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TAXES AND TAX ADMINISTRATION: THE COURSES OF REFORM AND CERTAIN TAX CONTROL ASPECTS

Porezi i Poreska uprava – pravci reforme i neki aspekti
poreske kontrole

Abstract

Good results notwithstanding, the fiscal consolidation is not complete – the public debt is extremely high and the fiscal deficit has not yet been fully reigned in. In addition to the public enterprise reform, future fiscal results will depend on the collection of public revenue. A potential tax reform – tax rates changes – would not have a crucial impact on public revenue increase and grey economy suppression, as tax rates are not the key obstacle to doing business in Serbia. The key role in grey economy suppression is that of the Tax Administration. In this paper, we shall map out the general directions of desirable Tax Administration reforms, such as the changes in the organisational structure, number and structure of staff, development of an adequate information system, etc. In a separate chapter, we shall address the new regulatory solutions pertaining to inspections, which should, in the field, lead to the achievement of the desired public revenue collection objectives.

Keywords: *public revenue, tax administration, grey economy, tax rates, inspection oversight*

Sažetak

Fiskalna konsolidacija, i pored veoma dobrih rezultata, nije završena – javni dug je izuzetno visok, a fiskalni deficit nije stavljen pod potpunu kontrolu. Pored reforme javnih preduzeća, fiskalni rezultati će u budućnosti zavisiti od prikupljenih javnih prihoda. Potencijalna poreska reforma – izmene poreskih stopa – ne bi mogla presudno da utiče na povećanje javnih prihoda i smanjenje sive ekonomije, pošto poreske stope nisu ključna prepreka poslovanju u Srbiji. Ključnu ulogu u suzbijanju sive ekonomije ima Poreska uprava. U radu ukazujemo na osnovne pravce poželjnih reformi u Poreskoj upravi, kao što su promena organizacione strukture, broj zaposlenih i struktura zaposlenosti, izgradnja odgovarajućeg informacionog sistema i drugo. U posebnom delu osvrćemo se na nova regulatorna rešenja iz oblasti inspekcijiskog nadzora, koja treba na terenu da omoguće postizanje željenih ciljeva u oblasti prikupljanja javnih prihoda.

Ključne reči: *javni prihodi, poreska uprava, siva ekonomija, poreske stope, inspekcijiski nadzor*

Introduction

At the end of 2014, Serbia embarked on an ambitious three-year public finance consolidation programme, as a response to extremely unfavourable fiscal trends and the increasingly likely public debt crisis. A high fiscal deficit, which has been growing since the outbreak of the global economic crisis in 2008, reached 6.6% of GDP in 2014 (the highest in Europe), while the public debt reached whopping 72% of GDP – which were obvious signals that the national public finance was on the path that would be unsustainable in the long term. Fiscal consolidation results achieved thus far unambiguously show that many basic quantitative objectives (fiscal deficit decrease, arrest of public debt growth in 2017) have been achieved, and surpassed, in many ways. Namely, the overall permanent fiscal adjustment of about 4 p.p., planned for the three-year period, was achieved as early as in 2015 and 2016, which allowed for a slight public debt decrease in 2016 already (from 76% of GDP at the end of 2015 to 74.6% of GDP). This neutralised the direct danger of a public debt crisis a year earlier than was planned, which is certainly an excellent result.

There are several reasons why it would be too early and potentially dangerous to proclaim the initiated fiscal consolidation successfully complete at this point. Firstly, a strong fiscal deficit decrease in 2015 and 2016 was not achieved entirely by cutting public expenditure to a level suitable for the strength of the national economy, as originally planned. Since excessive current expenditures (primarily for pensions and salaries) and excessive budget support lent to an unreformed public sector had been identified as the main causes of the existing discrepancy between the public revenue and the public expenditures, fiscal consolidation measures were designed so as to resolve these key imbalances in Serbian public finance. However, except for a nominal pension and salary cut (comprising about 40% of the achieved permanent deficit decrease), the remaining austerity measures on the expenditure side of the budget mostly failed to yield the planned savings that would be of significance for the overall balance sheet. This is particularly true of the almost negligible effects that general government

downsizing had on the budget, which should have been one of the basic pillars of the fiscal adjustment. Despite the failure to achieve a significant share of the budget savings planned, at the end of 2016, the overall deficit was decreased more than had been envisaged (to mere 1.4% of GDP) – thanks to surprisingly high collection of tax and non-tax revenues. The increase in non-tax revenue in the last two years was mostly temporary (unusually high payments of dividends from public and state-owned enterprises, one-off revenue from the sale of 4G licence, etc.), while the collection of the tax revenue exceeding the plan stems from favourable macroeconomic trends and additional revenue coming from the suppression of grey economy. Overall, more efficient collection of tax revenue and some non-systemic savings on the expenditure side afforded about 50% of the overall permanent fiscal deficit decrease in 2015 and 2016 (approximately 2 p.p. of GDP) – which could easily turn out to be unsustainable if not supported by reforms.

