that have caused major changes in behavior (OECD, 2006, p. 28).

Over the last decade, the growing role of environmental taxes has been a hallmark of OECD countries' environmental policies, with a growing number of countries implementing comprehensive green tax reforms. Environmental taxes are linked to the "polluter pays" principle, according to which the costs of pollution prevention and control must be reflected in the price of goods and services that cause pollution as a result of their production and/or consumption. These taxes are a tool that can provide incentives for technological innovation and further reduction of pollutant emissions. Taxes on the purchase or use of motor vehicles and fuels, including taxes on petrol and diesel, generate most of the revenue from environmental taxes. In many countries, there is scope for expanding the use of environmental taxes.

Concerns of reduced international competitiveness in the most polluting (often energy-intensive) sectors of the economy are a major obstacle to the widespread application of environmental taxes. Some sectors may indeed face a net loss of competitiveness if countries expand environmental taxation, but other more environmentally friendly sectors of the economy could improve their competitiveness (OECD, 2001, p. 10).

the effects related to income distribution should also be taken into account. The data show that some environmental taxes they can be somewhat regressive, affecting low-income households more and may increase regional income inequalities in some countries. The full assessment of the effects of these taxes should include all compensation payments, tax breaks and the impact their employment. The positive environmental impact of the tax must also be taken into account. Measures to mitigate the effects of the regressive effects of taxation, such as reduced tax rates on lower incomes, can reduce the environmental effectiveness of taxes. Therefore,

the OECD (2001) recommends that governments seek other and more direct measures if low-income households need to be compensated (e.g. transfers). This will make it possible to maintain the price effect of the tax while reducing the impact of the tax on household income.

Shifting the tax burden from labor to pollution in order to reduce the tax burden on labor to encourage labor efforts and thus contribute to reducing unemployment, while having a positive impact on the environment is a frequently discussed option in the formation of modern tax policy, in line with the “double dividend” hypothesis. According to the OECD (2001, p. 12), the theoretical and empirical evidence for a double dividend is not convincing. However, a number of governments are implementing “green tax reform” with the intention of realizing a double dividend. If there is convincing evidence of a double dividend, they could counterbalance the arguments against imposing new or higher environmental taxes on concerns about their adverse effects on competitiveness and equity.

The introduction of an economic instrument and to reduce the harmful impact on the environment may be accompanied by disapproval from certain social groups. The OECD noted the positive attitude to Relevant measures in the public are related to the level of awareness of the environmental problem to be addressed by the instrument and whether it is considered to contribute significantly to its reduction (OECD, 2006, p. 21). In modern conditions, countries face a number of environmental challenges related to the conservation of the ozone layer, local air quality, acidification and eutrophication (acidification and eutrophication), water supply and water quality, waste management and lost biodiversity. Most OECD member countries have a priority goal of reducing greenhouse gas emissions in order to have a positive impact on climate change (OECD, 2001).

Another issue that is being discussed regarding environmental taxes is related to the costs of their administration. It is possible to develop a number of economic instruments for environmental policy with relatively low administrative costs. For example, taxes on petroleum products are usually imposed on a limited number of oil refineries and depots and are relatively easy to administer and apply. And the administrative costs of environmental tax reform in Germany are estimated at only 0.13% of revenue collected. According to the OECD, the administrative costs of an environmental tax system involving a large number of taxpayers can be maintained at a relatively low levels (OECD, 2006, p. 21).

Carfora et al. (2021) examine EU renewable and energy policies (RES) and internal barriers to energy investments. They believe that the evidence of the negative impact of environmental taxes on investments in RES should be interpreted as a sign that higher coordination is needed in order to make environmental tax legislation as homogeneous as possible and to move forward from taxation of renewable to non-renewable energy sources (Carfora et al., 2021, p. 6). These authors conclude that the higher the environmental taxation, the lower the propensity to invest in green technologies. A more effective way to increase investment in green energy requires a combination of support policies, subsidies and lower taxation. Along with support policies to encourage investment in RES, policymakers should implement reforms to promote the transition to clean energy by modifying tax

legislation. For example, by increasing tax revenues from more polluting energy sectors rather than greener energy sources.

Freire-González and Puig-Ventosa (2019, p. 322) indicate that Environmental taxation is one of the preferred policies among environmental economists. However, current environmental taxes in many countries do not have a proper design. The authors also give the example of the Spanish taxes on electricity, which do not differentiate between the types of electricity production and thus do not encourage the use of clean sources instead of polluting sources; they are perceived as *ad valorem* taxes and not as based on actual consumption, which would be more directly related to the actual impact. According to the results of their study, the taxation of non-renewable energy sources creates incentives for greater acceptance of renewable energy sources. They point out that tax reform that stimulates the transition to renewable energy will lead to better environmental and economic results in the medium and long term.

According to these authors, it is necessary to apply special treatment to the production of electricity from biomass, because, although it is classified as renewable, it carries a large amount of associated pollutants. They believe that the transition should focus on the development of other renewable technologies (wind, solar and water) in order to improve all pollutants in the long run. According to them, a tax on specific pollutants, rather than charging industries or technologies, would probably provide better results in terms of environmental performance. In addition to shifting taxes on electricity to non-renewable sources, additional measures can be taken to improve the economic effects of taxation. For example, the use of revenues from these taxes to reduce other existing taxes, such as labor taxes (Freire-González & Puig-Ventosa, 2019, p. 323).

7.6 Solutions and Recommendations

The reduction of personal income taxes it can be a tool to promote higher employment levels and bring about beneficial social effects, such as poverty reduction and social exclusion. The fiscal effect of reducing the tax burden on disadvantaged groups and taxpayers who are more sensitive to income taxation can be offset by shifting taxation to higher incomes or other appropriate tax bases, such as real estate, consumption, environmental pollution. The model of the tax and social security system can have an impact on alleviating inequalities, as well as on social mobility and social cohesion. Therefore, in order to achieve the goals of sustainable development and the well-being of society as a whole, a policy should be pursued in which the overall burden of taxation is progressive. Also, the efforts of those in power, politicians and civil society should be focused on pursuing a tax policy that supports increased investment and innovation, as they are prerequisites for sustainable development and prosperity.

In connection with the implementation of “green” tax reforms, it may be recommended to improve public awareness and to communicate effectively the

environmental problem and which the relevant environmental taxes can solve in order to increase the positive attitude to the environmental measures adopted and the level of tax morale. Opportunities could also be sought to reduce the administrative costs of the environmental taxation system, based on cooperation to share experiences and good practices. When implementing tax reforms aimed at protecting the environment and limiting its harmful effects on it, tax mechanisms should be considered that would stimulate the development of renewable energy sources and limit the use of non-renewable energy sources.

7.7 Future Research Directions

Given the research on the structuring of the modern tax system, it may be recommended to deepen research on the possible “double dividend” related to shifting the burden of taxation from personal income taxes to environmental taxes and arguing the usefulness of “green” tax reforms. To this end, it would be useful to take into account considerations related to concerns about the adverse effects of new or higher environmental taxes in the following respects: (1) on competitiveness in the most polluting sectors of the economy; (2) on equity in taxation, taking into account the possible regressive effect and possible increase of regional income inequalities.

7.8 Conclusion

The modern understanding of the role and functions of taxes makes it possible to look for complex effects in the conduct of tax policy—not only fiscal, but also economic, social and environmental, so that it can be used as part of the tools for sustainable development. In this regard, in the current conditions, the optimization of the tax system should be oriented towards achieving a balance between economic efficiency and social justice in taxation, as well as to the implementation of “green” tax reforms. The realization of these goals should take into account the dynamics of ongoing economic, social and environmental processes—locally, regionally and globally. Therefore, the tax policy should be flexible and adaptable, so as to solve in the best possible way not only the current problems, but also to create favorable conditions for stable development and prosperity of society as a whole.

The tax system of each country is formed under the influence of the dominant concepts and principles for the structure of society and the economy. The applied model of taxation and the conducted tax policy show, in a synthesized form, the leading preferences, attitudes and beliefs in a given country at a certain stage of its development. Therefore, they could be considered as an indicator of the state and capacity of the country concerned.

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Chapter 8

Strengthening the Integrity of the Tax Administration and Increasing Tax Morale



8.1 Introduction

This chapter examines issues related to the possibilities for increasing integrity (integrity) and combating corruption in the tax sphere. In this regard, criteria for assessing the level of integrity in the tax administration are systematized. Leading methodologies applied for quality management in the public sector organizations of the European Union countries, which are based on high ethical standards for achieving organizational excellence, have been studied. These issues are related to the possibilities for increasing the integrity (integrity) and improving the performance in the revenue agencies. The impact of the principles of good governance and the goals for sustainable development in the activity of the revenue agencies has been studied. These issues are related to the possibilities for improving the reputation of the tax authorities and the credibility of their work, as a prerequisite for increasing voluntary tax compliance.

The importance of tax morality for compliance with tax legislation has been studied, as well as the main factors influencing the willingness of individuals to pay taxes, with an emphasis on non-economic factors. In this regard, attention is paid to the motives of taxpayers, their attitude to taxation and their behavior, in order to broaden the understanding of tax morality and its mechanisms. Attention is paid to the characteristics of the main types of taxpayers and those who tend to avoid taxes. The influence of social norms, sanctions and law enforcement on the level of tax compliance is considered.

Measures against corruption in the field of taxation have been studied, with an emphasis on building ethical relations and maintaining integrity in the system. These issues are related to the possibilities for ensuring the public interest in the functioning of revenue agencies by increasing their transparency and exercising reliable supervision over their activities. In this regard, the main aspects of human resource management strategies in tax administrations have been studied; The current trends

for reforms in the revenue agencies of OECD countries, aimed at combating tax fraud and increasing the efficiency of public debt collection, are also discussed.

The purpose of this chapter is to contribute to increasing the integrity of the tax system, as well as to developing modern tax policies based on understanding the behavior of taxpayers and various factors of economic and non-economic nature that affect tax compliance.

8.2 Background

Studies of the applied principles of good governance in public sector institutions indicate that ethical behavior is perceived as an independent principle (Institut po publichna administratsia, 2015). In fact, this principle could be considered a “cornerstone” in the practical implementation of good governance, because without its implementation in the institutional culture and activities of revenue authorities is impossible to implement other principles of good governance, including rule of law, efficiency and effectiveness, openness and transparency, human rights, competence and capacity, responsiveness and openness to change.

Public sector institutions, incl. Revenue agencies are increasingly focused on applying the principles of good governance and adopting sustainable development goals. In this regard, quality management methodologies are applied in order to improve administrative activity. For example, the Common Assessment/Self-Assessment Framework (CAF), adopted as a standard for quality management systems in the public administration of the European Union. CAF is based on the concepts of organizational excellence initially defined by the European Foundation for Quality Management's (EFQM) Organizational Excellence Model and adapts them for public sector application in order to improve the efficiency of public institutions and organizations. In this regard, eight fundamental principles of organizational excellence have been defined (Institut po publichna administratsia, 2013a), which distinguish the traditional bureaucratic public organization from the public organization oriented towards total quality:

- Focus on results that satisfy all stakeholders in achieving the set goals.
- Focus on the needs of current and potential citizens/consumers.
- Inspiring leadership with a clear mission, vision and values of the organization, creating and maintaining an internal environment in which people can participate fully in achieving the goals of the organization, as well as ensuring consistency of goals in a changing environment.
- Management of related resources and activities as a process, and basing decisions on data and information analysis.
- Optimizing the contribution by involving and developing employees, creating a working environment of shared values, a culture of trust, openness, empowerment and recognition.

- Improving the organization through continuous learning to innovate and improve opportunities.
- Develop and maintain useful partnerships and relationships that increase the capacity of countries and create value.
- Taking social responsibility by public sector organizations, respecting environmental sustainability and striving to meet expectations and requirements at the local and global level.

Therefore, ethics is built into the CAF, because without integrity, organizational excellence cannot be achieved. Based on the results of a study of self-assessment practice in public organizations in European Union countries (Institut po publichna administratsia, 2013b), some examples can be given:

1. **Leadership Assessment:** Develop a management system that prevents unethical behavior and also supports employees in dealing with ethical dilemmas that arise when different values of the institution are in conflict.
2. **Evaluation of results related to people:** Achieved results in terms of competence, motivation, satisfaction, attitudes and performance of employees. Awareness of staff of possible conflicts (e.g. a member of staff teaching a relative) and the importance of ethical behavior (e.g. attitude towards intellectual property).
3. **Evaluation of the results related to social responsibility:** Outside of its main mission, the institution should adopt responsible behavior in order to contribute to sustainable development. This may include the organization's approach and its contribution to quality of life, environmental protection, protection of global resources, equal employment opportunities, ethical behavior, public engagement and contribution to local development. In relation to this aspect of the evaluation, it is important to take into account the views on transparency, the impact on the quality of life and democracy, the support of citizens, the approach and results in terms of the environment.

Ethics in public services can be defined as those common values and norms that employees in public organizations must observe in the performance of their duties. The moral nature of these values/norms, which can be formulated or implied, refers to what is considered to be right, wrong, good or unacceptable behavior. While values serve to establish moral principles, norms can indicate what is legal and ethical in a given situation (Institut po publichna administratsia, 2013a, p. 76).

According to the principles of good tax administration of the OECD (2001), the role of revenue authorities is to ensure compliance with tax legislation, and the promotion of voluntary tax compliance should be their main goal. It is pointed out that the ways in which the revenue authorities interact with taxpayers and employees influence the public perception of the tax system and the degree of voluntary compliance. Taxpayers who are aware of their rights, expect and receive fair and effective treatment are more likely to comply. Qualified and committed employees who are valued and treated fairly will be more likely to act honestly and professionally in all their dealings with taxpayers. Voluntary compliance is also encouraged

through clear and simplified administrative systems and procedures. Voluntary compliance improves when it is easier for taxpayers to do so.

The OECD (2013, p. 2) emphasizes the importance of tax morality for tax compliance, citing data from the World Values Survey (WVS), a global research project that conducted representative national surveys in almost 100 countries examining changes in values and people's beliefs under the influence of social and political factors. The WVS is a source of empirical data on people's attitudes towards tax compliance, democratic governance and trust in government, covering the majority of the world's population (nearly 90%). Research shows that despite the strong correlation between a country's level of development and its tax revenues, there are significant differences between countries at similar stages of development. For example, Jordan and Guatemala have very similar levels of GDP per capita, but tax revenues in Jordan are about 33% of GDP, while in Guatemala revenues are only about 13% of GDP. Also, citizens of some countries are happy to pay their taxes, while others do not (OECD, 2013, p. 1). These differences can be explained through the prism of tax morality: research on tax behavior shows a significant link between tax morality and compliance with tax requirements in both developing and developed countries. Tax morality is an important determinant of the "gray economy" and has a significant impact on tax evasion (Torgler, 2011). Research to date (OECD, 2013) has identified a number of socio-economic and institutional factors that can influence people's willingness to pay taxes:

- **Socio-economic factors:** Includes marital status, religion, gender, educational attainment, employment status, economic status (eg self-reported) and economic problems (whether the household can save and manage or should save and borrow).
- **Institutional factors:** They concern the government and citizens' perceptions of spending taxes, thus influencing their willingness to pay them. These factors include support for democracy, trust in government and redistribution preferences, such as whether taxing the rich and subsidizing the poor is a priority.

8.3 Increasing the Integrity of the Tax System

Clarifying the issue of increasing the integrity (integrity) in the tax sphere implies a study of its determinants: on the one hand, ethics in the tax administration and on the other—tax morality.

Adopting the principles of good governance and the Sustainable Development Goals (SDGs) draws attention to the issues of integrity in the tax system, as the level of integrity determines the aspirations and actions aimed at strong institutions and partnerships to achieve the SDGs (United Nations, 2015). The specific aspects that directly concern the activities of the revenue agencies are the following:

- Promoting the rule of law (including compliance with tax laws) at national and international level and ensuring equal access to justice for all.

- Significant reduction of illegal financial and arms flows by 2030, enhanced recovery and recovery of stolen assets and the fight against all forms of organized crime (tax crimes are often linked to other types of financial crime).
- Significant reduction of corruption and bribery in all its forms.
- Development of effective, accountable and transparent institutions at all levels.
- Ensure at all levels an inclusive decision-making process based on the principles of responsiveness, greater participation and representation.
- Ensuring public access to information and protection of fundamental freedoms in accordance with national law and international agreements.
- Strengthen relevant national institutions, including through international cooperation, with a view to building capacity at all levels, especially in developing countries, to prevent violence and combat terrorism and crime.
- Promoting and implementing non-discriminatory laws and policies for sustainable development.
- Increased mobilization of own resources, including through international support for developing countries, in order to improve national capacity to collect taxes and other revenues.

In recent years, one of the priorities in tax reforms in the countries of the European Union (EU) is related to compliance with tax legislation (Evropeyska komisija, 2017, p. 25). The approach taken in this direction is related, on the one hand, to the promotion of voluntary compliance with tax obligations and, on the other hand, to the application of enforcement tools. The aim is to ensure compliance with tax legislation and the implementation of tax policy, using all the power of the revenue authorities to ensure compliance with the rules by taxpayers, including: means of cross-border cooperation, effective audits, access to information and intelligence, and the implementation of efficient tax collection procedures. In addition, it is essential to promote trust, transparency and a culture of compliance with tax legislation through various means:

- Informing taxpayers about the value created through tax revenues; monitoring and displaying the results of the activities of the tax authorities.
- Encourage taxpayers to be more ethical in paying their taxes, using communication and education campaigns to explain why it is important for everyone to pay their fair share. They should be aimed in particular at young people as future taxpayers.
- Collaborate with businesses to improve compliance with tax legislation, using information on the behavioral economy to encourage taxpayers to perform their duties properly and in a timely manner.

