

# Good system of taxation and controlling instruments as prerequisites of better system governance

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# Tax and its role in economy

- Definition: Tax is contribution of wealth to the state and other governmental bodies to satisfy public needs by public authorities, collected based on unilaterally defined manner and in unilaterally decided amounts in line with a general law (Sokol and others)
- Tax is forcible giving and it is primarily a transfer in money, without a specific counter service given to the contributor (Wagner, Wittmann):
- Logic of any state: J.B. Colbert, 17 century; “The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing”

# Public revenues

- Tax
- Contribution
- Allowances
- Government loans
- Other public revenues, paid by entrepreneurs and/or citizens
- (Contributions formally have voluntary nature, but all these public revenues, except for the specific governmental loans, have a compulsory character)

# Tax burden, as a percentage of GDP (Heritage Foundation, 2012)

- 1. Denmark 49.0
- 2. Sweden 47.9
- 3. Belgium 46.8
- 4. Germany 40.4
- 5. USA 26.9
- 6. China 17.0
- 7. Vietnam 13.8
- **OECD: 34.8 (1975: 29.3%)**
- SEE COUNTRIES
- 1. Bosnia and Herzegovina 41.2
- 2. **Croatia 37.8** (only tax 26.6) - highest 1998: 51%
- 3. Bulgaria 34.4
- 4. Serbia 34.1
- 5. Montenegro 28.0
- 6. Albania 22.9
- History: Rome, 2 century: 10%; France 1788: 11.6%; USA 19. century: 4.5%; USA 1944: 31.5%; Sweden 1950: 20%; Sweden 1975: 41.3%; Hungary 1985-90: 45.5%

# Arithmetic sum of all important rates of tax, contributions, and reimbursements Forbes, Tax Misery Index, 2009

- This index includes the rates of tax on income, profit, wealth, social security, VAT; it is calculated and has ideological nature)
- 1. France 167.9
- 3. Belgium 156.4
- 9. Finland 136,1
- 13. Hungary 124.0
- 19. Poland 116.0
- **36. Croatia 100.2**
- 40. Ireland 94.8
- 48. USA 85.3
- 59. Bulgaria 73.5
- 61. Macedonia 70.9

# Taxation system in the Republic of Croatia in 2012

- Purpose: Financing the needs of state budget, local administration and out-of-budget funds
- Budget 35.2% of GDP
- Local administration, 20 counties, 127 cities and 429 municipalities spend annually: 4.5% of GDP
- Out-of-budget funds (waters, forests, roads, and environment) spend annually: 2.5% of GDP
- **TOTAL 2012:** **42.2% of GDP**

# Fiscal revenues

- Role of fiscal revenues:
- A) allocation
- B) redistribution
- C) stabilization

Central state budget (billion kuna, FX 7.4 for 1 €) **2012**

kuna: **110 billion kuna**

- VAT 41 billion kuna (37% of revenues)
- Contributions 41 billion kuna
- Profit tax 6 billion kuna
- Income tax 1 billion kuna
- Customs 2 billion kuna
- Excise duties 12 billion kuna
- Property tax 1 billion kuna
- Fees 3 billion kuna
- Donations and other 3 billion kuna

# Fiscal revenues II

- Revenues of local administration are: property revenues, county revenues (for vessels, vehicle engines), sanctions, surcharge on income tax, as follows: municipalities 10%, towns up to 30,000 residents up to 12%, towns over 30,000 residents 15%, city of Zagreb up to 30%, tax on vacation houses, on companies, utility fees, temporary stay fees
- Revenues from the out-of-budget funds: various surcharge fees as contribution for waters, contributions for forests, share in the price of fuels for roads and others
- Special part shall be surcharge fees for certain institutions, such as contribution for the Croatian Chamber of Commerce