The key for the successful collection of the planned tax revenue in 2017 and the years to come lies in the consistent and determined implementation of the Tax Administration reform. In 2015 and 2016, very good results were achieved in tax revenue collection (greatly surpassing the original plans), in large part due to the successfully implemented measures of grey economy suppression. Keeping the tax revenue collection at a level similar to that in 2016 and perhaps some additional improvements in the years to come would be among the key factors for the success of the entire fiscal consolidation programme. The analysis of the tax revenue growth achieved so far shows that it was predominantly the result of certain *ad hoc* measures in the field, implemented by the Tax Administration (inspections of businesses, more rigorous control of VAT refunds, excise refunds, etc.). There are, however, indications that the measures from 2016 have, for the time being, exhausted room for further increase in tax revenue. In addition, since the increase of revenue collection efficiency in 2016 was not rooted in the systemic reforms of the Tax Administration, the question is whether the achieved collection rate can even be maintained in 2017. To preserve tax collection efficiency from 2016 and to improve it in the years to come, a comprehensive reform of

the Tax Administration – its modernisation and capacity increase – is an absolute priority.

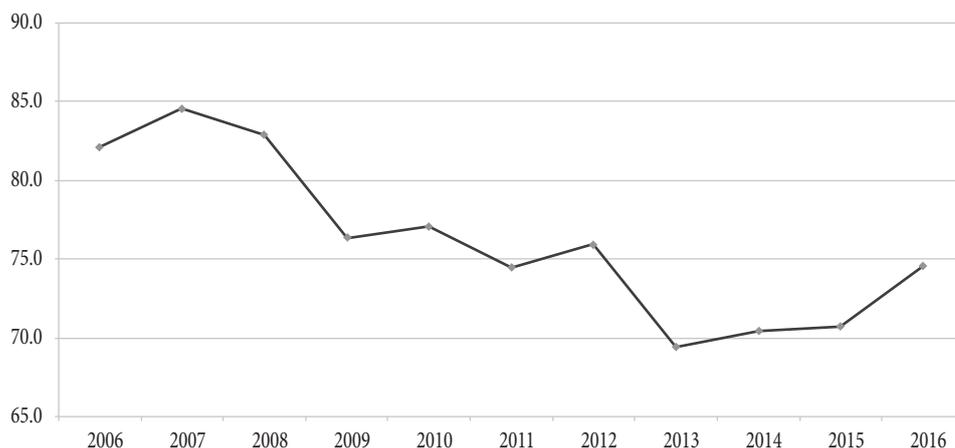
The issue of grey economy

First of all, the informal sector is a systemic problem; permanently high level of grey economy indicates the existence of structural problems within the economy, inadequacy of the legislation, as well as lack of institutional capacities for its implementation. The complexity of grey economy is primarily reflected in: its multidimensional character, as it appears in various forms and at all levels of economic activity; its capillarity, i.e. the fact that the harmful effects of grey economy are usually the consequence of activities of a large number of small, individually irrelevant, players; and its propensity for expansion, as it is impossible for businesses that conduct their activities entirely in line with the law to compete with those that do business partially or entirely in the grey zone and thus, in the medium term, they must either lose their market share and cease their activities or move a portion of their business into the informal zone. These properties of the informal sector exclude, in large part, the possibility of finding swift and easy solutions and require a systemic approach to the resolution of this problem, over several years.

In the last decade, there have been several bouts of significant growth of grey economy and a consequent drop in tax collection efficiency [3, p. 36]. The first wave of grey economy growth was caused by the global economic crisis in 2009, while the second came in 2013 as a result

of internal factors, primarily due to the decrease in tax administration capacities. The decline in tax discipline was stabilised in the first half of 2014; in the second half of that year, certain increase was observed in tax collection and this positive trend continued throughout 2015. There is still room to increase the efficiency of VAT collection in the years to come, which was recognised in the Fiscal Strategy, but there are also risks that it may decrease (as was seen in 2013). The efficiency of the value added tax collection can be monitored using the indicator called C-efficiency. This indicator basically compares the overall revenue collected to the level that should have been achieved based on the corresponding macroeconomic aggregates, assuming flawless collection. This indicator shows an increase in VAT collection rate starting from the last quarter of 2014, which is a consequence of the successful implementation of certain measures aimed at suppressing grey economy. In 2016, there was also somewhat accelerated growth of VAT collection efficiency, bringing it almost to the level from 2012 (prior to the steep drop that came in 2013). Still, achieving the collection level from 2012 would be just the first step in restoring the collection efficiency from the period prior to the economic crisis in 2008. There is definite room for the VAT revenue to keep growing, above the planned level, in 2017 and the years to come. This possibility was recognised in the Fiscal Strategy for 2017, with forecasts for 2018 and 2019. However, without a comprehensive Tax Administration reform, there is a risk that the growth of tax collection efficiency may grind to a halt, or even be overturned, just like in 2013.