Hauptman et al. (2014) believe that the size of the informal economy gives an initial idea of the degree of tax evasion. According to Robinson and Slemrod (2012), and Kleven et al. (2011), cited by Hauptman et al. (2014, p. 481), a significant part of tax evasion consists in lowering the declared values in the official sector. The ability to declare unreliable values and the level of tax morale are decisive factors for the gray economy and the amount of hidden taxes. In this regard, a better understanding of

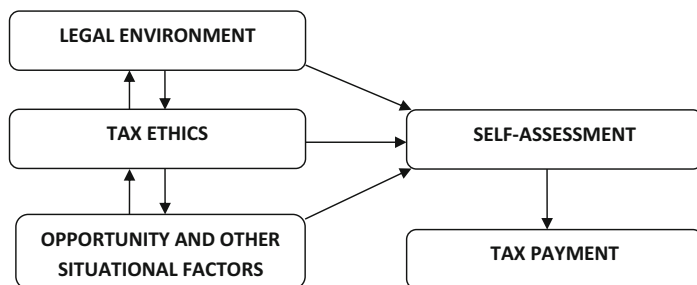


Fig. 8.1 Model of taxpayer compliance behavior. Source: Song and Yarbrough (1978)

taxpayers' motives and attitudes towards taxation can improve both voluntary compliance and the efficiency of tax administration.

Compliance with tax laws is influenced by five main factors—deterrence, personal and social norms, the complexity of the tax system, the economic environment, fairness and trust in the tax administration. An OECD study (2010) distinguishes between three types of fairness in taxation.

1. **Distributive fairness:** Understanding that the government spends tax revenues wisely.
2. **Procedural fairness:** Understanding that the tax administration adheres to procedures that are fair when working with taxpayers.
3. **Retributive fairness:** The perception that the tax administration is fair in enforcing penalties when the rules are broken.

Hauptman et al. (2014) conclude that tax evasion resulting from shadow economic activities and incomplete reporting of income in tax returns leads to unintentional redistribution from those who follow the rules to those who do not follow the rules and creates unfair competition between formal and informal participants. This further weakens tax morale and may lead to more tax evasion.

According to Song and Yarbrough (1978, p. 442), in a tax system largely based on voluntary tax compliance, standards of tax ethics for taxpayers are extremely important. Also important are the attitude towards fiscal and tax policy, tax audits and audit experience, the appropriate distribution of the tax burden, the fairness and efficiency of the tax administration, the fairness of certain taxes and the shortcomings of the income tax. In countries where the tax collection system is largely based on voluntary compliance by taxpayers, a high standard of tax ethics is crucial. If a significant proportion of taxpayers evade their tax obligations, then no effort by the tax administration will be able to provide adequate revenue for the government. Therefore, these authors study the level of tax ethics among taxpayers and what influences it. They present a simple model of taxpayer compliance behavior, which is shown below in Fig. 8.1.

Song and Yarbrough (1978, p. 444) point out that voluntary compliance, including self-assessment and eventual payment, is determined by three main factors: the overall legal environment, citizens' tax ethics and other situational factors operating

at a given time; and place. They believe that all these factors are to some extent interrelated. The legal environment influences tax ethics and tax ethics standards are influenced by situational factors.

1. **Equal environment:** Legitimacy of laws, the effectiveness of law enforcement, understanding of citizens and acceptance of their legal obligations.
2. **Tax ethics:** The norms of behavior governing citizens in their relations with the government have a significant effect on the behavior related to compliance with tax legislation.
3. **Situational factors:** They facilitate or hinder voluntary compliance, such as income levels, unemployment rates, tax rates and the efficiency of the tax administration.

In connection with the need to increase the integrity of the tax system, the results of the research of Song and Yarbrough (1978) in the following aspects can be taken into account:

- **Taxpayers' attitudes and knowledge of the tax system:** Actual behavior may differ from taxpayers' attitudes. Due to technical complexity, fiscal and fiscal policies rarely arouse public interest or curiosity, so a lack of public knowledge in this area can be expected.
- **The impact of tax audits:** They are held in order to increase revenues and maintain the desire for voluntary compliance with tax laws. In this regard, the main assumption is that the public is encouraged to comply more with the law, if there is a real likelihood that some specific declarations will be audited. People tend to refrain from using forms of tax evasion that are easiest to detect during an audit.
- **The impact of the applied approach for distribution of the tax burden among the citizens (proportional or progressive taxation):** For most middle-class taxpayers, the idea that people have to pay taxes according to their solvency (the progressive tax system) is an acceptable basis for allocating the tax burden.
- **The impact of administrative efficiency and fairness:** The high trust and good reputation of the revenue agency in the public is a great advantage. In this direction, the following have an adverse effect: imperfections in the laws and errors in the administration; unequal treatment of taxpayers in different places and at different stages of tax proceedings; the feeling that they receive less aid from the government than they pay taxes; the assessment that the tax administration is inefficient; the efforts made by individuals to prepare and file a tax return.
- **The impact of the types of taxes applied:** The preference for indirect taxes at the expense of direct taxes (income and property taxes) is growing. In relation to income taxation, citizens most often point out as problems: too high tax rate, too many "loopholes" in the laws, too complex to understand regulations, burdening the middle class with the highest tax burden and "punishing" the honest and law-abiding.

The results of research (Song & Yarbrough, 1978, p. 451) on taxpayers' attitudes and attitudes show that: (1) the loss of confidence in government policy and the

unstable political system lead to inefficiency of the tax system; (2) the ever-increasing tax burden, without tax laws becoming simpler and fairer, leads to a deterioration in tax ethics.

The standard model of Allingham and Sandmo (1972) assumes that risk-averse individuals weigh the benefits and costs of tax evasion in order to optimize their compliance with regulatory requirements. According to this model, a higher penalty or a higher probability of disclosure should lead to a reduction in tax evasion. However, the authors note that their model does not cover all motives for tax compliance and pays little attention to non-monetary factors in taxpayers' decision whether to evade taxes.

Luttmer and Singhal (2014, p. 149) point out that the tax authorities focus mainly on law enforcement, but they also seek to increase tax morale in society, i.e. creating a social norm for compliance with tax laws and voluntary compliance. According to them, tax administrations pursue policies that reflect their belief that non-monetary factors are important in decisions to comply with tax laws. They point out that more than half of the US states have programs that reveal the names of top tax debtors publicly on government websites. As an alternative to shaming tax evaders, public recognition of taxpayers and large taxpayers can be applied, a strategy adopted by a growing number of developing countries.

These authors consider tax morality as non-monetary motives for compliance with tax legislation. For example, people may have some intrinsic motivation to pay taxes or feel guilt or shame for non-compliance. They may comply with tax laws due to reciprocal motivation, i.e.: the desire to pay taxes in exchange for benefits provided by the state to them or other members of society, although their remuneration would be higher if not pay taxes. Individuals may also be influenced by the behavior of others and the possibility of social recognition or sanctions from the environment. Cultural or social norms can affect the strength of these internal motives, reciprocal motivation or sensitivity to the environment. Luttmer and Singhal (2014, p. 151) recognize that public recognition could improve companies' reputations and, as a result, increase their revenues. According to them, tax morality has a significant impact on tax compliance decisions, although they see law enforcement as a key driver of law enforcement.

Tax morality is usually used as a concept, but it can be more accurately described as a set of basic motives for compliance with tax law (Luttmer & Singhal, 2014, p. 155). The main mechanisms through which tax morale could work are the following:

- **Internal motivation:** Determines the amount of taxes that the individual decides to pay.
- **Reciprocity:** It depends on the individual's attitude towards the state, such as the public goods provided by the state or perceptions of the fairness of the tax system.
- **Impact on environmental and social influences:** Paying taxes may depend on the views and behavior of others.
- **Long-term cultural factors:** May affect the willingness to pay taxes.

- **Information imperfections and maximizing utility:** Individuals may misunderstand the likelihood of being exposed to tax evasion (i.e. the likelihood of an audit and its consequences) and may be reluctant to lose.

Understanding tax morality and its mechanisms enables tax policy makers to have access to a wide range of tools to influence tax compliance when dealing with tax evasion. Encouraging taxpayers by presenting information in a more accessible form or by instructing and reminding them to pay can also reduce tax evasion (Luttmer & Singhal, 2014).

According to Chang and Lai (2004), the traditional literature only looks at the actions of taxpayers and ignores the different types of behavior of other agents, such as all related third parties (customers) involved in the tax collection process. They point out that in many countries, a common sales tax is an important source of revenue for the government, but sales tax evasion is widespread. However, compared to studies on personal income tax evasion, sales tax evasion has not been sufficiently analyzed. In this regard, they investigate the joint tax evasion of the seller and his customer. Such co-tax evasion is prevalent not only among many small suppliers and family businesses, but also among other so-called “difficult to tax” taxpayers, including independent contractors (tenants, restaurants, builders, etc.) and independent professionals (plumbers, lawyers, architects, etc.). According to these authors, joint tax avoidance behavior is widespread in many Asian developing countries. Thus, in order to avoid sales taxes, many small businesses in Asian countries maintain two sets of accounts.

Increasing the penalty for tax evasion can create space for sellers and their customers to profit from trade through joint tax avoidance activities. The undercover seller may give his customers a discount on the price in exchange for their cooperation, to avoid punishment. Some consumers are willing to participate in joint tax avoidance (in whole or in part), for example through money transactions or by accepting illegal receipts and invoices in order to earn a discount. With the increase of these venal consumers, the deterrent effect of sanctions imposed for tax evasion may be reduced by the vicious sales effect (Chang & Lai, 2004, p. 346).

The consumer is more likely to comply with the social norm and refuse to participate in joint tax evasion if there are many other customers who also do so. On the contrary, if the social norm can not sufficiently deter non-compliance with tax laws, it will fall apart and joint tax avoidance will increase. If sales consumers predominate in the economic system, then the social norm tends to increase the degree of joint tax evasion (Chang & Lai, 2004, p. 347).

Sandmo (2005, p. 649) points out that, from the taxpayer’s point of view, in order for tax evasion to be optimal, it is necessary and sufficient that the expected penalty rate be lower than the normal tax rate. He points out that it is important to distinguish between different types of income, as the probability of disclosure is not the same if they are not declared. Salary income tax is usually reported by the employer and will be likely to be discovered if the taxpayer is tempted to lower it; in this case, the model predicts that there will be no attempt to avoid it. In addition, empirical research shows that people tend to overestimate the likelihood of detection. He

also points out that people refrain from tax evasion as well as speeding, shoplifting and environmental pollution, not only because of their assessments of the expected punishment, but also for reasons related to social and moral considerations.

Becker's (1968), quoted by Sandmo (2005, p. 659), believes that the goal of achieving a certain degree of deterrence of tax fraud can be achieved through high probability of detection (frequency of audits) and low penalties or low probabilities of detection and high penalties. According to him, the desire to reduce the cost of tax administration leads to the preference of the second alternative. Concerning the arguments for a lower marginal tax rate to tackle tax evasion, Sandmo (2005, p. 660) points out that the optimal tax analysis does not offer a clear conclusion on this issue. He expressed the view that punishment and auditing were more appropriate tools, at least as long as tax evasion was not a predominant social problem. The decision to evade taxes may depend on the individual taxpayer's perceptions of the behavior of others. The more widespread the concealment, the more socially acceptable it may become and the lower the subjective assessment of the likelihood of detection. According to him, this is a good reason to control tax evasion; relaxing policy measures in this direction can trigger mechanisms that lead to a much lower level of compliance with tax laws. The author draws attention to the influence of political and economic forces that determine the policies that taxpayers follow. Is skeptical that the low level of enforcement of tax laws in some sectors or countries is entirely due to cost considerations; it may also be due to the resistance of the electorate to achieve a higher compliance rate. According to him, the reasons for such resistance may be—the assessment of the overall fairness of the tax system and the personal interest in poor law enforcement (Sandmo, 2005, p. 660).

Blackwell (2002), cited by Benno Torgler (2003a, p. 286), focuses on experiments that examine the impact of traditional determinants, such as tax rate, audit probability, and fine. The results show that increasing audits and fines will increase tax compliance; there is a tendency for higher tax rates to reduce tax compliance, but it is not significant.

Pommerehne et al. (1994), cited by Benno Torgler (2003a, p. 286), analyze the relationship between the provision of public goods, government waste, considerations of fairness and tax compliance by taxpayers. They focus on morality as a human inclination and pay attention to taxpayer behavior; model the interaction between the individual and institutions as a dynamic process to track the erosion of morality. According to them, periodically the individual reflects on the experience so far and decides how much taxes to pay; factors such as a higher number of fellow citizens who have paid lower taxes and a higher level of government waste lead to less willingness to pay taxes.

Torgler (2003a, p. 287) points out that in some tax audit practices, those taxpayers who are known not to have complied with the requirements in the past will be audited more frequently in the future; taxpayers who declare lower income than some threshold level will certainly be audited. Alm et al. (1993), cited by Torgler (2003a, p. 287), consider that such audit rules can generate significantly greater compliance than random audits. Torgler (2003a) considers tax morality (intrinsic motivation to pay taxes) as a dependent variable, and therefore examines the factors

that shape it. He points out that data from the World Values Survey (WVS), choosing Canada, have found convincing evidence that trust in government, national pride and religiosity have a systemic positive effect on tax morality (Torgler, 2003a, p. 297).

According to Alm et al. (2010, p. 1), the tax administration has traditionally focused on law enforcement—looking at taxpayers as potential criminals and emphasizing suppressing illegal behavior through frequent audits and severe penalties. However, in recent years the tax administration recognizes this paradigm is incomplete on. Instead, a new approach is being applied with an emphasis on the services that the tax administration provides to taxpayers. The role of law enforcement is recognized, but the supporting role of the tax administration as a service provider for taxpayers is also emphasized. The results of their research show that the policy of increasing the information services of the tax administration, which allows taxpayers to calculate their tax liabilities more easily, along with improving the image of the tax administration (positive perception of citizens), can be a useful tool to combat tax evasion. They recommend having comprehensive policies that take into account the diverse motives of individuals to comply with tax laws.

Based on an analogy with the results of the work of Vogel (1974), Torgler (2003b, p. 188) defines four main types of taxpayers:

1. **Social Taxpayers:** They are influenced by social norms, feel guilty when they declare less, avoid being exposed and are ashamed when they do not declare and are caught. In addition, they are very sensitive to the beliefs of people, especially their loved ones. They react emotionally and very strongly to the changes they feel: if others pay taxes, they are also willing to pay; on the other hand, reducing the contribution of others reduces their willingness to contribute.
2. **Intrinsic Taxpayers:** The motivation of these taxpayers includes a sense of obligation that motivates a person without being forced. They are sensitive to institutional factors, such as the behavior of the government or the tax administration. The way the government treats people affects their assessments and their willingness to cooperate. They have a certain inherent motivation to pay taxes. Their willingness to cooperate does not depend on the extent to which others contribute to society, but they depend on the institutional conditions under which they have to pay their taxes.
3. **Honest Taxpayers:** These taxpayers are not even looking ways of tax fraud. Their behavior does not correspond to changes in tax policy parameters, such as taxes, fines or audit frequency.
4. **Tax Evaders:** They are at the other extreme and have low tax morale. They take into account the possibility of a higher penalty or a higher probability of an audit. It can be argued that these taxpayers compare the value of tax evasion with the value of honesty.

Torgler (2003b, p. 195) points out that if there are different types of taxpayers, tax policies can have different effects on them. Thus, finding strategies that have a positive effect on all types of taxpayers is a challenge. A government based on a well-functioning democratic government creates more trust than a dictatorship. Lack of public confidence can undermine government revenues and thus the ability of

government to perform its functions. Scholz and Lubell (1998), Slemrod (2000) and Wintrobe (2001), cited by Torgler (2003b, p. 195), draw attention to “trust” as the determinant. According to them, trust in civil servants can increase the positive attitude of taxpayers to the tax system and the payment of taxes, which has a positive effect on tax compliance.

Slemrod (2007, p. 31) examines the characteristics of those who tend to avoid taxes and reaches the following conclusions: (1) the rich tend to reduce their taxes through legal “avoidance” measures, such as tax havens, while those on lower incomes seek more outright evasion; (2) married taxpayers and taxpayers under the age of 65 have significantly higher average levels of inconsistency from others; (3) men avoid more taxes than women; (4) private companies may be more aggressive in looking for ways to lower taxes than public companies, as the former have less pressure on the capital market and can therefore “sacrifice” high-income reporting to reduce taxes due; (5) there is a positive relationship between the amount of intangible assets that the company owns and its tax deficit, which is explained by better opportunities for tax planning; (6) the percentage of annual remuneration of executives in the form of bonuses and the level of equity incentives from applicable share options are positively related to the tax deficit (tax deficiency).

8.4 Counteracting Corruption in the Field of Taxation

Corruption is identified as one of the main problems in developing countries, which has been the focus of attention since the last decade of the twentieth century, as it takes into account the economic and social damage it causes (Klitgaard, 1988). Leading economies also do not function without corruption, but they implement effective measures to counter and control its scale so that it does not undermine the foundations of a democratic society. Countries with stronger political competition are characterized by a stronger public response to corruption through laws, democratic elections and independent media (Shleifer & Vishny, 1993, p. 610). Globally, corruption is increasingly the main cause of public protests and is one of the main topics in election campaigns, as it poses a threat to the activities of individual departments and institutions, as well as national development in general. Therefore, in modern society, reliable mechanisms are sought to establish the rule of law, the transparent work of institutions and the fight against corruption. Klitgaard (1988) believes that the most harmful effect of corruption is the incentives for unproductive behavior it creates in citizens and the administration, as people begin to look for ways to engage in corruption schemes instead of acting more effectively. He points out that corruption thrives in an environment of ignorance and insecurity.