# Fiscal revenues III

- **VAT**, for goods and services, turnover exceeding 31,000 €, per rates 5,12, standard: **25%**
- (EU: Hungary: 27,18,5....Slovenia 20,8.5%....Germany 19,7%..etc.)
- **Profit tax: 20%**
- (EU: Belgium 34%,France 33.3%,Italy 31.4%, Austria 25%, Czech Republic ... Poland 19%, Bulgaria 10%...etc.)
- **Income tax:** personal deduction 2,200 kuna ... 300€
- Tax rates:

<b>0 - 2200 kuna</b>	<b>12%</b>
<b>2200 - 8800 kuna</b>	<b>25%</b>
<b>8800+</b>	<b>40%</b>
- Minimal basis for the calculation of contributions 2753,45 kuna
- Maximal basis for the calculation of contributions 47.202,00 kuna (6,378€)
- **Other tax:**
- Purchase-sale of real-estate, every following the first is 5% of the value
- Lease of real-estate or intangible property 8.4%
- Capital profit: 12% + surcharge fee for certain municipalities
- Inheritance: 5%, except for relatives in first kinship line (son/daughter, brother/sister)
- **Excise duty:**
- Tobacco, alcohol products, energetic products, airplanes, vessels, vehicles, etc.

# Fiscal revenues IV

- Example of calculation of average gross salary – 7,811 kuna, average in Croatia 2012 (1,055 €)
- EXAMPLE: single person, tax 10%, FX 7.40 kuna for 1 €
- **Gross I** **7,811 kuna**
- I pension pillar 15% 1,171 kuna
- II pension pillar 5% 390 kuna
- **A) Contribution from gross salary** 1,561 kuna
- Benefits 2,200 kuna
- Taxable income 4.048 kuna
- tax 12% 264 kuna
- Tax 25% 462 kuna
- Total tax 726 kuna
- Surcharge 10% 72 kuna
- **B) Total tax and surcharge** 798 kuna
- Gross II (gross I + contribution) 8.998 kuna (borne by the employer: 1,215 €)
- Health care contribution 13% 1,015 kuna
- Employment contribution 1.7% 133 kuna
- Contributions for injuries at work 0.5% 39 kuna
- **NET SALARY (gross I - (A + B))** **5,452 kuna (736 €)**

# Fiscal revenues – expenditure of gross salary II – impact on price of labor

Year - Category	1994	2001	2012
Gross I	100	100	100
Contributions	24	21	20
Income tax	18	9	10
Net salary	58    170€	70    358€	70    736€
Gross II as % of net salary	212	166	166

# Fiscal expenditures – Budget 2012

- Budget 2012, total expenditures 120 billion kn
- Residents and households 64 billion kn
- Employed 24 billion kn
- Interest 8.5 billion kn
- Subsidies 6.5 billion kn
- Assistance 10 billion kn
- Other material costs 7 billion kn
- Budget deficit 2012: 10 billion kuna **3% GDP**, if local administration and out-of-budget funds are included: **3.8% GDP-a**

# Fiscal expenditures per relevant lines

- Health care: 21 billion kn or 6.1% GDP; contribution revenue: 18 billion kn
- Pension system: 36.5 billion kn or 10.6% GDP, contribution revenue 19.5 billion kn
- Croatian Army: 5 billion kn or 1.5% GDP
- Education: 15 billion kn or 4.3% GDP
- Police ministry: 4.5 billion kn or 1.3% GDP

# Informal economy and tax evasion

- Informal economy as a form of current, unregistered economic activity, with the consequences affecting all the actors of the industrial life in a territory (state, individuals, companies); A. Lewis, Ernando de Soto and others.
- Basic feature is that it generates GDP, but does not fall under the supervision of the state and tax regulations
- Tax evasion is 40-50% of grey economy; exact calculation of grey economy suggests the approximate value of the evaded tax (alternative: transfers of money to fiscal oases, approximately 60 of them worldwide, generates almost the same amount of tax evasion)
- Causes of tax evasion: “a broad scope of legislative and regulatory changes, redistribution of social wealth, inefficiency of public control institutions” – World bank, 2010; “non-functioning of ownership rights, high entrepreneur risks, high transaction costs, mistrust to constitutional system, inadequate legal system, and culture of non-payment - North,2010
- Tax evasion can be full or partial, and both forms are present regardless of level of development