Figure 1: Tax collection efficiency



Source: [4, p. 53].

The Fiscal Strategy for 2017 [8] estimates that the VAT revenue could be increased by about 1.8% of GDP in the upcoming four years, which is a difficult, but not an impossible goal. The Fiscal Strategy for 2017 states that there is great room for additional improvement in tax revenue collection. In fact, it emphasises that VAT collection increase alone, in the period 2017-2020, could result in additional revenue of about 1.8% of GDP for the general government. To achieve this goal in practice, the VAT collection efficiency would have to be restored to the pre-crisis level (2007) or even be increased to a somewhat higher level. Even though the presented assessment of the potential effects of VAT collection increase is not impossible, other independent studies on the subject of grey economy show somewhat more conservative estimates. For example, one relevant study estimates that in the medium term (three-year period), the suppression of the informal sector could lead to an overall increase in tax revenues of about 1% of GDP [6]. The fact that fundamental Tax Administration reforms have so far been implemented at a slower pace than was planned speaks in favour of the more conservative estimates. Successful suppression of grey economy requires decisive implementation of systemic measures for the improvement of the efficiency of tax authorities, over a period spanning several years (as evidenced by the prior experiences in the country, but also by the relevant international studies). Namely, grey economy is a systemic problem; if it is maintained at a permanently high level, it indicates the existence of structural problems within the economy, inadequacy of the legislation, as well as lack of institutional capacities for its implementation – which is why there are no quick and easy fixes to this issue and to the increase in revenue collection on these grounds.

Are tax laws the cause of grey economy?

It is frequently said that the tax rates, especially regarding income tax and contributions, are higher in Serbia than in the neighbouring countries. The data in Table 1 shows that the tax rates in Serbia are actually lower than the average tax rates in other Eastern European countries [1] (the tax loads in Western Europe are higher than in

Eastern Europe, but for a country in transition with a large informal sector, the most relevant comparison is with other countries in Eastern Europe). One of the possible sources of confusion is the fact that in Serbia, taxes and contributions are commonly expressed as a percentage of net salaries, while the standard European practice is to express taxes and contributions as a percentage of the overall expenditures of the employer, consisting of net salary, taxes, contributions paid by the employee and contributions paid by the employer (the so-called gross-2 salary). An identical amount of income tax and contributions will appear relatively smaller if compared to the higher gross-2 tax base, than if compared to the smaller net salary. Thus, the common way of expressing income tax and contributions in Serbia as 64% of the average net salary actually means that, according to the standard European methodology, the taxes and contributions amount to $64\% / (100\% + 64\%) = 39\%$ of the overall expenditures of the employer, i.e. 39% of the gross-2 salary. We will observe the common practice in Serbia, expressing tax and contributions for all countries exclusively as a percentage of the net salary.

It is important to note that, even though tax rates in Serbia are lower than the average in the region, the estimated level of grey economy is significantly higher than the average in Eastern European countries. The examples of Macedonia and Bulgaria show that even a decrease in income taxes and contributions cannot guarantee a drop in grey economy, if tax administration capacities are not strengthened. In addition, as can be seen from the examples of the Czech Republic and Slovakia, in the presence of a good tax administration and adequate social and economic environment, it is possible to have a far smaller informal sector than is the case in Serbia, even with significantly higher rates of income tax and contributions. Hence, the question is whether it would be rational to consider the drafts of comprehensive and demanding tax reforms without a prior development of adequate tax administration capacities in Serbia.

Even though income tax and contributions in Serbia are lower than the SEE average, the fact is that they are higher than in Macedonia and Bulgaria – our closest neighbours and direct competitors for attracting foreign investments.

Therefore, a reduction in tax and contributions rate could make Serbia more attractive for investments. However, a significant decrease in income tax and contributions is not realistic as a stand-alone reform measure. For example, a decrease from the current 64% to 50% of the net salary, which is one of the proposals that are being discussed in public at large, would yield a budget deficit increase of 2.4% of GDP, neutralising the positive fiscal consolidation effects achieved so far and landing Serbia back on the path of public debt growth. Significant relaxation of income tax and contributions would only be realistic as a part of a wider tax reform that would include an increase in the VAT rate to compensate for the loss of budget revenues and avoid a deficit increase [2].