Because integrity is a barrier to corrupt practices, issues of maintaining integrity in systems are often linked to anti-corruption measures (Nikolova, 2019). These measures usually include stricter ethics rules and mechanisms for prevention, monitoring and more effective sanctions (Georgiev, 2009). There are many definitions of corruption in the specialized literature. For the purposes of the present study, it will

suffice to clarify this concept, in general, as defined by Klitgaard (1988): “Corruption exists when the individual wrongfully puts his personal interests above those of the people or ideals he has promised to serve. It comes in many shapes and sizes—from insignificant to spectacular. It can include promises, threats, or both. The initiator may be a civil servant or an interested client; the result may be an act or omission of one of the parties; may include illegal or lawful services; it may be inside or outside a public organization.” (Klitgaard, 1988, see p. xi). As risk areas for the development of illegal and corrupt behavior can be mentioned—the tax authorities, police, customs agencies, public procurement. Various authors (Klitgaard, 1988; Noonan, 1984) point out that corruption is at the heart of an ethical problem and analyze the moral, philosophical, theological and cultural aspects of corrupt behavior, along with the economic one.

In accordance with the OECD Principles of Good Tax Administration (2001), revenue authorities are encouraged to build ethical relationships with taxpayers and employees, as follows:

- **Relations with taxpayers:** They apply tax laws in a fair, reliable and transparent manner; communicate to taxpayers their rights and obligations, the possibilities for appeal, procedures and protection mechanisms; provide quality information and respond promptly to inquiries, requests and complaints from taxpayers; provide accessible and reliable information services on the rights and obligations of taxpayers.
- **Relationships with employees:** They maintain high ethical standards and communicate with their employees in an ethical manner; identify and resolve conflicts of interest between public duties and personal affairs of employees; recruit and promote employees on the basis of merit and equal opportunities, and protect them from arbitrary dismissal; maintain high professional standards by providing effective training opportunities for employees to enable them to deal with the complex tax challenges of globalization; provide remuneration to employees at a level sufficient to attract and retain competent persons.

Counteracting corruption is closely linked to accepted ethical standards and values in the tax administration and in society as a whole, as it requires a high level of integrity. OECD surveys (2015) conducted over many years have found that most revenue agencies develop a strategic plan covering a medium-term period of 3–4 years. Such documents aim to define the key directions and priorities, the organizational goals and tasks for the respective period, against the background of a announced organizational mission, vision and set of values. Excerpts from published strategic plans of some revenue authorities (Australia, Latvia, New Zealand, South Africa, the United Kingdom and United States) shows that the values accepted (norms of conduct) by revenue authorities usually include—honesty, professionalism, mutual respect, trust, fairness (procedural justice), continuous improvement and innovation. Some revenue authorities (such as the United States and South Africa) are included in their plans a brief description of the main environmental factors that have influenced their strategic decisions. For example, in its plan, the South African Revenue Service (SARS) is concerned about the spread of corruption in the public

sector as a whole and the threat it poses to voluntary tax compliance (OECD, 2015, p. 114).

In most countries, the tax system is responsible for generating the vast majority of the revenue needed to finance public services. According to the OECD, revenue authorities need adequate powers and autonomy to work effectively and efficiently. On the other hand, they must work in a fair and impartial manner, be subject to a number of inspections to ensure the transparency of their activities and proper accountability for the overall governance of the tax system (OECD, 2015, p. 23).

According to the OECD, more than half of the countries surveyed (32 out of 56 countries) have set up semi-autonomous revenue administration bodies (OECD, 2015, p. 29) in the following variants:

1. **Unified semi-autonomous body:** The functions of the tax administration, together with the supporting functions (e.g. IT and human resources) are performed by a single semi-autonomous body, with the head reporting to a government minister (usually the finance minister).
2. **Unified semi-autonomous body with formal board or advisory group comprised of external officials:** Tax administrative functions, together with the necessary supporting functions (e.g. IT and human resources) are performed by a single semi-autonomous body headed by a government minister and manager/supervisory board composed of external staff.

These revenue bodies (revenue agencies), which are set up as semi-autonomous bodies (with or without a board), consistently report that they have greater autonomy than single or multiple directorates within the structure of the Ministry of Finance, especially in relation to—allocation of budgetary resources, determination of staff levels and composition, criteria for recruitment, recruitment and dismissal, and negotiation of remuneration levels. The OECD emphasizes that even with increased autonomy, revenue authorities still need to work in frameworks that ensure that they remain accountable to the government and the citizens they serve. To this end, management boards composed of external representatives can be established and supervised by external agencies that monitor the day-to-day operation of the tax system (2015, p. 33).

According to the OECD (2015, p. 42), in 11 countries a management (advisory) board or council has been set up between the revenue authority and the relevant minister to provide independent advice on the revenue authority's plans and actions, as well as arrangements of the tax administration. In all cases, the members of the board shall include non-revenue officials. Although the specific functions of the boards (councils) vary from country to country, they all perform oversight functions and/or have a role in strategy development and planning, approval of core policies, signing of official budgets and business plans, and overall evaluation of performance. Without exception, the members of the board do not participate in issues related to the taxation of individual taxpayers and do not have access to specific information about taxpayers. Also, in the formation of the supervisory functions, it is important to ensure the implementation of an independent ongoing review of the implementation of the revenue authority—not only formally, but with a real

possibility for adjustments. In this regard, the number of members who form the Supervisory Board, how they are nominated, elected and replaced, how decisions are made, to whom they are reported and how their implementation is monitored are crucial.

In connection with the independence (autonomy) of the revenue authorities, there is a need for reliable control over the activities of the tax administration to ensure that it is lawful and in the public interest. This also requires the implementation of effective anti-corruption control in the tax system. Governments in ten OECD countries have set up independent and specialized bodies to deal with complaints about the tax administration (tax ombudsman); in the majority of other countries, the handling of taxpayers' complaints is the responsibility of the Government Ombudsman's Office (or a similar body); two countries (Australia and the United States) have established a separate and independent supervisory authority for the tax administration (OECD, 2015, p. 22).

The governments of Australia and the United States have set up specialized bodies, independent of the revenue authority, to report on the performance of the tax administration. These bodies work separately and independently of the national audit bodies, which monitor the work of all state agencies. For example, in the United States, the attention of The Treasury Inspector General for Tax Administration (TIGTA) is focused entirely on the tax administration in order to ensure independent oversight of the activities of the Internal Revenue Service (IRS). According to the OECD (2015, p. 47), TIGTA's audit and investigative activities have the following purpose:

- Promoting economy, efficiency and effectiveness in the administration of the nation's tax system.
- Detection and deterrence of fraud and abuse in IRS programs and operations.
- Protect the IRS from external attempts to corrupt or threaten its employees.
- Review and make recommendations on legislation and regulations related to tax programs and operations.
- Prevent fraud, abuse and deficiencies in IRS programs and operations.
- Informing the Secretary of the Treasury and Congress about the problems and the progress made in solving them.

The level of the salary, the periodic evaluation of the implementation and the linking of the additional remuneration (bonuses) of the revenue bodies with the results of their work, the opportunities for professional development, the creation of a supportive work environment—these are factors influencing the motivation of employees, the quality of their work and their propensity to engage in corrupt practices. In the conditions of increased autonomy of revenue agencies, which, according to the OECD (2015, p. 33), covers the hiring, management and release of human resources, as well as the process of forming the remuneration of revenue authorities, it is essential to deal with Corrupt behavior of employees becomes the level of integrity in the system. The tone of the summit is crucial for the efficient and effective operation of revenue agencies and tackling corruption in the tax system. This is related to the establishment of high ethical standards, ethical norms and

values as part of the institutional culture. It is not enough just to formally introduce a Code of Ethics for the revenue authorities, but to implement it in the activities of the tax administration. Also crucial to success is the personal example of the governing bodies in the revenue agencies. The possibility to make independent decisions regarding the selection and development of staff, the periodic evaluation of the implementation and the formation of remuneration of the revenue authorities creates preconditions for unscrupulous targeting and treatment of human resources in the tax administration. When decisions on who will be appointed, promoted, rewarded, punished or dismissed are taken autonomously, without maintaining a reliable level of integrity and oversight in public sector institutions, the actual results may be unfavorable from the point of view of public interest.

An OECD study (2015, p. 142) analyzed aspects of the human resources management strategy in Member States' revenue agencies. The majority (88%) of revenue authorities report having a formal human resources management strategy, and the vast majority (93%) have assessed current and future skills needs and the availability of plans, to meet these needs. Most revenue authorities (80%) have staff remuneration levels linked to public sector pay scales. More than two-thirds say they have some flexibility in rewarding good performance. Most revenue authorities report having staff development initiatives to increase business awareness (63%) and risk management capacity (89%). In OECD countries, most revenue authorities have a sufficient degree of autonomy to manage recruitment, although for most this is subject to budgetary constraints set by the government or the Ministry of Finance. Based on an analysis of the results of this large-scale survey of revenue agencies in OECD countries, the following conclusions: (1) the amount of the remuneration of the revenue authorities is flexible and is formed in the administration, based on an assessment of good performance; (2) staff development is not focused on ethical behavior, but rather on the development of professional competence.

There is an inverse relationship between the level of integrity and corruption in an organization (system): the more honest the employees, the lower the level of corruption. Therefore, the fight against corruption always presupposes the affirmation of moral values, where the "the tone of the top" and the personal example of the leadership in the organization are especially important. In this sense, it is necessary not just to have a Code of Ethics in an organization, but its norms to be accepted as values by the staff and to comply with them. The adoption of high ethical standards in the work of revenue authorities can contribute to: achieving a productive work environment and building a culture of employee empathy for work processes and activities; self-awareness and personal responsibility for honest behavior; high quality of the provided administrative services and building a positive public image of the revenue agency (Nikolova, 2019).

Based on a study for the period from 2007 to 2017 of the interaction and integrity in the system of the National Revenue Agency (i.e. the reformed tax administration of Bulgaria, in connection with the country's accession to the EU), conclusions were drawn and conclusions (Nikolova, 2019) that relate to ethics and integrity in revenue agencies:

1. Well-functioning quality management systems (QMS) contribute to the development of interaction and integrity in an organization. On the other hand, integrity is at the heart of quality management, because without it it is not possible to improve activities and work processes.
2. The main tools that can be used to ensure and maintain integrity in the system of the Revenue Agency are: introduction of anti-corruption measures; developing ethical standards, a human resources management strategy and a handbook for newly recruited staff; maintaining an efficient quality management system in line with modern standards and developing a manual for the application of its components; introduction of mechanisms for assessment of personal performance and rewarding the personal contribution of employees in the work processes.

In addition to the existence of ethical norms for the conduct of revenue authorities, the functioning of reliable mechanisms for the supervision of revenue agencies and objective handling of complaints against the tax administration, to tackle corruption in this area, it is also important reliable accountability and transparency in the system. Over the last decade, much of the reforms made in public sector institutions have been related to the issue of organizational autonomy. According to Crandall (2010), there is a tendency for governments to increase the autonomy of their departments and agencies in order to achieve better performance by removing barriers to their effective and efficient governance, while maintaining adequate accountability and transparency. In public administration, autonomy usually refers to the extent to which a government department or agency is able to operate independently of government in terms of funding, budget, human resources and administrative practices. It can be assumed that expanding the autonomy of public sector institutions—without ensuring integrity, accountability, transparency and oversight—could have catastrophic consequences for the ability to safeguard the public interest, as the preconditions for the formation and prosperity of corrupt practices. This danger deserves special attention with regard to the tax administration due to its role in providing revenues for the implementation of the state budget and government programs. Like all state bodies, the revenue bodies are responsible to the citizens they serve, resp. Reliable governance and oversight mechanisms are needed to ensure reliable accountability, transparency and lawful action in the public interest.

OECD (2015, p. 61) refers to a 2010 International Monetary Fund study on a functionally organized tax administration, which found that governments were looking for ways to improve operational performance while increasing transparency and accountability within their departments and agencies. Without an appropriate organizational structure, revenue administrations cannot operate effectively and their revenue collection efforts will be suboptimal. In the absence of a function-based organization, extensive procedural and operational reforms are likely to be ineffective. In addition to these views on improving the efficiency and care for increasing the transparency and accountability of revenue agencies, a recommendation can be added to focus on opportunities to increase the integrity of the tax system by establishing and maintaining high ethical standards as a barrier for the development

of corrupt practices, poor implementation or biased use of the broad powers of revenue authorities to serve private interests. According to the OECD (2005, 2015), over the last 20 years, governments have made major changes in the way they govern the public sector; maintaining effective control in more autonomous agencies is a challenge.

Reforms in the area of tax administration have been undertaken in response to recommendations from the International Monetary Fund, the European Commission and the World Bank in Romania. They are aimed at combating tax evasion, reducing the administrative burden on taxpayers and increasing the efficiency of collection. The restructuring process seeks to minimize direct contact with taxpayers, the provision of services to taxpayers through the use of a stable self—service website, an accessible call center and other means. Reduced physical contact minimizes opportunities for corrupt behavior (OECD, 2015, p. 76).

According to the OECD (2015, p. 243), over the last two decades, many revenue authorities have increased the use of modern computing technologies to collect taxes and provide improved electronic services to taxpayers. The use of IT by citizens and businesses has increased significantly over the last decade, and revenue authorities can take advantage of this by offering a wider range of online self-service options that are both easy and attractive for taxpayers to use. In addition to making it easier for taxpayers to comply with the law and ensuring higher standards of service, revenue authorities are also more efficient. The main types of electronic services that can be provided to taxpayers are:

- Providing a complete set of tax and other information, forms and calculators on websites.
- Electronic filing of tax returns for basic taxes.
- Providing pre-filled tax returns for personal income tax.
- A set of electronic payment options for all taxes.
- Access to protected detailed personal information for taxpayers through online portals.
- Call centers to provide more affordable phone calls.

Increasing the share of e-services provided by revenue agencies not only leads to higher satisfaction with their work, but also to increased organizational efficiency and reduction of direct contacts with taxpayers, which is a prerequisite for reducing vicious practices in the tax sphere.

DeBacker et al. (2015) link corporate tax evasion to foreign corporations in the United States to levels of corruption in the countries of origin of the owners, based on a study that uses data from more than 25,000 IRS corporate tax audits. The authors find that corporations with owners from more corrupt countries evade more US taxes. For example, a company owned by a country with a level of corruption in Nigeria has a level of avoidance that is significantly higher than a similar company owned by a country with a level of corruption in Sweden.

Andvig and Moene (1990), quoted by Sandmo (2005, p. 656), conducted a study of corruption and pointed out that it is more expensive to be honest when corruption is common. Sandmo (2005) draws an analogy with them and points out that it may

be less risky to evade taxes when evasion is widespread. From this it can be concluded that tax morality directly depends on the efficiency and effectiveness of the judiciary and the level of corruption in a system. When tax fraud and abuse go undetected or unpunished, and when taxpayers feel that public revenues are being used inefficiently or illegally, then the propensity to voluntarily meet tax obligations decreases significantly.

Alm (1999) examines non-economic factors influencing tax compliance and concludes: (1) social norms and social customs are important—taxpayers will fulfill their obligations as long as they believe that compliance with tax laws is the social norm; conversely, if non-compliance with the law becomes widespread, then the social norm of compliance disappears; (2) because some taxpayers define any tax payment as a loss, they are likely to declare less income than planned; (3) if taxpayers place more weight on the probability of an audit than usual, then compliance with tax law will be greater.

Torgler (2011, p. 54) concludes that the failure of a country's legal system undermines tax morale and compliance with tax law. In addition, regulatory constraints and bureaucratic procedures limit the functioning of markets, increasing incentives to operate in the informal economy or to evade taxes. A more legitimate and responsive government can be considered an essential precondition for achieving tax compliance. If individual and business contracts are not implemented, and productive efforts are not protected, then the incentives for illegal activity increase. Citizens feel cheated if corruption is widespread, the tax burden is not spent well and are not protected by the rules of law. Such a situation increases attitudes towards non-compliance with tax laws. Owsiak (2007, p. 223), quoted by Torgler (2011, p. 54), examines the tax reforms of countries in transition and states: "The reforms that are taking place in the post-communist countries, at the current stage of profound restructuring of the economy, should not rely solely on tax cuts, but instead, focus on measures to improve citizens' trust in the law and eliminate resources of tax abuses. Creating a legal framework to make the tax system stable, transparent, simple, taxpayer-friendly, accompanied by the simultaneous application of a rational mechanism for allocating and controlling public spending, emphasizing the link between taxes collected and the benefits gained by local communities, will determine whether society will welcome the development of tax-related civic behaviors."

According to Torgler (2011), social norms and social capital are key factors in understanding the motivation to comply with tax laws in countries in transition and other regions; in addition, social capital is a determinant of economic phenomena such as macroeconomic performance. Knack and Keefer (1997), cited by Torgler (2011, p. 54), find a strong link between the variables of social capital (civic debt) and economic growth.

Becker (1968), quoted by Slemrod (2007, p. 43), states with regard to penalties that the government will seek to set the penalty for detected crimes as high as possible, so that even at a low resource cost of enforcement, the overall expected deterrent effect will be large. In these cases, corrupt tax administrators have the opportunity to abuse the system and severely punish unintentional mistakes. The

more severe the penalty, the more damage a corrupt administrator can do in the event of an unintentional mistake. Therefore, the more severe the punishment, the more thorough and cautious the prosecution process must be. In addition, with more severe penalties, courts may be more reluctant to find a taxpayer guilty of absconding, so a practical consequence may be less sanctions.