# Evaluation of informal economy and tax evasion (Tax Justice Network, London 2011)

- Evaluations of informal economy and tax evasion differ according to different authors, for even more than 200%
- Due to serious approaches, objections are given too, based on observations by other institutions and authors
- Methods of calculation of informal economy and tax evasion are different, such as:
  - \* cash flow in balance sheet
  - \* employment according to official statistics and surveys
  - \* listing of property owned by non-residents in fiscal oases
  - \* assessment of tax evasion based on statistically relevant samples

## Evaluation of informal economy and tax evasion per countries II, as % GDP, OECD,2010

State	Informal	Tax evasion
Sweden	4.7	2.1
USA	8.6	2.3
PR China	12.7	2.3
Japan	11.0	3.1
<b>CROATIA</b>	<b>15.0</b>	<b>6.1</b>
Germany	16.0	6.5
Italy	27.0	11.6
Greece	25.0	12.0
Brazil	39.0	13.4



# Evaluation of informal economy in Croatia according to different authors

- 1) Mađarević-Šujster, 2002, World bank for 1994-2000: **14%**, tax evasion 5.6 – 7.5% GDP
- 2) Economic institute, Zagreb, 2005, **16%** GDP
- 3) Deutsche bank, 2009, **16%** GDP
- 4) M. Švec, 2009, period 2001-2007, **8%** GDP, based on assessment of movement of labor force
- 5) National institute for statistics, 2009, informal economy: **15.8%** GDP ... 21 billion kuna
- 6) IMF, 2010, **22-34%** GDP
- 7) World bank, 2010, **33,4%** GDP (very critical assessment based on transfer of capital to fiscal oases, e.g. For Denmark it is approximately 18.2% GDP ... usual is 5% ... but Danish Fiscal Ministry established in 2011 that the value of 11% of GDP is annually transferred to 55 fiscal oases)
- 8) F. Schneider, Linz; 2012, informal economy **29.5%** GDP

**Financial outflow of capital based on crime, corruption and tax evasion 2001-2010, Global Financial Integrity, Washington, 2012, D.Kar - S. Freitas - SEE, current foreign currency exchange**

No.	State	Total billion \$	% GDP annually
1.	Serbia	51,4	14.5
2.	Bulgaria	15,8	5.0
3.	Croatia	15,2	4.0
4.	Romania	8,8	1.0
5.	BiH	8,3	8.2
6.	Montenegro	6,2	23.1
7.	Macedonia	4,6	14.8
8.	Albania	1,3	1.7

# Tax evasion in Croatia

(according to: Rogić, Lugarić, Šimović, School of Economics in Zagreb, 2007)

- Bases for tax evasion shall be:
- a) illegal economy: smuggling, prostitution, human trafficking, gambling, etc
- b) unregistered economy
- c) informal economy (based on forged balance sheet, infringement of labor contract, violation of social security, money laundering)

# Legal regulations related to tax evasion

- General fiscal law (responsibility of participants in trading with goods and services)
- Special fiscal laws: VAT, income tax, profit tax, company tax, dividend tax, etc.
- Republic of Croatia Criminal Code, Article 286 ... in case of intentional tax evasion, in the amount exceeding 10,000 kuna (1350 € ... between 6 months and 5 years in prison, and in case of “significant gain”, 3-10 years in prison with the reimbursement of damage and evaded tax)

# What influences the level of tax evasion

- Level of democracy and effectiveness of institutions
- Trust into the state and the level of corruption
- Effectiveness of legal system
- Purpose of tax expenditure and fairness of the wealth distribution
- Level of transparency and availability of information