The necessary changes to the tax administration

An in-depth reform and development of the Tax Administration are of key importance for efficient economic environment and for the suppression of the informal sector. International experience and examples from Serbian practice strongly indicate that the development of adequate tax administration capacities, primarily the Tax Administration itself, is of key importance for suppressing grey economy and improving business climate. Serbia has the smallest number of tax officers per capita of all the countries in the region, their salaries are not competitive compared to the private sector (especially in the case of more experienced tax officers), while the Serbian Tax Administration is also burdened with a large number of non-tax related competencies (software legality, real estate valuation, VAT refund on

baby products, etc.). Particularly alarming is the situation with tax inspectors, of which there are only 500, even though international experience calls for at least 1,000 (qualified) tax inspectors for a country like Serbia. Strong social and political support, dedication over several years, expert support and increase in funds allocated for tax administration will be necessary for the resolution of the accumulated systemic problems of tax collection.

Improving tax control efficiency requires an in-depth reform of the key segments of tax administration. In the current organisation of tax authorities, there are many challenges and obstacles that must be overcome and reformed to establish an adequate legal and organisational framework for efficient detection of tax evasion. Specifically, the national organisational structure of the Tax Administration would have to be thoroughly modified and human resources improved and organised in a way that would maximise tax revenue. In addition, an integrated information system would have to be developed to allow for efficient resource management and risk-based identification of tax evasion. These issues have also been recognised in the publication of the International Monetary Fund [5].

Tax Administration downsizing and centralisation should be one of the priorities for reform. The idea of Tax Administration rationalisation and aggregation of its organisational units have been discussed among the expert public for over a decade. Thus, for example, when the VAT system was being introduced in 2005, it was decided that only 55 of the (largest) tax offices would be equipped for work with VAT taxpayers. Even though this step was meant to represent an introduction into the

Table 1: Tax rates and the assessed level of grey economy in Eastern Europe, in %

Country	Income tax and contributions	VAT	Profit tax	Grey economy (% of GDP)
Bulgaria	52	20	10	32
Czech Republic	74	21	19	15
Croatia	62	25	20	25
Hungary	93 (70)	27	19	22
FYR Macedonia	47	18	10	~30
Romania	77	20	16	30
Slovakia	74	20	22	16
Slovenia	74	22	17	24
SEE Average	69	22	17	24
Serbia	64	20	15	30

Source: [5].

Note: In Hungary, income tax and contributions comprise 93% of the net salary for workers with no dependents, i.e. 70% in case of two dependents, due to significant tax exemptions.

rationalisation of the tax offices network, no additional reform steps were made in this segment in the last decade. This is why organisational rationalisation is one of operational priorities within the efforts to increase the efficiency of tax authorities.

The breakdown of organisational units into smaller units has a negative impact on human resource management, as it hinders the transfer of knowledge and career advancement of the employees and endangers the uniformity of tax procedures in practice. Namely, the taxpayers are distributed among organisational units according to the territorial principle and it is unrealistic to expect that all offices will be able to develop adequate capacities for the wide range of services and controls performed by the Tax Administration, especially since certain types of control require a certain level of industrial specialisation. In addition, local tax procedures without an adequate information supervision system significantly increase the risk of errors, but also open opportunities for abuse and corruption.

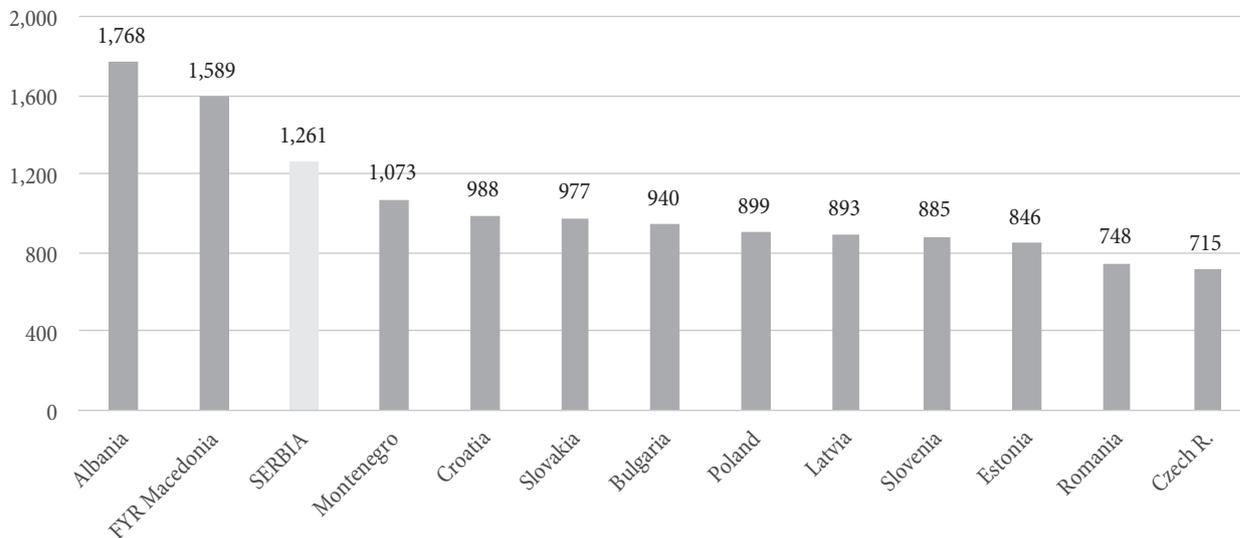
The number of Tax Administration staff is among the lowest in the group of comparable countries in the region. Even though it is the largest system in the Ministry of Finance, with over 6,200 employees, Serbian Tax Administration has fewer employees per capita than comparable countries. Figure 2 shows that Serbia has one Tax Administration employee per 1,261 inhabitants,