8.5 Solutions and Recommendations

Based on a study of systematized practical rules for the implementation of good governance in European public administration (Institut po publichna administratsia, 2015; Council of Europe, 2008), the following criteria can be proposed for assessing the integrity of tax administration:

- **Codes of ethics:** Have ethical rules been introduced and applied to revenue authorities, incl. to announce interests, gifts and hospitality.
- **Decision-making procedures:** Are they reliable, especially in areas that are vulnerable to corruption, including public procurement.
- **Review of anti-corruption measures:** Is there an annual review of anti-corruption measures and is it reliable, i.e. through internal or external audit is carried out.
- **Policies for recruitment, promotion, reassignment and/or sanctioning of employees:** Are they in accordance with established standard practices and procedures.
- **Conflicts of interest:** Are revenue authorities required to declare potential conflicts of interest that may affect decision-making and whether they refrain from participating in such decisions.
- **Procurement:** Does the Revenue Agency ensure efficient and effective procurement and does it use pre-set selection criteria.
- **Transparency:** Does the Revenue Agency provide free access to public procurement documents and procurement decisions.

Many public sector institutions around the world have implemented quality management systems that are based on conceptual management models of organizations related to the ideas of Total Quality Management (TQM). The results of research (Nikolova, 2019) show that some revenue agencies in European Union countries have already gained experience and progress in the implementation of quality management methodologies based on the Model of Organizational Excellence of the European Foundation for Quality Management (EFQM). In this regard, it may be recommended to share experience and learn good practices related to the implementation of modern quality management systems. in tax administrations, which can lead not only to improved efficiency, but also to increase the integrity of revenue agencies and confidence in their activities, and hence the tax morale in society.

The results of the study of the strategy for human resources management in the revenue agencies of OECD member countries (2015) show that staff development

guidelines are mainly related to professional competence and not to ethical behavior. In this regard, it could be recommended to focus on building an ethical work environment and developing personal integrity in revenue agencies—at all levels, including employees, control bodies, executives and executive directors, as the “the tone of the top” determines the level of institutional integrity and the results of measures to tackle corrupt practices.

8.6 Future Research Directions

In order to develop knowledge in the field of taxation and improve tax administrative practice, research on the impact of the regulatory framework and the judiciary on the level of tax morality and integrity in the tax system could be deepened, incl.: stability and rationality of regulatory requirements, effect of sanctions and penalties, duration of proceedings, taxpayers’ perceptions of fair procedures, objective treatment, etc. It may also be useful to study the factors that give rise to corrupt practices in the tax system and the indicators for their establishment, as well as countermeasures.

8.7 Conclusion

Effective control impact requires a reduction in the likelihood of tax evasion being avoided and tax violations and abuses remaining undetected and unpunished. This requires both a high level of integrity and efficient work on the part of the tax administration and the judiciary. In this way, it will be possible to ensure equal treatment of taxpayers in the performance of tax obligations, and compliance with tax laws will be considered a social norm. This will limit the likelihood of reaping competitive advantages from tax evasion. The efforts of revenue agencies, as public sector institutions, to implement the principles of good governance, in general, can contribute to achieving the goals of sustainable development, and in particular can lead to higher ethical standards in the activity of the tax administration, the level of integrity and the trust in it on the part of the taxpayers. All this can be the basis for increasing tax morale and voluntary tax compliance, which is the goal of effective tax policy in modern conditions.

When counteracting corruption in the tax system, it should be taken into account that it is part of corruption in the country as a whole, although it has its own specifics and channels for implementation. The fight against corruption should cover all levels of the Revenue Agency and all areas outside it. In order to deal with corrupt practices in practice, it is important to be able to timely report corrupt behavior by revenue authorities and vicious administrative practices, as well as to ensure reliable protection of whistleblowers. In addition, investigating and detecting corrupt practices is not enough to effectively deter this destructive social phenomenon—it is also

necessary to apply the penalties provided for the perpetrators. The overall effect of law enforcement is important in this regard.

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Chapter 9

Modernization of Approaches in Tax Control



9.1 Introduction

This chapter addresses issues related to the possibilities for improving the effectiveness and results of tax audits and inspections by improving approaches to tax control. In this regard, the main characteristics of the mediation, holistic, situational and systemic approach, the possible directions for their application by the revenue authorities, as well as the expected positive effects are considered. The basic mediation skills for constructive perception and management of conflicts are considered, the levels of conflict and the different types of needs, the impairment of which leads to confrontation and the emergence of conflict situations, are clarified. Attention is paid to mediation skills that can be useful in the work of tax authorities, emphasizing the skills for effective communication and opportunities for their application in administrative work with taxpayers and in the implementation of tax control. The tendencies and possibilities for application of the holistic approach in the tax sphere in the context of the principles of good governance in the public administration and the maintenance of performance management systems in the revenue agencies related to the ideas of Total Quality Management (TQM) are considered. In this regard, the positive effects of the holistic approach in the field of taxation in the management of performance in revenue agencies, as well as in risk management and the creation of an environment conducive to compliance with tax laws, as well as in the investigation of tax fraud. The possibilities for application of the situational approach in performing tax audits and tax audits are considered in order to increase their efficiency by identifying and interpreting the control situation in order to achieve adequate control impact. In this regard, the determinants of the control situation are systematized and considered. Attention is paid to the possibilities for applying a systematic approach in tax control for research and analysis of the objects of control (for example, an enterprise, its business and its reflection in accounting), as a system with its interconnected, conditioned and interdependent

elements. The possible positive effects of the application of a systematic approach in conducting tax audits and audits are clarified, for example, to study the interrelationship, dependence and conditionality between cash, expenses, income and financial result, to study fictitious purchases and sales, and other cases and schemes of tax fraud.

9.2 Background

Research shows (Alm, 1999; Alm & McKee, 2006) that taxpayers' decisions to avoid tax and evade income and the level of tax compliance depend on the likelihood for conducting an audit and the disclosure of the audit activity. This draws attention to the frequency of tax audits and the quality of audit activity, the measures of which are the effectiveness and efficiency of the deterrent effect against tax fraud.

The issues of the effectiveness of the tax audit are related to the risk assessment in the tax control, so that it is possible to limit the limited audit resources to the sites most likely to identify significant tax discrepancies. Also, the results of the audit activity depend on: the professional training of the auditors, their personal qualities and skills for detecting violations, proving violations and fraud, so that the findings of control bodies are stable when appealing tax acts, i.e. it is necessary to provide the findings with sufficient and reliable evidence.

According to the European Commission, in order to create a just society and a strong economy, it is necessary to increase tax compliance, as in this way it will be possible to provide tax revenues for public spending on education, health, infrastructure, defense and others (European Commission, 2017, p. 1). In this regard, it is important to improve administrative activity and control in the field of taxation, but also—building trust, promoting transparency and developing a culture of law enforcement, including tax. It states that tax authorities need to develop new strategies to ensure that taxpayers meet their obligations, giving preference to voluntary compliance. To this end, it is recommended to use the following tools (Evropeyska komisija, 2017, p. 25):

- Effective communication to taxpayers of the value created through tax revenues, as well as monitoring and displaying the results of the activities of tax authorities.
- Encourage taxpayers to be more ethical in paying their taxes, using communication and education campaigns, with a focus on future taxpayers, to explain why it is important for everyone to pay their fair share.
- Collaborate with businesses to improve compliance with tax laws and encourage taxpayers to perform their duties properly.

The position of the European Commission on taxation can be judged from the published Reflection Paper on Sustainable Europe by 2030. It states that tax systems in the European Union should be structured so as to address the basic social and environmental issues, as well as to provoke a complete change of behavior to achieve sustainable economic development (Evropeyska komisija, 2019, p. 26). In

this regard, the application of new approaches in tax administration and tax control is becoming relevant, such as a holistic approach to achieve synergies and coherence, as well as a mediatorial approach to reducing interpersonal conflicts, tax disputes and forced collection of tax receivables.

An OECD study (2012a, p. 57) states that strategies that can be implemented by revenue authorities wishing to improve their approaches to combating the shadow economy and related tax abuses include education and communication-based initiatives, tools to improve detection and deterrence, specialized law enforcement programs for significant tax evasion and illegal activities. This study focuses on the role of communication with taxpayers and methodological issues of tax control. All this gives grounds to consider in the following presentation the possibilities for improving tax control through the application of specific approaches—mediation, holistic, situational and systemic.

OECD (2001, p. 3) points out that the main purpose of revenue authorities is to ensure compliance with tax legislation. IN the ever-changing environment, revenue authorities need to constantly review their operational approaches and procedures to ensure that they make the most efficient and effective use of the resources available to them.

In the field of control, the term “approach” means the application of specific organization and methodological focus in the implementation of control actions. For example, achieving effective communication aimed at collecting data and information on the objects of control, behavior and driving interests of tax subjects, as well as resolving interpersonal conflicts in the tax sphere is related to the mediation approach. The perception and interpretation of the set of components as a whole, able to act and interact in a certain, unique to its nature way is associated with a holistic approach. The modification of the control research according to the peculiarities of a given situation in which the controlled processes take place or the controlled object functions is related to the application of the situational approach. The control actions aimed at studying the dependencies between the elements of a given system (their interrelation, dependence and conditionality) are based on a systematic approach.

9.3 Mediation Approach

At its core, mediation is a dispute resolution procedure that is an alternative to litigation. It provides the disputing parties with opportunities for greater speed, economy and efficiency than traditional litigation. In addition, it is carried out with minimal formalities, confidentiality, discretion, friendliness, use of experts, the ability to settle the dispute on the basis of the principles of fairness and in the interests of the parties. The purpose of mediation is to facilitate communication between the parties, to assist in identifying the real disputes and defining their interests, as well as to generate opinions for resolving the dispute. Disputes that may be subject of mediation are: civil, commercial, labor, family and administrative,

related to consumer rights and other disputes between individuals and/or legal entities, including when cross-border (Institut Itera, 2019a, p. 10).

Successful mediation requires conflict management skills and constructive perception of conflict, such as process, interaction, differences in goals, values, interests and needs, affected goods, competition for limited resources, threat or sense of threat. From the point of view of mediation, conflict is a natural phenomenon, and the key requirement in overcoming it is the ability to transform the consequences in a favorable direction. In this regard, conflict is considered to be at the root of change and brings energy that can be used constructively. When dealing with conflicts, the task is to understand the basic level of the conflict and to start the analysis of the situation from it. For the purposes of mediation, three levels of conflict can be distinguished (Institut Itera, 2019a, p. 5):

1. **Conflict of interest:** There is an objective-intellectual dimension, for example, a conflict of goals, rules and norms.
2. **Conflict in relationships:** There is a socio-emotional dimension, it involves conflict of roles and there is emotional engagement.
3. **Conflict of values:** There is a value-cultural dimension, such as conflict over justice, religious issues and cultural aspects.

Effective conflict management presupposes knowledge of the forces that provoke and drive conflict. Conflicts are based on affected needs, and other differences are derived from them. The basic needs are described by Maslow in a hierarchical pyramid, according to which the primary needs, at the bottom, are physiological needs (food, water, air, etc.) and only after their satisfaction, you can move on to meet the needs of more -high level, in their sequence—security, belonging and love, appreciation (respect), aesthetic and cognitive needs. Along with the basic needs, there are also specific communication needs. The concept for them was developed in detail by Roger Fisher (Professor of Law at Harvard Law School) and is fundamental to the Harvard Negotiation Model. These needs are the following (Institut Itera, 2019a, p. 7):

- **Recognition and acceptance:** When a person's thoughts, feelings and actions are recognized as justified.
- **Inclusion:** A sense of connection with another person or group, and relationships can be structural or personal; it is present when a person is treated as a colleague or partner.
- **And autonomy:** The freedom to influence or make decisions without being imposed by others; it is present when the freedom to make decisions on important issues is respected.
- **Status:** The position of one person compared to the position of others; it is present when the deserved position of a person is recognized.
- **Role:** Professional position and its corresponding activities that are expected in a given situation; it occurs when a person feels satisfied with their role and related activities.

In a conflict related to communication and relationships, one of these five types of needs is always affected. Identifying this hardened need and finding a way to properly meet it with the tools of mediation is the basis for resolving the conflict situation.

Mediation training develops the mediator's communication skills, as successful mediation is based on effective communication. Therefore, the application of a mediation approach in the system of tax administration and control can significantly improve communication between revenue authorities, partners and taxpayers in all desired aspects. Communication skills include various means, verbal and non-verbal techniques, with the help of which a person comes into contact with others more effectively. In the most general sense, communication can be defined as the transmission of information and understanding through the use of common symbols (Institut Itera, 2019a, p. 34). Communication skills and their characteristics are presented in Table 9.1.

Mediation also creates skills for dealing with problematic behavior, for example "Attacks on the mediator", which can be useful for revenue authorities when accused of prejudice or objections to the way they talk to taxpayers. In such cases, it is appropriate to ask what specifically worried the taxpayer. Disagreement should not be expressed. If the dissatisfaction is justified, even in part—an apology is recommended, consent to act differently from now on. If the disapproval is unfounded—it is recommended to accept the behavior as a natural reaction of resistance to the procedure, proceedings, revealed truth and established results (Institut Itera, 2019b, p. 39).

In order to improve the operation of modern revenue agencies, quality management methodologies are applied, such as the Common Assessment/Self-Assessment Framework (CAF). It is based on the concepts of organizational excellence, which are adapted to the public sector in order to improve the efficiency of public institutions. According to the CAF model, the self-assessment process covers both the favorable factors for the organization on which good performance depends and the results of the organization. It is necessary to take into account the causal relationship between the favorable factors (causes) and the results (consequences). Favorable factors include leadership, strategy and planning, people, partnerships and resources, processes (Institut po publicchna administratsia, 2020, p. 13). The influence of most of the listed favorable factors can be strengthened through the methods of mediation, including:

- **Leadership:** Through their personal behavior and way of managing human resources, leaders inspire, motivate and support employees. By acting as role models, leaders reflect the organization's established goals and values, encouraging employees to behave in the same way. Leaders support employees to achieve their goals by fulfilling their job responsibilities. Transparent management style based on mutual feedback, trust and open dialogue motivates people to contribute to the success of the organization.
- **Strategy and planning:** Includes identification of needs and expectations of stakeholders, the external environment, as well as relevant management

Table 9.1 Communication skills

Dementia for communication	Characteristic
Active listening	<ul style="list-style-type: none"> • An active process in which a conscious decision is made to listen to and understand the speaker's messages and is a key element of communication skills. • It requires patience—pauses and short periods of silence should be accepted. The listener should not be tempted to ask questions or make comments every time there is a few seconds of silence. • It requires giving the other party time to express thoughts and feelings. • It aims to support the party we are listening to, to reassure the interlocutor that we are listening carefully and that we are ready to help him, which can be done through: (1) non-verbal techniques—nods, gestures, looks, etc.; (2) verbal techniques—short retelling of what is heard, asking questions, reformulation, etc. • The goals of active listening are: to obtain information, to build trust, to reduce tension, to calm emotions, to bring to the surface unconscious or hidden interests and concerns, to clarify the goals, interests and concerns of the parties.
Non-verbal communication	<ul style="list-style-type: none"> • Non-verbal communication is manifested in: facial expressions, gestures, tone and pitch of the voice, gaze, body movements, posture, touch, physical distance, manner of dress, etc. • During communication a person perceives information as follows: body language (facial expression, posture, gestures)—55%, voice characteristics (intonation, pitch, rhythm, timbre)—38%, words—7%. Communication skills make it possible to determine whether there is a correspondence between speech and body movements.
Unification	<ul style="list-style-type: none"> • It aims to build trust and reach understanding through synchronization, which is based on the tendency to like each other's likes. • The areas of unification are: Physiological unification in posture and movement of the body; unification of the voice in terms of strength, rate of burning, rhythm, pitch, tempo, tone, phrases.
Empathy	<ul style="list-style-type: none"> • The ability to recognize the feelings and emotional state of others; it requires calmness, patience and attention, which creates a basis for expressing respect for different points of view.
Ask questions	<ul style="list-style-type: none"> • In order to clarify the situation and support communication; the questions are: (1) open—they allow for different answers and are suitable for gathering information, clarifying a position, opinion, predisposition to conversation; (2) closed—reveal the summaries, show the ambiguities, restore the erased, correct the distorted, clarify the ambiguities, extract the specific meaning; guiding—end with the words “right?”, “is that so?” and others.
Paraphrasing	<ul style="list-style-type: none"> • Retelling in your own words another person's statement, which helps to show that we are listening and trying to understand what is being said, as well as to check whether we understand correctly what we are hearing.
Summary	<ul style="list-style-type: none"> • It is especially suitable when talking to people who have a tendency to talk for a long time; it is useful to summarize the content of the conversation from time to time so as not to distract the information in the conversation. • Summarizing in practice is a repetition of key aspects of information—it should be neutral, without assessments, without decisions.

Source: The author according to the Itera Institute (2019a)

information; developing strategies and plans based on the information gathered; communicating, implementing and reviewing strategies and plans.

- **People:** Involves managing and improving human resources to support the organization's strategy; the development and management of the competencies of the employees; the involvement and empowerment of employees, the support of their well-being.
- **Partnerships:** Includes the development and management of partnerships with relevant organizations, as well as working with citizens and civil society organizations.