# The amount of tax evasion in Croatia

- It is difficult to determine the amount of tax evasion even in the most conscientious fiscal states: e.g. in Sweden, it is 2 – 9.5% GDP, depending on the source
  - Croatia: Mađarević-Šujster, 2002, 5.5 – 7.5% GDP:
    - evasion of income tax and contributions to and from the salary 4.1% GDP (alternative: 6%): mostly: civil engineering, retail, entrepreneurship and restaurants and hotels services, etc.
    - profit tax evasion 0.2% GDP
    - excise duty evasion 0.3% GDP
    - VAT evasion 1.0% GDP
- Rogić, Šimović, Lugarić, 2007: 7.0% GDP total

# Tax supervision

- Ministry of Finance, and Tax Administration (inspectorate) supervise the tax in Croatia
- 20 Regional Tax administration offices with 600 inspectors
- Results of tax supervision 2004 and 2011
- 2011: 1.7 billion kuna of the new tax revenues collected or 1.5% of the budget, that is, 10% of the evaded tax
- Supervision on the annual basis included around 10% of the active legal persons (average 2004-2011)

Tax supervision results	2004	2011
Control	16,411	7,911
Petty offense	6,418	5,482
Criminal offense	94	150

# Measures to prevent tax evasion

- 1. Institutional: building tax administration and relations with tax payers, education of tax administration officers through universities and their adequate payment
- 2. Legal: stability and continuity of tax legislation, rigid sanctioning of tax evasion in Croatia, better monitoring of tax payers through the electronic tax records (as of 2009, there is PIN number for all residents and companies)
- 3. Socio-economic: need for building tax morality, trust into state institutions, transparent budget system, primarily related to the manner of expenditures of the budget resources



**Simplicity in tax payment – evaluation of tax systems –  
research by Pricewaterhouse Coopers  
– World bank –IFI, 2012**

- Three factors were taken for the evaluation of tax systems: number of paid tax, hours spent to apply the tax regulation relative to SME, tax rates (average) in reference to commercial profit in a state
- The above specified criteria were weighted for 185 countries, in which the biggest world audit company has its offices or temporary missions

# Evaluation of tax systems II

- The best tax systems are those in: United Arab Emirates, Qatar, Saudi Arabia, Hong Kong (China - SAR), and Singapore
- The worst tax systems are those in: Guinea, Chad, Venezuela
- The rating of the following countries is: UK 16, Norway 19, Sweden 38, USA 64, Germany 72, Austria 77, Poland 114, Italy 131
- Rating of SEE countries (Balkan):
- Macedonia 24.... like Finland\*
- Croatia 42.... like Iceland
- Kosovo 44
- Slovenia 63
- Turkey 80
- Montenegro 81
- Bulgaria 91
- BiH 128
- Romania 136
- Serbia 149... like Argentina\*\*
- Albania 160
- \* Macedonian system has, along with Vanuatu, the smallest tax rates of commercial profit
- \*\* Serbian tax system has, along with Venezuela, an ample system of payment: 66 compared to 18 in Croatia

# CONCLUSION

- Tax system, as a part of public revenues/expenditures has to be such to support economic activities aimed at maximization of sustainable human development. System of asymmetric pseudo-liberal capitalism, supported by various forms of monetary expansion, aimed at maximization of profit, results also in significant evasion of tax revenues (EU27 in 2010, tax evasion was evaluated at 8% GDP or 22% of tax revenues, from 10% of tax revenues in Austria to 35% in Bulgaria)\*
- It is evaluated that the tax evasion in Croatia is 15% of tax revenues: alternative World bank: 35% (based on share of 33.4% of informal economy in GDP)
- To reduce the tax evasion, the most important is to: build democratic and transparent society with efficient system of tax supervision and building of trust between the state and tax payers
- \* According to: EU Parliament, R. Murphy, 2012, "Closing the European Tax Gap"