while the average in the observed sample is lower by 18%. Therefore, it cannot be said that the Tax Administration has a problem with excess employees, unlike other public administration sectors.

Inadequate educational and age structures of the staff make it more difficult to increase the efficiency of tax authorities. According to available data, only 55% of the employees in Tax Administration received higher education, while the average in the comparable countries is 12 p.p. higher. At the same time, the average age of Tax Administration staff is over 50, while the average in the comparable countries is 44. High average age of Tax Administration staff can lead to a high natural workforce outflow in the upcoming period, which, combined with the existing employment limitations in the public sector, could seriously jeopardise Tax Administration’s ability to perform its tasks. In addition, unfavourable age and educational structures represent an additional aggravating factor in the process of modernisation of the information infrastructure and training of staff for its efficient use.

Inadequate staff allocation by sectors additionally undermines the efficiency of tax authorities. This is reflected primarily in the fact that a small number of staff is engaged in the basic functions, i.e. control and revenue collection, while the majority work on support tasks such as administration, human resources, receipt and processing of tax returns, etc. Thus, the Tax Administration has at

Figure 2: Tax Administration employees per capita



Source: [1].

its disposal around 600 field control inspectors, which is about 10% of the total staff and well below the international recommendations that inspectors should comprise about 25% of the total staff. Amendments to the Law on Tax Procedure and Tax Administration in 2014 introduced the position of a tax controller. Around 300 employees were subsequently transferred from administration to work on simpler inspection tasks, such as employee registration control and issuing fiscal receipts in retail shops. This resulted in a significant increase in field controls; however, it is clear that the tax controllers cannot serve as an adequate or sustainable replacement for the shortage of qualified tax inspectors. Additionally, there are indications that a disproportionately large number of tax inspectors is engaged in the control of small and medium taxpayers, whereas optimal allocation would call for a greater focus on large and medium taxpayers, responsible for the dominant part of tax revenues. This is why special attention needs to be paid to the establishment of adequate capacities within the Centre for Large Taxpayers in the upcoming tax administration reform.

The lack of a unified information system represents a large obstacle to more efficient operation of tax authorities. Currently, Serbian Tax Administration does not have an adequate, comprehensive and modern information system at its disposal. Instead, relevant data and information are fragmented in several ways. There is organisational fragmentation, as there is no central database that would, in a uniform manner, store the detailed data available in individual organisational units. In addition, there is no adequate centralised database that would aggregate, in one place, tax information from separate databases pertaining to different forms of tax, such as VAT, corporate income tax, personal income tax, etc. The development of a modern and comprehensive information system is, therefore, one of the operational prerequisites for Tax Administration modernisation in the upcoming years.

Successful suppression of grey economy requires several years of decisive implementation of the measures for improvement of the efficiency of tax authorities, increased likelihood of tax evasion detection and adequate implementation of penal policies. A well-known result from economic theory shows that economic actors (rationally)

compare the potential profit they could achieve by doing business in the grey zone and the potential damage and fines they would suffer if they were caught in tax evasion. This is why it is important to direct the reform efforts towards: 1) increasing the likelihood of detecting tax evasion and 2) implementing suitable penal measures for businesses evading taxes.

The legislative framework prescribes (relatively) suitable sanctions for tax evasion, but it is necessary to improve the implementation of this legislation in practice. The penal provisions prescribed by the Law on Tax Procedure and Tax Administration can be regarded as relatively adequate when it comes to tax evasion and operating in the grey zone. However, there are numerous examples showing that relevant institutional capacities must be improved, both in tax administration and within prosecutorial and judicial bodies, to ensure adequate implementation of penal provisions in practice. Thus, for example, many tax evasion cases that the Tax Administration filed in the past never got adequate closure in the court. In addition, there were numerous cases in which sanctions prescribed by the courts for serious evasions were excessively mild – which does not contribute to the prevention of, nor does it serve as a deterrent for future tax evasion.