According to the principles of good tax administration of the OECD (2001), the main role of revenue authorities is to ensure compliance with tax legislation, and the promotion of voluntary compliance must be a strategic goal. It is pointed out that the ways in which the revenue authorities interact with taxpayers and employees influence the public perception of the tax system and the degree of voluntary compliance. Taxpayers who are aware of their rights, expect and receive fair and effective treatment are more likely to comply with tax laws. Qualified and committed employees who are valued and treated fairly will be more likely to act honestly and professionally in all their dealings with taxpayers.

Given the characteristics made so far, mediation can enable effective communication and building full-fledged relationships in the tax administration and with stakeholders outside it, as well as resolving interpersonal conflicts, which is a prerequisite for strengthening leadership, good implementation and achieving strategic objectives of revenue agencies. The adoption of mediation approaches in the work of the tax administration can significantly improve the communication between the control authorities and the taxpayers and increase the trust in the tax system.

According to the United States IRS website (September 2014), cited by the OECD (2015, p. 287), among the fundamental rights of US taxpayers are:

- **The Right to Be Informed:** Taxpayers have a right to know what they need to do to comply with tax laws. They have the right to clear explanations of IRS laws and procedures in all tax forms, instructions, publications, notices and correspondence. They have the right to be informed of IRS decisions regarding their tax accounts and to receive clear explanations of the results.
- **The Right to Quality Service:** Taxpayers have the right to receive prompt, courteous and professional assistance in their dealings with the IRS, to be spoken to in a way they can easily understand, to receive clear and easy-to-understand communication from the IRS and to speak to a supervisor inadequate service.
- **The Right to Challenge the IRS's Position and Be Heard:** Taxpayers have the right to raise objections and provide additional documentation in response to official or alleged IRS actions, to expect the IRS to review their timely objections and documentation quickly and fairly, and to receive a response if the IRS does not agree with their position.
- **The Right to Privacy:** Taxpayers have a right to expect that any inquiry, verification or enforcement action by the IRS will be in accordance with the

law, that it will not be more intrusive than necessary, that all rights in the current process will be respected, including protection against confiscation and a hearing will be provided where applicable.

- **The Right to a Fair and Just Tax System:** Taxpayers have a right to expect the tax system to take into account facts and circumstances that could affect their basic obligations, ability to pay or ability to provide information in a timely manner. Taxpayers are entitled to assistance from the Taxpayer Protection Office if they experience financial difficulties or if the IRS does not properly and promptly resolve their tax problems in the normal manner.

According to the OECD (2015, p. 125), the involvement of taxpayers and their involvement in dialogue is closely linked to their perceptions of the procedural fairness of treatment by revenue authorities. Therefore, the realization of taxpayers' rights can be greatly facilitated by the availability of mediation skills for dialogue, effective communication and conflict resolution.

In addition to the cases discussed so far, the application of mediation skills (effective communication) can be useful in conducting a tax audit to gain a general idea of the state of the enterprise. The tax authorities contact the taxpayer, dialogue with him, ask questions, review the accounting documents and records in order to get an idea of the audited activity and to assess in which aspects it will be necessary to make in-depth inspections. In the initial interview with the taxpayer, the auditor should look for a way to talk to the business owner, even when the accountant undertakes to provide the necessary evidence and explanations regarding the details of the audit. In this way, the auditor can obtain important information about the owner himself, his business practices, who operates the company's income and expenses, and other useful data. The information gathered in this way can be used to determine the standard of living of the taxpayer. In addition, an audit may include a visit to the company's premises to assess the nature, scope and extent of the activity performed; to look for indicators for the implementation of side activities, the number of employees, the size and condition of the property, inventories, etc. (Foks & Bergherm, 1998).

Necessary skills in working with taxpayers include the ability to clearly explain the auditor's position to avoid possible misunderstandings. The auditor must be able to express himself clearly and listen carefully; the taxpayer may not be familiar with the terminology used in the administration and the auditor should make sure that the taxpayer understands it well. In case the auditor is not convinced that the taxpayer fully understands the opinion expressed, he can ask him a few questions to find out the level of understanding. The auditor may need to repeat some very important requirements more clearly to ensure that he or she is properly understood. Hearing the taxpayer is an important part of the communication process. It is very useful for auditors to have active listening skills, including: a thorough understanding of what is being said without interruption; skills for asking questions, for listening carefully, for assessing the answers, for using dialogue as a means of getting an idea of the circumstances around the company and possible tax problems. The auditor should develop skills and express himself in writing, especially when preparing the final

report (report) on the results of the audit, in which the findings and conclusions should be presented clearly in logical sequence (Foks & Bergherm, 1998).

The OECD (2012a, p. 53) points out that some countries use a multilateral communication approach to streamline standard policies for voluntary disclosure by taxpayers. For example, Canadian and Australian revenue authorities that have third-party data (such as eBay) have taken steps to disseminate this information widely through the media (press releases). Subsequently or in the same communication, the revenue authority emphasizes the essential sanctions related to hidden income and usually allows a period of time during which taxpayers can make voluntary disclosures. This avoids the full penalties that could be applied if they do not and are subsequently audited. Another example of a voluntary disclosure strategy can be cited. The IRS has announced a voluntary program to allow U.-S. taxpayers with unopened foreign accounts to declare such accounts retroactively. Individuals in the United States with foreign accounts are required to report the existence of the accounts annually on a special form. Failure to declare an existing foreign account can lead to severe civil penalties and can constitute a crime (OECD, 2012a, p. 44).

9.4 Holistic Approach

Holism as a concept originated in the early twentieth century when Jan Smuts published his book *Holism and Evolution* (1926). Holism is associated with the idea that systems (physical, biological, chemical, social, economic, mental, linguistic) and their properties should be considered as a whole, not just as a collection of parts. The meaning of the term depends on the specific context, for example, it may relate to: (1) the overall education of the person in terms of intellectual, social, emotional, mental, physical and creative potential; (2) the socio-economic system as a whole and not individual parts of it and the interactions between the different socio-economic systems; (3) systems theory, according to which the whole is very rarely equal to the sum of its individual components; (4) the parts of something are closely interconnected and explicable only by reference to the whole (IGI Global, 2022).

In accordance with the principles of good governance and in order to improve implementation in the tax administrations of a number of countries, quality management systems (QMS) have been introduced, based on the ideas of Total Quality Management (TQM). According to these ideas, governance is seen (Zink, 1998) not as a short-term rationalization program, but as a holistic concept of governance that can contribute to solving complex problems.

The European Foundation for Quality Management (EFQM) has been developing and developing the EFQM Excellence Model since 1992. The model is the most popular organizational management framework in Europe and is widely used in public sector institutions. According to him, the perfect organization strives for sustainable development by managing its processes and resources so as to achieve

useful results not only for themselves but also for society. The EFQM model is based on a holistic approach to the organization and is a tool that can serve to integrate sustainable development principles into its strategies, plans and programs (Serban & Ghenta, 2009, p. 353). The use of EFQM makes it possible to see the whole, to adopt a holistic point of view and to assess that an organization is a complex but at the same time organized system. An organization should not be seen as linear, mechanical and predictable, but rather as a complex adaptive system composed of interdependent people in a dynamic living world (EFQM, 2021, p. 11).

At the core of the management philosophy of the EFQM organizational excellence model are the following fundamental principles: (1) results orientation; (2) focusing on customers; (3) leadership of goals, values and integrity; (4) process-based management; (5) involvement and development of associates; (6) stimulating learning, creativity and innovation; (7) building partnerships; (8) responsibility for a sustainable future. The evaluation framework, according to the model of excellence, contains nine criteria. They are the main guidelines for self-assessment and determining the level of “perfection” of the organization (Institut po publiczna administratsia, 2015, p. 50). The criteria are divided into two categories:

- **Opportunities:** These include leadership, collaborators, policy and strategy, partnership and resources, processes.
- **Results:** They relate to associates, customers, society, key performance results.

Organizational excellence is measured by key results for the benefit of customers, associates and society and is achieved through leadership that drives policy and strategy; they are realized through the use of people, partnerships, resources and processes. Innovation and training help to improve results (Tuzharov, 2008).

The wide scope and complexity of administrative activity in the field of taxation and control give rise to the adoption of holistic methodologies for business management, such as the EFQM model. Revenue agencies that introduce and maintain modern QMS have the opportunity to achieve sustainable development of their activities and the desired results, in accordance with the adopted strategies, plans and programs. The specific areas that could be improved through the introduction of the EFQM organizational excellence model are the following: administrative capacity and efficiency of the tax administration; human resources development and training; quality of services provided to taxpayers; voluntary compliance with tax obligations and increase in tax revenues.

In the revenue agencies, as well as in the other institutions in the public sector, there are internal audit departments. Modern conditions place new demands on them—to move away from their traditional focus on internal control and expand the scope of their activities. In addition, internal audit is expected to move from finding findings to providing solutions, recommending changes in policies and procedures, improving processes and training. In this regard, Mark Steranka (2015) makes the following recommendations for achieving a more holistic and impactful approach to internal audit:

1. **Think Beyond Controls:** Internal audit activities should not be limited to internal controls, but should focus on the assessment of corporate risk—analysis of people, processes, equipment and systems, as well as evaluation of effectiveness. By adopting a more holistic approach to internal audit, which covers internal control, risk management and efficiency, organizations can create a culture of safety, transparency, efficiency and effectiveness.
2. **Provide Practical Solutions:** One of the most common criticisms of internal auditors is that they provide only general recommendations, limiting themselves to identifying the need to develop missing policies, update outdated procedures, simplify processes or increase efficiency. However, internal auditors have a unique opportunity to provide solutions because they can assess situations directly. Sharing best practices and experiences from other organizations could also be helpful to support management processes and the implementation of sound policies and procedures, streamlined operations and improved productivity—through strong communication, cooperation, coordination, reporting and reporting. Making decisions.
3. **Work Collaboratively:** Cooperation and independence are not mutually exclusive. Internal auditors and auditees could partner to make improvements. Without cooperation, the organization's ability to make improvements is severely limited. Auditors could examine the auditees' insights by collaborating with them, verifying the facts, and testing the practicality of their recommendations. Auditors are encouraged to think outside the box and work with the auditees, not on them. And auditors are encouraged to seek best practices from their auditors and use their experience to gain practical advice.

A study of tax control practice, based on OECD research, shows that revenue authorities are currently taking a holistic approach, mainly in managing risks and creating an environment conducive to compliance with tax laws. To a lesser extent, such an approach is used to reduce the shadow economy.

According to the OECD (2015, p. 123), revenue authorities have traditionally implemented a strategy for compliance with tax laws based on deterrence through the use of audits and sanctions. Gradually, a holistic view emerged, including the use of more multifaceted approaches and a focus on understanding risks. The Forum on Tax Administration (FTA) report "Compliance Risk Management: Managing and Improving Tax Compliance" (OECD, 2004) describes how revenue authorities can prioritize risks and select appropriate treatment based on an analysis of the main drivers of taxpayer behavior. According to him, effective risk management strategies can be implemented only after the drivers of taxpayers' behavior are properly understood. It is concluded that there are economic and non-economic factors of tax compliance, such as: age, level of education, moral compass, gender, industry, personality, circumstances, perceived cost of compliance and risk assessment. It is stated that the most effective strategies for combating tax evasion are likely to be multilateral and systematic (OECD, 2004, p. 72).

According to the PROTAX Risk Assessment and Combating Toolkit (2020, p. 30), fraud investigators need to take a holistic approach to identify the main

factors that have led to tax fraud. The authors cite some examples of fraud factors, such as: Internet use, virtual currencies, congested or insufficient law enforcement agencies (lack of resources), inefficient tax administration (limited administrative capacity), unfriendly and complex tax mechanisms and lack of public awareness of fraud.

OECD (2015, p. 125) presents a holistic approach to compliance with tax laws for taxpayers who are small and medium-sized enterprises. This approach is a practical framework on which revenue authorities can generate value (for themselves, for taxpayers and for society) by creating an environment that affects tax compliance. The frame has four dimensions:

- Real-time and advance action so that problems can be prevented or addressed when they arise.
- Focusing on end-to-end processes, not just focusing on revenue authority processes and trying to get the taxpayer's processes to fit into them.
- Facilitate compliance.
- Active involvement and involvement of taxpayers, their representatives and other stakeholders in order to achieve a better understanding of the taxpayer's point of view.

9.5 Situational Approach

Regardless of the field of application—education, pedagogy, management, control, medicine, etc., the situational approach involves interpreting and evaluating the specific situation in order to form adequate behavior, attitude and impact on it. According to this approach, there is no universally effective way of acting—valid for every situation, therefore the specific situation should be approached individually.

From the standpoint of this approach, it can be concluded that a tax audit or tax audit will be effective when their implementation is appropriate to the specific situation. This is because audits and inspections focus on the income, profits (revenues) and assets of individuals. Each person, as well as the related income, profits (income) and property are unique—no two companies are the same or two individuals, which requires taking into account the specifics of the specific controlled situation and apply an individual approach to it (Nikolova, 2019).

In 1973, the French mathematician Benoit Mandelbrot introduced the term “fractal” to describe objects that are very similar but not identical, such as trees, clouds, earthquakes and more. If we use this terminology, we can define enterprises (and individuals) as fractal objects, because two or more enterprises (or individuals) are essentially similar but not identical. It is the non-identity of the objects of control that gives grounds for the application of the situational approach in the performance of audits and inspections, in order to realize an effective control impact. In particular, this approach presupposes the formation of an individual model for their

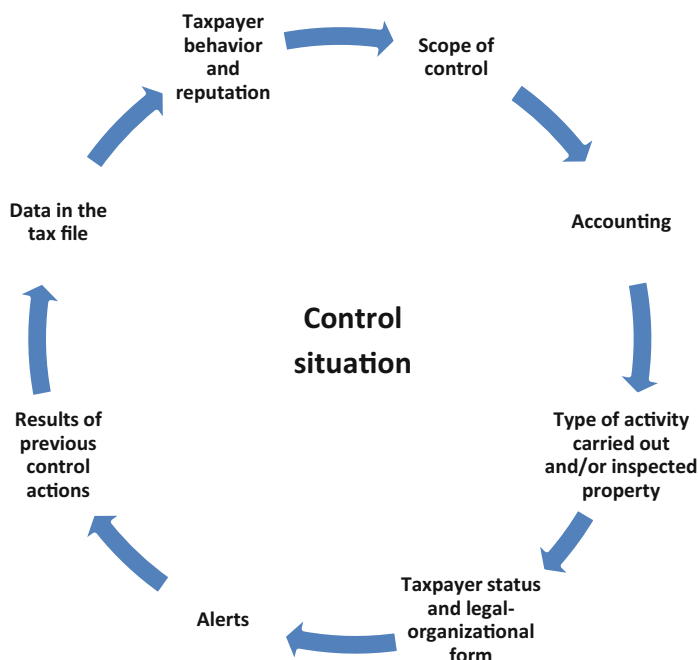


Fig. 9.1 Determinants of the control situation. Source: The author

implementation, adequate to a specific control situation, which contains appropriate guidelines, hypotheses, methods and information sources for tax control (Nikolova, 2019).

The control situation can be defined as a set of known conditions, facts and circumstances related to an audit or inspection, based on which the unknown state of the object of control will be established.

The control situation can be identified and interpreted based on its determinants, which are presented in Fig. 9.1. The determinants of the control situation can be considered:

- **Scope of control:** This refers to both the period of time being audited (e.g. one month, quarter, year, several years) and the tax liabilities being audited—direct taxes and/or indirect taxes.
- **Accounting:** The presence or absence of an obligation to keep accounts determines whether the tax authorities will be able to use accounting data created in the taxpayer's accounting. Some taxpayers who are individuals are not required to keep accounts in accordance with applicable accounting legislation.
- **Type of activity carried out and/or inspected property:** The activities that are audited/inspected—trade, production, services, construction, tourism, transport, agriculture, etc. and the inspected property (movable or immovable).

- **Taxpayer status and legal-organizational form:** Individual or legal entity, also—limited liability company, joint stock company, cross-border company, branch of a commercial company, etc.
- **Alerts:** Availability of data from external sources on tax violations and crimes related to the controlled object.
- **Results of previous control actions:** Existence of findings from previous audits/inspections and from other control bodies related to the taxpayer, which are relevant to the present case.
- **Data in the tax file:** Availability of specific certificates, licenses, certificates and other documents.
- **Behavior and reputation of the tax subject:** Timely fulfillment of tax obligations, maintenance of good manners and business ethics, responsiveness and willingness to assist in performing the audit/audit.

On the other hand, despite the great diversity, there is a certain similarity (essentially similarity) between different companies and between different individuals, as they have some common features. This makes it possible, after interpreting and assessing the control situation, to apply pre-defined standard models for conducting audits and inspections. At the heart of these models is the similarity between the individual audits and inspections of a given type, regardless of the specifics of the specific control situation and the variety of control objects. No control situation is exactly the same as another, but there are certain key characteristics on the basis of which similarity can be sought between individual audits and inspections. These are: scope of control (direct and/or indirect taxes), presence or absence of an obligation to keep accounts (i.e. presence or absence of accounting data created in the taxpayer's accounts), type of activity carried out or owned property (trade, production, services or movable and immovable property), taxpayer status (individual or legal entity) and legal-organizational form (sole trader, limited liability company, joint stock company, cross-border company, cooperative, non-profit association and etc.).

For example, the control situation for two or more separate companies will be similar when performing an audit with VAT scope, if they are legal entities, have a trade activity and according to the latest Annual Financial Statements have atypical long- term tangible assets. This similarity will be present, regardless of the fact that the enterprises are not identical in terms of ownership—managers, employees, customers, suppliers, sales range, markets, scale of activity, turnover, etc.