In addition to more adequate implementation of penal measures, more efficient detection of tax evasion (i.e. increased detection likelihood) would represent a key prerequisite for the reduction of grey economy in the upcoming period.

If taxpayers see that the tax authorities have started performing more efficient controls and detecting a larger number of tax evasion cases, they will (rationally) conclude that they would more likely be caught in tax evasion and will thus be more encouraged to report their business activities legally. However, more efficient detection of tax evasion requires in-depth, decisive reform within the Tax Administration.

The Government's tax administration transformation programme

The Government's Tax Administration Transformation Programme for 2015-2020 [7] is a suitable first step in the

suppression of the informal sector. The Government of Serbia adopted the Transformation Programme in the first half of 2015, followed by an Action Plan, which generally allows for an in-depth reform of the Tax Administration and the development of a modern institution capable of efficient detection and prosecution of tax evasion. Specifically, the Transformation Plan allows the Tax Administration to thoroughly reform its key operational shortcomings, such as the irrational organisational structure with a large number of small and inefficient offices, weak and insufficient human resources and fragmented and obsolete information systems which do not allow for efficient resource management and risk-based tax evasion identification.

There are certain improvements in the implementation of the Tax Administration Transformation Programme, but significant delays have been registered in certain segments. Although certain improvements have been made after the adoption of the Government's Transformation Programme, the key improvements in the development of adequate staff capacities of the Tax Administration are not being implemented in line with the original plans. According to the available data, it seems that the largest progress has been made in establishing the Tax Administration's e-services; it is expected that in 2017, it will be possible to submit digital returns for all types of taxes. On the other hand, planned hiring and training of the new staff have only just begun. Namely, in September 2016, a competition was open for the hiring of 100 junior inspectors; the competition has not been definitely closed, even though it is of utmost importance for the operation of this institution, bearing in mind the unfavourable age distribution of the staff and the trend of retirement of the most experienced employees. A serious obstacle to the reinforcement of Tax Administration's human resources lies in the uncompetitive salaries when compared to the private sector, which is why it is extremely difficult to keep the best staff. Even though this problem has been known for a long time, nothing has practically been done to resolve or at least mitigate it. Relevant state bodies must recognise the significance of the Tax Administration in the success of grey economy suppression and support the Tax Administration in implementing the key elements of the Transformation Programme.

Tax control and the Law on inspection oversight

The Law on Inspection Oversight came into full effect on April 30, 2016. The Law regulates content, types and forms of inspection, as well as the inspection procedure, competencies and obligations of the participants in the inspection process and other issues relevant for the subject matter of inspection. Inspection is defined as a task of the state administration, the content and meaning of which are prescribed by the law regulating the operation of state administration, with the aim of acting preventatively or prescribing measures to ensure the lawfulness and safety of business operations and actions of the subjects of inspection. Inspection is also defined as a body within an internal organisational unit, or an internal organisational unit itself, or inspectors of a state administration body or the administration body of the autonomous province or unit of local government, or any other entity with public competencies, which performs the act of inspection; the subject of inspection is defined as a legal person, entrepreneur and natural person, organisational form through which a natural or legal person is performing business activities for which no obligation of registration has been prescribed, as well as an entity with public authorisations as prescribed by the law.

The Law also applies to tax control, i.e. tax inspection, which is performed by the Tax Inspection – Sector for Control within the Tax Administration.

Applicable legislation

The Tax Inspection, in performing inspection (tax control) activities, implements a specific (sectoral) law – Law on Tax Procedure and Tax Administration in the first place; then the Law on Inspection Oversight as a general (systemic) law regulating inspection; and finally the Law on General Administrative Procedure. The Law on Tax Procedure and Tax Administration comprehensively regulates the procedure of determination, collection and control of public revenue subject to the law (the tax procedure), rights and obligations of taxpayers, registration of taxpayers and tax felonies and misdemeanours, while at the same time representing a special law compared

to the Law on Inspection Oversight, with regards to the provisions regulating tax control and tax inspection. Article 4 of the Law on Inspection Oversight prescribes that, in the process of inspection regulated by a special law, the provisions of the special law are to be applied directly if the special law regulates inspection in the said field in a different manner. Therefore, the Law on Tax Procedure and Tax Administration, as the special law, applies to any issue regulated in the Law on Tax Procedure and Tax Administration in the manner different from the Law on Inspection Oversight. Therefore, the Law on Tax Procedure and Tax Administration, as the special law, applies to any issue regulated differently in the Law on Tax Procedure and Tax Administration than in the Law on Inspection; the Law on Inspection pertains to the remaining issues. When an issue is not regulated in the Law on Tax Procedure and Tax Administration or in the Law on Inspection Oversight, the next legislation to consider is the Law on General Administrative Procedure, as the law regulating the administrative procedure in general, as well as other general legislation regulating public administration. The Law on Inspection Oversight is, therefore, an “intermediate level” law, between the Law on Tax Procedure and Tax Administration, as a special law, and the Law on General Administrative Procedure, as a general law.