It is the similarity between the control sites that allows for the application of standard models for tax control, but due to the individual characteristics of the sites it is also necessary to take into account the specifics of the control situation and to implement individual control impact by forming appropriate control guidelines and hypotheses outside the type model. According to Nikolova (2019), in order to achieve maximum efficiency in tax audits and inspections it is necessary: on the one hand, to assess and take into account the specifics (characteristics) of a particular control situation, and on the other hand—to look for similarities with other situations that have already been studied (modeled).

9.6 System Approach

The application of a systematic approach in tax control presupposes that the object of control is smoothed out as a system. According to this approach, the system is a whole, which consists of interconnected, conditioned and interdependent elements, each of which contributes to the characteristics of the whole. The same element can be part of one or more systems, and in one or another system each element can participate with one property, with many properties simultaneously, or with different properties. Each of the elements of the system can be considered as a relatively independent system—thus the elements are subsystems of the system. In turn, they can also be considered as composed of smaller subsystems.

The application of a systematic approach, for the purposes of tax audits and audits, can contribute to the derivation of significant links and dependencies between the elements of the controlled system (object of control) and their subsequent study. For example, a systematic approach should be applied to tax audits of large taxpayers to audit the parent company with its subsidiaries, as well as to tax audits of a company that has separate branches and divisions. In these cases, in order to achieve the best results from the control impact, the audit should cover the whole group of companies to be considered as a system (Slavkov, 2001). This application of a systems approach does not exhaust its potential. Other examples can be given.

Traditionally, the object of tax control is the economic activity of the enterprise—considered as a system, it consists of the following main components: resources for the activity (including premises and/or land, vehicles, facilities, equipment, business inventory, financial resources, human resources, intangible resources, raw materials and supplies), technology and organization of activities, suppliers and customers of the enterprise, costs and revenues. Thus, the economic activity of each enterprise includes three subsystems:

- Acquisition and storage of the resources necessary for carrying out the activity.
- Transform these resources through technology.
- Realization of the received products, goods and services on the market.

Therefore, in the perception of economic activity, as a system provides an opportunity to discover and explore the relationship between the resources of the enterprise, their transformation and realization. Based on such an approach (Nikolova, 2019), when conducting tax audits and inspections, it could be established: fictitious purchases and/or sales, increased and/or reduced costs, lack of financial and/or production capacity, etc.

All business activities carried out during a given reporting period should be reflected in the company's accounting, and the taxpayer's accounting data themselves can also be considered as a system. The data on the economic activity are consistently reflected in the primary documents, in the accounting accounts and in the annual financial report of the enterprise. In this regard, the data are grouped by separate accounting objects—capital, reserves, loans received, tangible, intangible and financial assets, inventories, suppliers, customers, staff, partners, expenses,

income, etc. The individual accounting objects can be considered as subsystems of the accounting system, and the data for the individual accounting objects are subsystems of the accounting data system of the enterprise.

The application of a systematic approach to the accounting data of the enterprise makes it possible to study the interrelationship, dependence and conditionality of their components. For example, cases where employees “on hand” actually receive higher salaries than accrued. Thus, on the one hand, the employer avoids part of the compulsory insurance, and on the other hand, the employee avoids part of the income taxes. With regard to the unaccrued but actually paid part of the salaries, there is a double effect: a decrease in cash, which is not reported, and an increase in the financial result, because any unreported expenditure (including salaries) indirectly leads to an increase in the financial result, which is the difference between the amount of income and the amount of expenses. To offset this effect, the employer often resorts to fictitious purchases, which are reported as real costs and as a real reduction in cash. Usually, the subject of fictitious purchases with such purpose are—advertising services, internet services, construction and repair services, rents of movable and immovable property, etc. In these cases, it is the systematic approach that makes it possible to study the interrelationship, dependence and conditionality between cash, costs and financial results (Nikolova, 2019).

Another example is the fictitious purchases of goods and services in order to misuse a tax credit and recover VAT from the budget. In these cases, the systematic approach requires revealing the interrelationship, dependence and conditionality of these purchases and the corresponding sales. The tax treatment of purchases only, by adjusting the tax credit used, without adjusting the sales—creates subsequent abuses, because the “sale” of these fictitious goods and services in fact, in turn, leads to a fictitious purchase from another person. Thus, the application of a systematic approach to the fictitious purchase and sale of goods and services can create an opportunity to detect and counteracting organized schemes (chains) for VAT fraud. According to a systematic approach, when disclosing fictitious services, it is necessary to make adjustments not only to the used tax credit related to them, but also to the reported expenses (Nikolova, 2019).

9.7 Solutions and Recommendations

According to an OECD study (2012b) Many of the efforts of revenue authorities to work smarter in line with modern requirements in the field of public administration are related to the application of information technology (IT), especially to increase tax compliance and implementation of audit strategies. Revenue authorities are increasingly relying on IT for risk analysis, workload management, information exchange, service delivery and communication with taxpayers. A significant number of revenue authorities expect improvements in the application of IT to be a key factor in increasing efficiency. In relation to these trends, it should be noted that the use of IT can indeed improve the work of tax authorities, but should not be favored, as in

the field of control (audit) the leading role is played by the human factor—training, experience and skills. Therefore, the improvement of tax control should include not only the introduction of modern IT, but also the improvement of methodological tools and applied approaches in control activities.

Given the results of the study of approaches to tax control, the following conclusions and suggestions can be made:

1. **Mediation approach:** Techniques and skills inherent in mediation are also applicable in the field of tax control. They could improve the work of tax authorities in the following areas:
 - (a) Human resource management and resolution of interpersonal conflicts in the tax administration.
 - (b) Preliminary study of the activities of taxpayers and collection of information through an interview.
 - (c) Determining the cause of deviations from the norms—intent or negligence.
 - (d) Discussion of the findings in the acts of the revenue authorities at the end of the audit.
 - (e) Objections to the actions and conduct of the revenue authorities and settlement of disputes in this regard.
 - (f) Achieving voluntary disclosure by taxpayers.
 - (g) Communicating the vision, mission and strategic goals of the revenue agency.
 - (h) Creating a culture of systematic compliance with tax obligations by sending public messages.
2. **Holistic approach:** The application of this approach could improve the activity of the tax administration in the following aspects:
 - (a) Evaluation of the activity and optimization of the work processes.
 - (b) Human capital development and efficient resource management.
 - (c) Partnership management, cooperation and synergies to achieve synergies and coherence.
 - (d) Risk management and improvement of the control impact.
 - (e) Improving the activity of the internal audit departments.
 - (f) Improving the services provided to taxpayers.
 - (g) Increasing voluntary compliance with tax laws.

9.8 Future Research Directions

In order to improve the methodology of tax control and increase the effectiveness of tax audits and inspections, standard models for their implementation could be developed and applied in a given control situation, as a systematic set of appropriate information sources, control guidelines, hypotheses for verification, applicable approaches, methods and means. Possibilities for applying modeling to tax fraud investigations could also be explored. In this way, it will be possible to contribute to

the improvement of tax control practice and counteraction to tax fraud, as well as to the expansion of scientific knowledge related to the implementation of effective and efficient control impact in the tax sphere.

9.9 Conclusion

The introduction of innovative IT and the improvement of the applicable approaches in the tax control can lead to higher efficiency and increase of the trust in the activity of the revenue agencies, as a result of which the planned tax revenues should be collected regularly. To this end, the integrity of the tax system should be strengthened, as the development of technologies and methodological tools of tax control, without raising ethical standards and integrity, could not meet modern societal needs for sustainable institutions.

In order to achieve a real deterrent effect on tax fraud, it is necessary to maintain high tax morale in society, to carry out effective law enforcement and effective tax control, and to have a well-functioning judiciary. Improving tax control (audit) is essential to counter tax fraud. In this regard, attention should be paid to the implementation of the audit activity, to the search for more effective and efficient approaches, and to the improvement of the methodological tools of control.

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Chapter 10

Increasing the Administrative Capacity in the Field of Tax Control



10.1 Introduction

This chapter addresses issues related to the development trends of the tax administration, as part of the public administration of each country, aimed at improving administrative capacity in accordance with the principles of good governance. In this regard, attention is paid to the definitions and characteristics of the concept of “administrative capacity”, as well as the related challenges and guidelines for development. The main issues related to the conduct of electronic tax audits, as well as the prospects for their development have been studied. These issues are related to the issue of increasing the effectiveness of tax control and the ability of revenue authorities to detect tax fraud in a timely manner. In this regard, attention is paid to the current practices of some revenue authorities related to the application of computer forensics, analytical technologies for electronic databases, geospatial and network analytics, click flow analysis, real-time analysis, online-based, automated tax audits (electronic audits) and their characteristics. Emphasis is placed on the attitudes for the implementation of electronic tax audits, considering the expected positive effects and challenges for tax authorities and taxpayers. Another round of studied issues is related to the trends for digitalization of taxation and the activities of the tax administration. In this aspect, attention is paid to the possibilities for application of the innovative Big Data technology—based on the digital transformation of the taxation and control system. The expected positive effects of these innovations are also discussed: counteracting tax fraud and shadow economic activities, shifting taxation to the point of transaction, eliminating the need to file most tax returns, and providing smarter services than revenue agencies that can be personalized according to the specific characteristics and needs of taxpayers, so as to inform and guide them according to the events and activities for which they currently need support. The approaches of the revenue authorities for access and analysis of the data from the systems have also been studied for electronic and payments, which

are often used to conceal business revenue. Based on these studies, the possibilities for improving the implementation and performance of the tax administration in accordance with the systematized by the OECD Committee of Fiscal Affairs (CFA) characteristics, principles and criteria for “good tax administration” that can be used as basic guidelines for the development of tax systems and reform of tax administrations. In this regard, a set of fiscal plans (benchmarks) developed by the European Commission’s Directorate-General for Taxation and Customs Union, which contains practical guidelines and clear criteria based on best practices in the European Union (EU), is also considered, against which the tax administration can measure its own operational capacity and inspire reforms. Some attention is paid to the opportunities for improving the activity of the tax administration and the results of its functioning through the application of modern performance management systems, oriented to the development of administrative capacity in accordance with the Concept of Sustainable Development.

10.2 Background

Public administration is responsible for sustainable economic prosperity, social cohesion and human well-being. It influences public trust and creates the conditions for creating public value (Evropeyska komisija, 2017). The issues related to the institutional and administrative capacity are closely related to the idea of development and modernization of an institution, oriented towards the application of new approaches and tools in the implementation of the activity. Institutional and administrative capacity building is also directly related to the ability of public sector organizations to identify and solve problems, to develop and implement programs to improve implementation. Within the EU, the *Fiscalis 2020* program related to taxation in the European Union for the period 2014–2020 has been implemented, which provides mechanisms, funds and financing in order to improve cooperation between tax administrations. In this regard, the proposed measure includes joint actions, such as seminars, workshops, trainings, multilateral inspections, the creation of expert teams, etc., in which Member States and their officials can participate on a voluntary basis. The common goal of these joint actions is to deepen administrative cooperation and improve the administrative capacity of Member States in the field of taxation (Evropeyska komisija, 2012, p. 4). Institutional and administrative capacity, incl. in the field of taxation and control, can be considered in a narrow sense when dealing with issues such as e-government and IT resources, also, can be considered more broadly, in connection with the improvement of structures, human resources, systems and applicable tools.

According to the OECD (2012a, p. 41), revenue authorities strive to work smarter by applying modern information technology (IT), especially to facilitate compliance with tax laws and implement audit strategies. Revenue authorities are increasingly relying on IT for risk analysis, workload management, information sharing and

service delivery, and communication with taxpayers. It is expected that improved IT application will be a key factor in increasing efficiency.

Since the beginning of the twenty-first century, a number of reforms have taken place in the EU to improve public sector institutions in the following aspects: quality of services, fair treatment of citizens, cost and efficiency, ethical behavior of employees, transparency and openness, innovation, equal access to services, policy effectiveness, staff motivation and attitude to work, attractiveness of the public sector as an employer, coherence and coordination of policies, citizen participation, reduction of internal bureaucracy (bureaucratic burden), increasing public confidence and social convergence. In this regard, the European Commission's (EC) Thematic Information Paper on the Quality of Public Administration (Evropeyska komisija, 2017, p. 2) states: "Over the last two decades of reforms in the Member States, cost-effectiveness has improved somewhat and the efficiency of public administration. Overall, institutions have become more open and transparent, and access to services and the quality of services have improved. However, citizens' trust in governance, social cohesion and the attractiveness of the public sector as an employer have declined. There is not enough improvement in terms of working in partnership and networks." These reform trends, in order to increase the administrative capacity of the countries of the European Union (EU), affect all areas of administrative activity, including tax administration. The main challenges in strengthening administrative capacity are the following:

- **Prolonged formalist restructuring and reform fatigue:** For example, Meyer-Sahling and Jan-Hinrik, cited in the EC Thematic Information Paper (Evropeyska komisija, 2017, p. 3), believe that Member States that joined the EU after 2004 have carried out significant administrative reforms as part of their preparations for membership; the aim of the reforms was to modernize policies, improve efficiency and coordination, and create a merit-based public administration to attract and retain highly qualified staff. In many of these countries, a few years after joining the EU, initial ambitions have waned and a number of aspects of administrative change have remained volatile and fragmented.
- **Performance and accountability:** Sustainable governance indicators reflect the ability of governments to ensure sound policies and measure the competences of the social partners for participation and oversight. In this regard, there is a risk that revenue agencies may not put into practice their formal provisions for better policy-making, as well as veil accountability.
- **Development of the potential of the employees:** The tendency for aging of the employees in the tax administration creates a risk related to the long-term capacity, the institutional stability and the quality of the services. Attention should be paid to the introduction of effective strategies for attracting talent, knowledge transfer and offering career development. On the other hand, it should be borne in mind that the politicization and neglect of merit in hiring employees create corruption in the public administration (including tax administration) and undermines the implementation. Most human resources policies are focused on efficiency, and developing the potential of employees is not always a priority.

Thus, process management becomes leading at the expense of people management (Evropeyska komisija, 2017, p. 5). However, it should be borne in mind that the state of human resources and what is happening in the administration in general has a direct impact on its capacity to provide services.

- **Quality of public services:** According to a study of the Standard Eurobarometer № 85 of 2016, cited in a thematic information document of the EC (Evropeyska komisija, 2017, p. 5), the quality of public services in a country is in line with the conditions for doing business, the level of public well-being and trust in the public administration, incl. Tax administration. The quality of public services is a good indicator of the overall functioning of the state.
- **Providing online services:** Well-designed e-government services can change the quality and efficiency of public services provided. The e-government is associated with initiatives related to the following principles: (1) “Digital by default”—mandatory e-services for business; (2) “Only once”—re-use of information; (3) “Inclusion and accessibility”—access of citizens to the Internet and use of mobile devices; (4) “Cross-border by default”—cross-border services and business mobility; (5) “Interoperability by default”—to accept an electronic document issued abroad and to use foreign electronic identification; (6) “Reliability and security”—the ability to manage personal data by citizens when using online public services; (7) Electronic Identification (eID)—can guarantee a unique identification of the person and the possibility to provide a service to the person entitled to it; (8) Transparency—concerns the responsibilities, efficiency and process of providing electronic services and related personal data.
- **Freely accessible data:** The publication of “freely available data” increases the transparency and accountability of institutions and stimulates the provision of innovative online services by private operators. Also, freely available data can inspire research and citizen participation in policy-making.
- **Reducing budget expenditures:** Targeted cuts are more rational than the general approach, but in the practice of many EU countries, proportional cuts are given priority.
- **Social challenges:** Related to globalization, demographic change, climate change, technological change, public confidence in governance and more.

In addition to the aspects discussed so far, administrative capacity is also related to the development of cooperation capacity. There is a tendency to replace the traditional hierarchies with new forms of organization related to the so-called “Network management”, which is based on cooperation and coordination within the public administration, as well as with stakeholders and intermediaries. This includes overcoming isolation in different administrative units, while sharing infrastructure, processes, data, assets, knowledge, resources, content and tools (Evropeyska komisija, 2017, p. 11). Creating analytical capacity and a better database, analyzing behavior and stimulating creative thinking are also guidelines for developing administrative capacity in the process of drafting strategies, policies and programs (Evropeyska komisija, 2017, p. 13). The capacity to actually implement existing policies and legislation is essential in all areas of public administration. In this

regard, if the existing regulatory framework is not implemented or its poor implementation is not controlled and not adequately sanctioned—the reliable functioning of the administration is at significant risk. In such cases, there is a problem with the quality of independent inspections and public oversight (Evropeyska komisija, 2017, p. 14).

In his study, Borisov (2018) clarifies the concept of “administrative capacity” by pointing out that it is generally associated with the ability of administrative structures to achieve the set goals, and that it remains one of those categories for which there is no commonly accepted definition. According to (Honadle, 1981), quoted by Borisov (2018, p. 19), administrative capacity varies within the defined activities to be performed and it is unlikely that a consensus definition of administrative capacity in the field of public administration will be reached. The terms “administrative capacity”, “capacity development” and “capacity building” appeared in the 1980s and were preceded by other theories, models and approaches to the administrative management capacity (Borisov, 2018, p. 19).

Borisov (2018, p. 22) considers that instead of looking for a difference between good governance and administrative capacity, it is more useful to look for synergies between them that reveal the meaning of their sharing; in this way, “administrative capacity for good governance” can be developed. According to him, capacity is the ability to achieve those goals that at some point we associate with our understanding of good governance. Administrative capacity is created by acquiring certain competencies by employees and building structures, performing specific functions, applying certain mechanisms and principles, introducing rules and regulations, as well as through management style and control methods, opportunities for self-analysis, self-assessment, self-development and self-improvement (Borisov, 2018, p. 22).

10.3 Perspectives of Electronic Tax Audits

According to OECD data (2015, p. 217), tax audit and audit activities represent the main investment of resources of revenue agencies in the surveyed countries (including 34 OECD countries and 22 other countries). About 40% of the surveyed revenue authorities report that over 30% of human resources are earmarked for tax audits, investigations and other verification activities. Therefore, the resources used for these activities and the contribution they make to revenue collection and overall compliance with tax laws are significant. In the conditions of rapid development of technologies, an increase in the use of electronic tax audits can be expected, as a means of more efficient work. However, electronic tax audits could not completely replace traditional audit work. With regard to the results of tax audits, according to the adopted standards for the administrative capacity of EU revenue agencies, the aim is to determine whether a balance has been struck between remote audits and on-the-spot audits of taxpayers (European Commission, 2007).

Tax audit is one of the areas in measuring the operational capacity of tax administrations in relation to fiscal plans (benchmarks) developed by the European

Commission's Directorate-General for Taxation and Customs Union. The aim is to maximize the effectiveness of tax audits, which are a key element of the tax compliance strategy (European Commission, 2007). In this regard, the strategic sub-objectives and criteria for their implementation include:

- **Stable legislative basis for tax audit and access to data from computer-based systems of the taxpayer:** A criterion for achieving this goal is whether the legislation requires taxpayers to provide access to data from computer-based systems.
- **Use of the most appropriate and modern tools and techniques for tax audit of taxpayers' accounting systems, including computerized ones:** Criteria for achieving this goal are—whether tax auditors are provided with sufficient training, information and logistical support for effective audits, as well as and whether auditors are regularly provided with specialized technical information and support for the latest audit software approved for use in the relevant jurisdiction.

In the modern practice of some revenue authorities finds application computer forensics since the methods used to facilitate non-compliance with tax laws are constantly becoming more complex. For example, in Belgium, cases of electronic suppression of sales, such as found that in the retail pharmacy sector, fraud was carried out with business software to manipulate registered receipts by two methods—reduction of actual daily sales by a certain percentage or complete elimination of sales. An electronic audit strategy for detecting electronic sales manipulations has been adopted. In connection with this, an overview is performed by IT specialists of: the composition and structure of the automated system; information flow; the number and content of the files; the moment and periodicity of the manipulation; and system records. The results of the audit after a review by experts have revealed significant amounts of unreported income and reduced taxes (OECD, 2012b, p. 34).

Researchers from the Vienna University of Economics and Business (Brezina et al., 2021) conducted a survey among 331 business taxpayers and 530 tax auditors from Austria in the following aspects:

- Acceptance by taxpayers and tax auditors of online-based, automated tax audits (electronic audits).
- The effects of electronic audits on the trust and power of tax authorities.
- The characteristics of electronic audits that affect the perceived benefits and disadvantages of them for taxpayers and tax auditors, examining four specific characteristics—data confidentiality, audit security, transparency and independence from tax intermediaries.

The results of their study show that the acceptance by taxpayers depends on these characteristics and in particular on the security of the audit, i.e. that the electronic audit cannot be followed by a conventional tax audit of the same period. According to these authors, although this feature increases the acceptance and trust of taxpayers, it is of concern to tax auditors, who respond with less support for electronic audits and a sense of loss of power. Brezina et al. (2021) found a discrepancy between the

perceptions of taxpayers and tax auditors regarding electronic audits. By using automated analyzes, statistical methods and algorithms, electronic audit programs can identify deviations, request clarifications and subsequently assess tax liabilities automatically and in a timely manner. In this way, electronic audits could expand the electronic programs of the tax administration, which have been introduced in different countries based on electronic filing systems such as ELSTER in Germany, e-File in the US, FinanzOnline in Austria or myTax in Australia. Electronic audits are aimed in particular at medium-, small- and micro-enterprises, which usually face a low probability of audit. As electronic audits represent a radical change in the traditional exercise of tax control, their voluntary use is expected to be the first step in their implementation. In the long run, once voluntary implementation is successful, electronic audits may become mandatory (Brezina et al., 2021).

According to these scholars, the automation of tax audits is the next step in efforts to digitalize tax administrations for the following reasons (Brezina et al., 2021):

- Striving to reduce staff costs and increase the effectiveness of audits through the use of electronic audit programs in a constantly growing number of companies with limited audit resources.
- Electronic audits can be seen as an opportunity to increase transparency in the field of taxation, which aims to ensure the adequacy of the data provided in a timely manner and reduce administrative costs for taxpayers and tax authorities, enforcement and litigation.
- Electronic audits can be seen as a large-scale application and improvement of computational and IT-based analyzes of taxpayer data already used by tax authorities around the world to build on conventional tax audits.

Based on the results of the study of Brezina et al. (2021), can be systematized in Table 10.1 the expected benefits and challenges for tax authorities and taxpayers from the introduction of electronic audits.

The results of the Austrian study show conflicting views of taxpayers and tax auditors regarding electronic audits and the online-based audit process, in which taxpayers may choose to regularly upload detailed accounting data to the online platform of tax authorities and receive automatic tax audits and assessments of the tax due. Taxpayers indicate 36% intention to use electronic audits, while tax auditors indicate 46% intention to support the implementation of electronic audits—at this stage the acceptance of electronic audits on both sides is low.

Differences in reactions warn against conducting electronic audits without taking into account both points of view. The results of the study can be useful in the process of digitalization of the tax administration and provide information on how to improve efficiency without compromising trust (Brezina et al., 2021, p. 6).

According to the Florida Department of Revenue's 2002 brochure on electronic sales tax audits (applicable to audits of other taxes as well), electronic auditing is a computer-assisted audit using electronic records to perform all or part of the audit. Electronic audits may be reduced the joint efforts of the taxpayer and the revenue department to perform the audit, and the shorter audit time leads to cost savings.

Table 10.1 Expected effects of the introduction of electronic audits

Electronic audits	
Expected benefits	Challenges
<p>Electronic audits promise benefits for both taxpayers and tax authorities:</p> <ul style="list-style-type: none"> • First, continuous monitoring and immediate feedback when uploading data can lead to the prevention of unexpected tax payments and inadvertent non-compliance. • Second, the conventional filing of tax returns and subsequent tax audits incur administrative costs for both taxpayers and tax authorities. In contrast, electronic audits can improve efficiency for both parties by shifting some of the administrative burden to automated systems. 	<ul style="list-style-type: none"> • In many countries, small and micro enterprises are not frequently audited. Therefore, the move to continuous, full disclosure of detailed data represents a drastic increase in taxpayer oversight, which may meet with resistance. • Conventional tax audits still rely primarily on human experience and judgment. Therefore, both taxpayers and tax auditors may have little confidence in the results of an automatic analysis of tax data. • The low level of acceptance of electronic audits can not only jeopardize the use of electronic audits, but also undermine other digitization efforts in the tax administration, as well as the overall link between taxpayers and tax authorities.
<ul style="list-style-type: none"> • Electronic audits dramatically increase the audit coverage of taxpayers, which allows the tax authorities to focus their resources on taxpayers with significant discrepancies. 	<ul style="list-style-type: none"> • There are concerns among taxpayers and tax auditors about the confidentiality of data and audit accuracy, which hinder the widespread adoption and use of electronic audits.
<ul style="list-style-type: none"> • Electronic audits affect the perceived strength and trust of tax authorities, which are the two main factors determining tax compliance. Taxpayers' trust in tax authorities in conducting electronic audits is expected to increase. 	<ul style="list-style-type: none"> • Tax authorities can increase the collection of data on taxpayers by conducting electronic audits, which could shift the balance of power in favor of tax authorities.
<ul style="list-style-type: none"> • Voluntary electronic audits can encourage voluntary compliance with tax legislation for both small and large enterprises, provided that they are combined with taxpayer-oriented services. • Taxpayers value audit security (follow-up audits for periods for which an electronic audit has been performed are not performed) and reduced risk of unexpected tax payments or litigation. 	<ul style="list-style-type: none"> • Taxpayers may view electronic audits as a disproportionate invasion of privacy that could undermine their credibility. • Tax auditors can expect deliberate misuse of electronic audits by taxpayers. Unlike taxpayers, they react particularly negatively to audit security (follow-up audits for periods for which an electronic audit has been performed are not performed). • The loss of the possibility of conducting conventional ex-post audits leads to less approval of electronic audits and a significant reduction in the perceived power of the tax authorities. Tax auditors are suspicious of the integrity of taxpayers and fear that there may be abuses of electronic audits to evade taxes. • Tax auditors are primarily concerned about the loss of power. Also, because electronic audits represent a significant change in the responsibilities of tax auditors, they may be concerned about their professional future, especially when follow-up (manual) audits are prohibited.

(continued)

Table 10.1 (continued)

Electronic audits	
Expected benefits	Challenges
	<ul style="list-style-type: none">• Tax auditors are concerned about the accuracy of electronic audit results when additional follow-up audits are prohibited.• Tax auditors have significant concerns that electronic audits may be misapplied or even misused by taxpayers.

Source: The author based on Brezina et al. (2021)

Electronic audits are applicable when taxpayers use computer equipment to record their business and maintain accounting data electronically.

Specially designed software for conversion and analysis of electronic data is used for the purposes of electronic audits. Electronic audit uses a variety of audit techniques, including electronic detailed audit and sampling:

1. **Electronic detailed audit:** When conducting an electronic audit, it may be possible to review each transaction, which eliminates the need for sampling. If a detailed audit can be performed at the same time as the sample, then a detailed audit is preferred. This technique is commonly used to audit sales data. For example, detailed audit procedures that may be performed on sales transactions are: a comparison of the total invoice tax with the sales tax returns and the general ledger; recalculation of the total tax due and comparison with the total invoiced tax; export all taxable sales transactions in a separate file to be reviewed for applicable tax rates; inspection of taxable and exempt products, etc.
2. **Sampling:** Includes sampling of part of a much larger group or population and giving a conclusion for the whole population based on the results of the sample audit. In most cases, the test can be carried out much faster than a detailed audit and is therefore cheaper for both taxpayers and the revenue department.

The confidentiality of all information about taxpayers, whether on paper or electronically, is ensured by existing laws. Any breach of confidentiality by any employee of the department is considered a crime (Florida Department of Revenue, 2002).

Special skills are required to verify electronic records by tax authorities. The computer auditor should be an experienced revenue authority who has completed an intensive computer training program. This training focuses on computer systems that process voluminous data. For example, a computer audit specialist must receive intensive training at the University of North Texas, which covers almost 1 year and is complemented by on-the-job training. In addition, he received an educational course on statistical sampling (Johnson & Quaal, 2002).

10.4 Digitization and Taxation

The successful implementation of information technology in the tax administration can improve its work and be a prerequisite for the future success of revenue authorities in managing compliance risks and responding to growing expectations of taxpayers for service. The introduction of Big Data technology combined with improved analysis creates an opportunity to improve taxation. This innovative technology also offers opportunities to manage taxation, transition to a real-time tax system, counter tax fraud and shadow economic activities (OECD, 2016).

Over time, access to real-time or near-real-time data is expected to allow the provision of smarter services that can be customized for individuals and business taxpayers. In addition, the ability to acquire information about taxpayers' life events over time will allow revenue authorities to offer interactive services that can inform and guide taxpayers according to the events and activities they currently need support from (OECD, 2016, p. 30).

The segmentation of taxpayers, considered as clients of the tax administration, allows the revenue authorities to improve the service of their clients and to provide useful information needed by taxpayers to fulfill their obligations properly. In this regard, the aim is to segment taxpayers not only by type, but also to identify similar patterns of behavior. Special attention should be paid to two specific segments:

- **Young citizens who are future taxpayers:** Revenue authorities' digital strategies must take into account that future taxpayers will be more accustomed to mobile devices than personal computers, applications than portal solutions, and short and easy consumer navigation (Gartner, 2015).
- **Tax intermediaries such as accountants, financial advisers and tax planners:** As the level of digital maturity of these service providers and their customer's increases, they will stimulate the demand for more sophisticated services to support new digital customer models (Inland Revenue, 2016).

The use of digital technologies in tax administration, the introduction of sophisticated tools for analyzing big data and improving the customer experience (i.e. taxpayers) require the tax authorities to acquire specialized skills, especially in the field of service promotion, data analysis and information technology. As a result of the use of new IT, it is expected to improve relations with taxpayers and increase compliance (OECD, 2016, p. 36).

Trends for digital transformation of the tax administration include the development of so-called "Intelligent portal" (web portal) that collects information from various sources to provide access to real-time or timely data streams. It is subject to configuration and customization by the administration and the user. This allows information to be presented to the user proactively or in response to requests for service in a way that reflects previous use or preference. To deliver a particular service, the smart portal will be able to collect information from various sources, especially from access to big data. The main features of the Intelligent Portal, which facilitate the delivery of modern services to taxpayers, include: security of access,

security of use, proactive personalized service, easier consumer travel and support through online help and customer service (OECD, 2016, p. 77).

Big data technology allows administrations to consider providing proactive services to taxpayers that can be better tailored to their situation. To this end, web portals will need access to information about taxpayers, including analysis of models of interaction, types and times of transactions, etc. Many tax administrations use or seek to use of pre-filled declarations as a way to improve compliance, weight reduction to taxpayers, simplifying and streamlining business processes. Smart portals aim to enhance the reputation of the tax administration, as well as to improve the proactive provision of useful information, support and guidance to taxpayers and community members to facilitate their tax compliance activities and, where necessary, educate them on the tax system (OECD, 2016, p. 84).

However, tax administrations should not rely on web portals as the only form of digital access for taxpayers. They should provide convenient access points, including built into the financial systems of companies and personal banking. For example, cloud-based banking or accounting services that a taxpayer uses to run his business could provide easy access to rules or guidelines from the tax administration, which will allow him to provide information on VAT and salaries to the tax administration without the need for filling in individual declarations or special documents (OECD, 2016, p. 89).

According to the OECD (2016, p. 40) data analytics is an important tool to help revenue authorities address the specific needs of individual and business taxpayers. In addition to supporting tax audits and assessments, data analysis should identify changes in taxpayers' life cycles to help them comply with legal requirements and be informed about how changes in the situation may affect their tax obligations and their right to use other government services.

Some revenue agencies have strategies in place to access and use data from electronic payment systems (EPS) to detect hidden income since some undeclared economic activities may be related to the use of such systems. For example, the practice of taxpayers redirecting business revenue to an offshore bank account that can be accessed from almost anywhere in the world by using a debit or credit card transaction through the banking system. Electronic business platforms (such as eBay), which have grown worldwide in recent years, can be cited as possible examples of this. Some revenue authorities have identified potential ones risks associated with specific types of electronic payment systems; in particular, a number of countries (e.g. Australia, Canada and Germany) have announced the opening of arrangements involving eBay and PayPal services to conceal business revenue. The United States has identified some common schemes used to move taxable income to offshore areas. Some of these include the use of providers of electronic payment systems, debit cards and credit cards (OECD, 2012b, p. 51).

An OECD study (2012b, p. 53) systematized the approaches of revenue authorities to access and use data from systems for electronic payment:

- Legislative framework that allows the revenue authority to receive data from banks and internet service providers on a regular basis. This data is processed

systematically and compared with the information from the tax returns in order to identify discrepancies.

- Access to transaction data from a third party source and compare this information with tax registers.
- Legislative measures aimed at increasing transparency for actual ownership of offshore accounts and assets.
- Policy to encourage voluntary disclosure of information by taxpayers.
- Legislative framework for the provision of information by banks and ISPs on request, where the request meets certain conditions.
- Specialized training of auditors to be able to detect, research and interpret data from electronic payment systems.
- With agreements for the exchange of tax information for offshore accounts and assets.
- Information provided proactively by other tax jurisdictions.
- Internet research activities to identify entities that have not met their tax obligations.

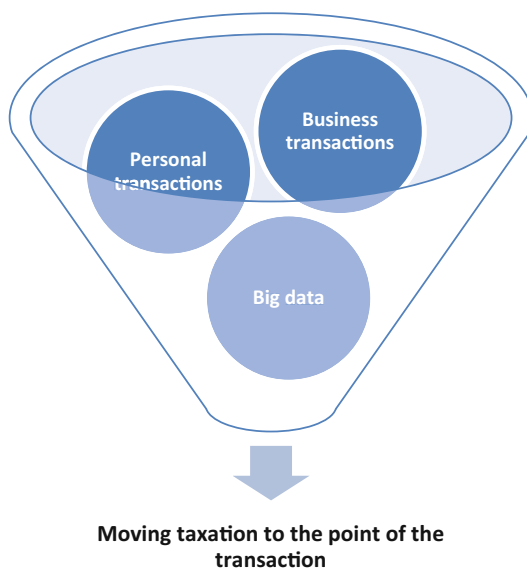
Electronic payment systems increase the ability to make international transactions. In this regard, there is a need to improve cooperation to address the challenges of increasing the exchange of information on electronic payment transactions across national borders (OECD, 2012b).

Big Data technology provides an opportunity to create new tools that will help revenue authorities provide proactive services, better manage and address tax risks—tax avoidance, evasion and fraud, and improve other targeted activities, including debt collection. Big data is a large and complex, often unstructured data set that is difficult to work with using conventional tools and techniques. This is data collected from a wide variety of sources, including the Internet, social media, sensors, text messages, video, images and audio files, and other often unstructured sources. The ability to analyze data in real time or in a timely manner provides revenue authorities with the prerequisites to change the way they manage the risks and services they provide to taxpayers (OECD, 2016).