Monitoring

Tax Inspection collects information and monitors and analyses the state of affairs within its competence. These operations include the collection and analysis of data received through checklists, direct data collection, data collected from state bodies, statistical and other data, as well as the collection and analysis of inspection, administrative, judicial and business practices within its field of inspection and other relevant operations.

On its official web page, the Inspection publishes the list of entities that have been inspected, based on the data collected using checklists, and for which it has been established that they have achieved the highest level of compliance of business practices with the legislation and other regulations, as well as the list of those that have not made their business practices and operations compliant

with legislation and other regulations at all. This provides positive and negative examples and incentives for legal business operation and action, which yields multiple benefits, while illicit behaviour yields multiple negative consequences.

In terms of the least compliant entities, Article 7, Paragraph 7 of the Law on Tax Procedure and Tax Administration prescribes that the Tax Administration shall publish, on its official web page, twice a year – on the last day of the respective six-month period, the name, TIN and amount of tax debt for tax debtors owing the amount equal to or exceeding 20,000,000 dinars (for legal persons) or 5,000,000 dinars (for entrepreneurs); such disclosure does not constitute a breach of the obligation of safeguarding confidential information. We believe that this is a concrete embodiment and a special legal regulation of the legal institute from Article 8, Paragraph 5 of the Law on Inspection Oversight, which brings advantages in terms of implementation; in this manner, the provisions of Article 8, Paragraph 5 of the Law on Inspection Oversight are meaningfully applied to the aforementioned parties (tax debtors).

As for those that demonstrate the highest compliance with the law, we believe that disclosure of the list of such entities does not constitute a breach of the obligation of safekeeping confidential information in tax proceedings. Namely, Article 7, Paragraph 5 of the Law on Tax Procedure and Tax Administration prescribes that the obligation of safekeeping confidential information is only breached if the aforementioned documents, facts or data are used or disclosed in an unauthorised manner. Publishing the list of inspected legal entities that have achieved the highest degree of compliance with the law and other regulations, in our opinion, does not constitute an unauthorised disclosure, or any other type of unauthorised disposal of such data; on the contrary, this is an authorised activity of the tax authorities, grounded in law. The authorisation for this activity is, therefore, contained in the law itself, i.e. its source of law is the Law (legal authorisation), more specifically, Article 8, Paragraph 5 of the Law on Inspection Oversight. A positive comparative example of disclosing taxpayers who have achieved the highest level of compliance with the law is the activity of the

Tax Administration of Montenegro which publishes the “White list” – the list of taxpayers that have demonstrated the highest degree of fiscal discipline, adherence to tax regulation and fulfilment of tax obligations.

Risk assessment

The Law on Tax Procedure and Tax Administration prescribes that the tax control is to be performed based on an annual plan, or a special plan, adopted by the Director of Tax Administration, which is based on the assessment of task risk and tax significance of individual taxpayers. Risk assessment is comprised of several elements, the most significant of which are the probable severity of harmful consequences and the likelihood of such consequences occurring, as well as criteria used to assess them, steps undertaken and techniques applied during assessment, and other relevant factors. The severity of harmful consequences is to be assessed starting from: the nature of harmful consequences (stemming from the type of business activity of the legal entity in question, or the properties of the goods) and the scope of harmful consequences (the higher the turnover and, thus, the public revenues derived from it, the greater the severity of the likely damage, which means that the risk increases). As far as we know, tax inspection uses several criteria for risk assessment and control prioritisation in its work: the turnover achieved; activity – especially whether the activity in question is a so-called high-risk industry (such as, e.g. real estate development); results of previous controls; the total amount of the newly discovered public revenue; size of the taxpayer; related entities; whether the legal representative of the taxpayer undergoing control had also been the legal representative of other taxpayers, the control of which had revealed irregularities and breaches of law; whether the legal representative of the taxpayer undergoing control had also been the legal representative of other taxpayers which had been stripped of their TIN; late tax returns; frequent changes of the business seat, documentation pertaining to cash payments, etc. According to the Tax Administration’s assessments, newly established legal entities carry higher risk, especially in the first year of doing business. There are several aspects to this risk –

newly established businesses, as a rule, have no experience in complying with their tax obligations, so omissions are more likely; there is insufficient data on their operation (they are insufficiently known, i.e. they have no “history”); newly established businesses have very high expenditures (procurement of equipment, goods, etc.), which are not equally matched by turnover; and they file for the refund of previous taxes, raising doubts as to possible abuses, etc. These criteria are checked against those prescribed by the Law on Inspection Oversight by analysis and comparison.