Collecting large data from third-party sources and combining them with tax data can enable revenue authorities to develop and create personalized electronic services to address the specific needs of individual and business taxpayers. Combining Big Data with modern analytical technologies such as geospatial analytics, network analytics, text and voice analysis, click flow analysis, operational information and real-time analysis can significantly improve the performance of revenue authorities. The availability of real-time data may enable revenue authorities, instead of capturing and analyzing transactions that have taken place in the past, to make real-time or timely tax assessments, provided that their tax systems are integrated with the natural environment of taxpayers (OECD, 2016).

Combining Big Data technology with digital filing of tax returns could have a significant effect on tax administration in the future. Thus, revenue authorities will be able to introduce real-time or timely risk monitoring as well as conformity assessment. Combining big data technology with advanced analysis can create

Fig. 10.1 Technological transformation of taxation.
Source: The author based on (OECD, 2016)



opportunities to counter tax fraud and curb the informal economy. As part of this approach, Big Data can help revenue authorities research and build understanding of taxpayers' historical activity and behavior. Given that most tax liabilities are the result of taxpayers' transactions, over time it will be possible for revenue authorities to be able to move taxation to the point of transaction using Big Data technology, eliminating the need to file most tax returns (OECD, 2016). Such a possible transformation of taxation is presented in Fig. 10.1.

Big Data processing technologies can also allow revenue authorities to more broadly review similar transactions in the relevant economic field, group and compare, and not just analyze the risks of selected taxpayers. Thus, the prospects for revenue authorities are to move from an analysis of historical transactions to a state in which they can review the activities of taxpayers in real time. With the development of technology, structured and unstructured big data sets are expected to be used to support business processes in some or all departments of the tax administration—for identification, selection, compliance audits and decision making (OECD, 2016).

10.5 Improving the Implementation and Performance of the Tax Administration

The views of the OECD Committee of Fiscal Affairs (CFA) on what can be considered good characteristics of revenue agencies have been reflected in the systematized principles of good tax administration. Promoting voluntary compliance

must be a primary concern of revenue authorities. Voluntary compliance is promoted not only through fair and effective treatment, but also through clear, simple and convenient for taxpayers administrative rules, as it becomes easier for taxpayers to fulfill their obligations. Where compliance is not achieved on a voluntary basis, revenue authorities need to identify compliance risks and develop strategies to address them. These include education, service, marketing, risk profiling, auditing, joint efforts to combat avoidance, prosecution and proposals for legislative change. Revenue authorities are expected to address the opportunities and challenges of globalizing global economies and the resulting more complex administration of tax systems. It should be borne in mind that modern taxpayers are more sensitive to differences in inflation, tax treatment, exchange rates, tax rates and the ability of revenue authorities to monitor trade and income flows that exist in different jurisdictions (OECD, 2001).

In a synthesized form, the criteria for “good revenue authorities” relate to how they cooperate and interact with taxpayers, employees and other control bodies, as well as how they adapt to changes in their business and regulatory environment (OECD, 2001). In this regard, the principles of good tax administration provide guidelines for the development of tax systems in the following aspects:

1. **Relationships with taxpayers:** Responsiveness-based relationships are encouraged—they are achieved by providing accessible, reliable and timely information services, as well as by accurate and timely treatment of requests and complaints. This can be achieved, for example, by: facilitating relations with taxpayers through single portals for access to electronic services; improved electronic means of communication between taxpayers and revenue authorities; permitting the electronic submission of declarations; introduction of funds for electronic and payments and online access to account balances. In addition, the revenue authority should consult with taxpayers and other stakeholders on improving and updating basic policies and working procedures to ensure that the costs of complying with tax laws are kept to a minimum level. In this regard, it is also important to ensure that: the rights and taxpayers’ obligations, grievance procedures, and redress mechanisms are outlined and reliably disclosed through manuals, forms, public information, and educational programs; and taxpayer information is used only to the extent permitted by law.
2. **Employee relations:** Qualified and committed employees who are valued and treated fairly are more likely to act fairly and professionally in their relations with taxpayers. Although the salary and benefits paid to employees are not always under the direct control of the revenue management bodies, together with opportunities for the development and improvement of career, they can play an important role in creating an attractive work environment. Employees’ skills should be tailored to the tasks assigned to them. In modern conditions it is necessary to focus on support and development programs for employees. In this regard, it is important to ensure: effective and appropriate control over the appointment, promotion and dismissal of civil servants, which contributes to increasing the integrity of the administration. Community confidence in the tax

administration can be further enhanced by the introduction of codes of conduct and conflict of interest rules that minimize the possibility of personal interests competing with public obligations.

3. **Relations with other revenue authorities:** These agreements are based on tax agreements. These agreements are aimed at avoiding double taxation and preventing fiscal evasion, removing key obstacles to the development of economic relations between the countries. Good tax partners cooperate with other revenue authorities to prevent tax evasion and avoidance. In a globalized economy, global income taxation is only possible if there is a full and effective exchange of information between revenue authorities.
4. **Managing and adapting to change:** Good revenue authorities monitor changes in their business and regulatory environment and adapt their practices to them. They are also actively involved in international tax forums, where they exchange views on their administrative policies and initiatives to jointly address the common challenges facing tax authorities.

The OECD Center for Tax Policy has conducted a comparative study in 56 countries (OECD, 2015), which aims to facilitate dialogue between tax officials on important issues that can serve as a basis for identifying opportunities to improve the organization and functioning of national tax systems. Opportunities for improvement cover the following areas:

1. **Institutional structuring:** Includes the degree of autonomy of the revenue authority, which ensures independence from the executive, but requires weekly supervision to ensure the implementation of administrative activities in the public interest; integrating tax collection with social security contributions as a means of reducing administrative costs and streamlining revenue collection processes; the practice of entrusting revenue authorities with additional non-tax tasks (e.g. payment of social benefits, collection of non-tax liabilities, such as child support, etc.), the establishment of independent bodies to deal with tax complaints (e.g. tax ombudsman) and supervisory bodies of the tax administration.
2. **Organization of revenue authorities:** Includes reforms to improve the efficiency and performance of the tax administration, including centralization of management and reduction of office networks, as well as the introduction of special units for administration and control of large corporate taxpayers and individual taxpayers with high net worth, whose number and wealth have increased significantly in recent years.
3. **Strategic management:** Focus on focusing on increasing taxpayers' satisfaction with their tax obligations, introducing official standards for service delivery, and focusing on reducing administrative costs. There is significant potential to improve the transparency of the tax administration, for example, by publishing performance plans and reports. Attention should also be paid to improving the processes for identifying, assessing and prioritizing the key risks for tax compliance, which are mainly related to—the transfer of corporate profits, transfer pricing, VAT fraud and activities in the informal economy. In this regard,

opportunities are being sought for expanding the use of random audit programs, for risk profiling and for the purpose of measuring the tax gap.

4. **Human resources management:** It includes both the human resources management approach and the issues of recruitment and recruitment, measuring staff engagement, staff development and remuneration. Specific approaches and initiatives are being sought to improve organizational productivity and staff well-being. The trends are towards: application of clear criteria for qualification and experience in the recruitment of staff; staff development initiatives to raise business awareness; introduction of performance management systems and staff remuneration levels linked to public sector pay scales; conducting periodic surveys of staff on the level of satisfaction, commitment and motivation; sharing survey results with staff and consulting staff when considering responses to survey results.
5. **Budget and resources:** Salary costs have the largest share in the total administrative costs (50–90%) and for IT (10–20%). Revenue authorities in many countries aim to reduce their administrative costs, with some requiring significant reductions in the network of offices and staff.
6. **Implementation of the activity:** It includes monitoring and optimization in the following areas—revenue collection, tax refunds, taxpayer services, verification activities, dispute resolution and forced collection of unpaid tax liabilities. Many revenue authorities have significant potential to shift demand for services from costly channels (e.g. personal inquiries) to more cost-effective service channels (e.g. online services). The practice of applying standards for key areas of service delivery and performance monitoring is encouraged.
7. **Use of electronic services:** The aim is to provide modern online services in the tax administration, along with electronic filing and electronic payments by taxpayers. Pre-completion is an important element of the revenue authorities' strategy for electronic services. In order to reduce the share of expensive payment methods used through office networks, progress in fully automated tax collection is encouraged.
8. **Tax intermediaries:** Tax intermediaries play a significant role in the tax system of many countries, performing a number of tasks that are essential for their smooth functioning (for example, when filling out tax returns, advising taxpayers on the application of tax laws and administrative procedures, as well as their representation in relations with revenue authorities). Tax intermediaries are engaged by taxpayers primarily to assist them in meeting their tax obligations. Their widespread use in many countries means that tax intermediaries can play a significant role in achieving high levels of tax compliance, which helps revenue authorities and the community at large to achieve revenue collection targets. In this regard, it is recommended: the introduction of laws and regulations governing the activities of tax intermediaries related to tax transactions; the establishment of formal consultative arrangements for the engagement of tax intermediaries and their regular verification of the tax services provided; the regulation and registration of tax intermediaries; conducting public consultations and participating in online information services.

9. **Legislative framework:** Includes issues such as: regulating the rights and obligations of taxpayers; access to solutions; taxpayer registration and identification systems; third country reporting and information regimes; regimes for submission of declarations and payment; administrative review; forced collection of unpaid taxes; information and access powers; tax crimes (including the use of voluntary disclosure policies and approaches). The use of voluntary disclosure policies and programs is an underused strategy for many revenue authorities. The results from some countries (Australia, Chile and Israel) show that they can be an effective tool to encourage taxpayers to report past defaults, in particular with regard to the concealment of assets and revenues in offshore bank accounts.

European Commission's Directorate-General for Taxation and Customs Union has developed a set of fiscal plans (benchmarks) structured in 14 separate chapters, which contain practical guidelines and clear criteria based on best practices in the European Union against which the tax or fiscal administration can measure its own operational capacity (European Commission, 2007). They can be used to analyze the discrepancies between the current situation in individual countries and the standards (fiscal plans), on the basis of which to ensure the undertaking of fiscal reforms. The 1999 fiscal plans were originally designed to serve as an instrument for candidate countries to join the European Union in strengthening their administrative capacity in adopting and implementing Community legislation (*acquis communautaire*). The revised fiscal plans of 2005 are structured in the following five groups:

- **Framework, structure, and basis:** Comprehensive tax administration framework (FB01); structure and organization (FB02); and tax legislation (FB03).
- **Human and behavioral problems:** Ethics (FB04) and Human Resources Management (FB05).
- **Systems and operation:** Revenue collection and enforcement (FB06); tax audit (FB07); administrative cooperation and mutual assistance (FB08); and fraud and tax evasion (FB09).
- **Taxpayer services:** Rights and obligations of the taxpayer (FB10); taxpayer management systems (FB11); and voluntary compliance (FB12).
- **Maintaining features and tools:** Information Technology (FB13) and communications (FB14).

Each fiscal plan contains—purpose, strategic goals and indicators for the level of their achievement. Fiscal plans are intended to be used as a tool for self-assessment. They provide a comprehensive framework and indicators for assessing each area of tax administration.

After discussing in this chapter the guidelines in which work can be done to improve the activities of the tax administration and the results of its functioning, attention should be paid to specific ways to achieve these goals. In the administrative practice around the world, modern quality management systems (QMS) are used, which represent a unity of management philosophy, management approaches and tools for management of organizations. Among the most recognizable QMS are—ISO (International Organization for Standardization), EFQM (European Foundation

for Quality Management Organizational Excellence), CAF (Common Assessment/Self-Assessment Framework, adopted as a QMS standard for public administration in the countries of the European Union), Baldrige (QMS, popular in the USA). These are conceptual models for managing organizations, based on the ideas of Total Quality Management (TQM). These systems contain a number of common characteristics (Institut po publichna administratsia, 2015).

An example is the European Foundation for Quality Management's (EFQM) Model of Organizational Excellence, which is used in European administrative practice. This model takes into account both the benefits for the organization (institution) and the society, and thus, through its implementation, a balance is achieved between economic and non-economic indicators for the functioning of the respective administration. According to the EFQM Model, the perfect organization strives for sustainable development by managing its processes and resources so as to achieve useful results not only for itself but also for society. Serban and Ghenta (2009, p. 348) point out that the EFQM Model can be used to diagnose an organization's resilience.

European Foundation for Quality Management (EFQM) has been developing and developing the EFQM Excellence Model since 1992. The model is the most popular organizational management framework in Europe and has become the basis for determining the winners of national quality awards in many countries (Institut po publichna administratsia, 2015). A study of the practice in public administration regarding the implementation of quality management systems and the implementation of good governance highlights some advantages of the implementation of the EFQM Excellence Model (Institut po publichna administratsia, 2015, p. 51):

- Provides a comprehensive philosophy of good governance, incl. summarized good practices and a set of appropriate tools.
- It is characterized by flexibility, as it easily adapts to the specific needs and priorities of an administrative structure.
- It focuses on purposeful building and development of relations with stakeholders.
- It is suitable for organizations that provide priority services.
- It is suitable for administrations with a great diversity of functions and work processes, such as ministries, agencies, district administrations, municipal administrations.
- It has good opportunities for engaging and motivating managers and employees in the administrative structures for self-improvement, for justified innovations and improvements.
- There is a positive experience of using the system in a number of administrations in EU member states.

The EFQM model enables organizations across Europe and beyond to develop a culture of improvement and innovation (EFQM, 2021). It is used as a diagnostic model and serves as a basis for the development of activities with social and environmental responsibility. According to Serban and Ghenta (2009, p. 350), using this model, organizations can learn to evaluate themselves, to measure their own progress in order to continue their continuous development.

10.6 Solutions and Recommendations

Issues of administrative capacity should be linked to the principles of good governance in order to achieve synergies that enable sustainable development. Therefore, it can be recommended that the development of administrative capacity be linked to criteria for evaluating the results of the application of the principles of good governance and the principles of good tax administration, so that reforms in the tax system are in line with the Concept of Sustainable Development.

The administrative capacity, incl. in the field of taxation and control, can be considered in a narrow sense and linked to issues such as e-government and information technology (IT), but it is recommended to look at it more broadly so as to include issues to improve the organizational structure, development of human resources, work processes and procedures, as well as the applicable tools, methods and approaches.

Most human resources policies in revenue agencies focus on the efficiency of administrative and control activities, and the development of personal and professional qualities and skills, as well as the potential of employees are not always a priority. In connection with this trend, it may be recommended to focus on improving the management and development of human resources, as a prerequisite for improving work processes and implementation, which leads to increased administrative capacity. Only motivated employees of the tax administration and revenue authorities are able to improve its reputation and trust in its activities, which is a prerequisite for increasing voluntary compliance with tax laws.

Big Data technology, combined with improved analytical techniques, creates an opportunity to improve taxation and providing proactive services to taxpayers that can be better tailored to a specific situation and their needs. There are a number of challenges with the trends for the digital transformation of taxation and control related to the increase of electronic services, communication and data exchange, as well as real-time electronic analysis, electronic tax audits and the application of Big Data technology both for the tax authorities and for the taxpayers to be addressed. To this end, emphasis should be placed on raising ethical standards and integrity in the tax system to ensure that powerful innovative technologies are not misused by revenue authorities to the detriment of the public interest.

10.7 Future Research Directions

In order to improve the opportunities for detecting tax fraud and hidden income, it may be recommended to study the good practices and experience of the approaching authorities in the use and interpretation of data from electronic payment systems.

Research shows that combining Big Data technology with digital filing of tax returns will enable revenue authorities to monitor risks in real time or in a timely manner, as well as to assess the level of tax compliance. Also, it is expected that the

revenue authorities will be able to use Big Data technology to move the taxation to the point of transaction, which in turn will eliminate the need to submit most tax forms and declarations. In view of these trends, it may be advisable to carry out in-depth research on good practices and experience in the application of such technologies, as well as to ensure that they are used in a perfectly lawful manner and not in breach of ethical principles and norms.

In order to develop the administrative capacity of the revenue agencies, a study of the experience of the application of quality management systems (QMS) in the tax administrations of different countries may be recommended. Also, good practices in tax administrations for human resources development can be explored as a prerequisite for improving performance and increasing trust in revenue agencies. It will be useful to explore the possibilities for reliable supervision in the context of expanding the autonomous powers of tax administrations, so as to achieve the development of administrative capacity without compromising the public interest in the process of taxation and control.

At this stage, there are not enough in-depth studies on the activities of tax intermediaries and their impact on the level of tax compliance, as well as on the use of policies and programs for voluntary disclosure of tax information related to previous periods. Research in these areas can also contribute to the development of the capacity of the tax system.

10.8 Conclusion

The development of administrative capacity in the field of taxation and control is closely related to the modernization of revenue agencies in order to implement new approaches and tools to improve performance, quality of services provided, cooperation and synergies. This draws attention not only to optimizing the management of administrative activities and resources for its implementation—with an emphasis on the human factor, but also to the technology and methodology of tax control. Therefore, there is a need to improve the approaches and methodological tools applied by the revenue authorities so that they can respond to changing environmental conditions and trends towards digitalization and globalization.

Despite the tendencies for digital transformation in the revenue agencies, the balance of traditional audits and electronic audits should be sought in the implementation of tax control, as well as the balance between remote audits and on-site audits of taxpayers, as each audit process has a “creative character”, i.e. requires a combination of professional experience, intuition, knowledge and skills—in it the role of the human factor, as well as personal observations, perceptions and communication are indispensable.

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