Inspection plan, regular and special tax controls

The Law on Tax Procedure and Tax Administration prescribes that the tax control is to be performed based on an annual plan, or a special plan, adopted by the Director of Tax Administration, which is based on the assessment of tax significance and task risk of the observed taxpayer. This is regular supervision (regular control).

The Law on Inspection Oversight prescribes that the Inspection Plan shall be based on the ascertained state of affairs in the field of inspection and on the risk assessment. The Inspection is obliged to implement the Inspection Plan, except in specific, justified exceptional circumstances that prevent it from doing so. The Inspection is obliged to elaborate a strategic plan (for a period spanning several years) and an annual Inspection Plan. The Annual Inspection Plan is implemented through operative (biannual, quarterly and monthly) inspection plans. An Inspection Plan must comprise: frequency and scope of inspections, by field and by risk level; overview of the legal entities that shall be subject to inspection, i.e. activities that shall be supervised, if it is impossible to identify the legal entities that shall be inspected or if they are too numerous, with the information relevant for inspection and identification of legal entities that shall be subject to inspection; risk assessment for supervised entities inspection, or for supervised activities; territory on which, as well as the period of time during which, inspections shall be carried out; information on the forms of inspection that shall be carried out; information on the Inspection resources that shall be allocated for the performance of these inspections. Therefore, in case of

a large number of supervised entities, the supervised entities may be designated descriptively in the plan. In such a case, they are not identified, but are identifiable, i.e. can be identified based on the adequate parameters.

In addition to regular inspection, special inspections are also performed in cases in which there have been certain disturbances in the market, or if there are indications that the volume of illegal trade has increased. The examples of special tax controls are controls of turnover records through fiscal cash registers and controls of games of chance, as well as procedures for revoking authorisations for the performance of currency exchange activities at the request of the authorised exchange office. The reports (tip-offs) initiating tax control are submitted through the Tax Administration's call centre, the "Tax Alarm" web page or directly, in writing. These reports have the legal effect of an initiative to open proceedings and those submitting such initiatives are not parties to the proceedings that may be opened based on these initiatives. The risk stemming from each submission (report) is analysed. In our opinion, each instance of supervision that has not been planned in the annual plan, or the operative plan for the implementation of the annual plan, represents a special inspection and can be classified under one of the reasons for special supervision prescribed by the legislation.

As for the frequency of control, it was prescribed that the frequency of inspection shall be determined based on risk assessment, by the line Minister, who, for tax control, is the Minister of Finance, within 90 days of the day this Law comes into effect. However, this regulation (Rulebook) has not been adopted yet, even though the deadline for its adoption expired at the end of July 2015.

In addition to the regular (planned), there are special (unplanned) tax controls, depending on specific circumstances and risks. These concrete circumstances and risks may serve as grounds for special control for the period of time that has already been checked as part of a regular control, if the Tax Administration harbours sufficient doubt that a breach of legislative obligations has taken place, i.e. if it assesses that there is a significant risk of illegal tax evasion (e.g. unfounded VAT refund requests, other types of tax fraud and abuse, etc.). We find that, as a rule, legality and regularity of the fulfilment of tax

obligations of a particular taxpayer in a particular time period, which had been inspected through an already conducted supervision in which no irregularities or breaches had been found, should not be subject to a new tax control. However, in exceptional circumstances this can take place through special inspection, when the Tax Administration, based on the data at its disposal, deems it necessary to establish material facts.

Checklists

A checklist is a document comprising a list of priority issues for control and other actions within the competencies of the Inspection, identified in line with the severity of the possible harmful consequences in a given field in line with the rules of risk assessment; as well as the subject and scope of such control. The inspection is obliged to use checklists within the regular inspection procedure. Inspector, acting within the scope of the subject of inspection from the inspection order, undertakes such procedures and actions as are listed in the checklist. The inspector can undertake other verification procedures and actions that are within their authorisations, if they find, in the course of performing the inspection, that it is necessary to undertake them for the purposes of complete identification of the facts of the case and to assess whether the given entity's operation and actions were legal and safe, in cases when such verification procedures and actions are aimed at preventing or neutralizing direct hazards to human life and health, environment, flora and fauna. The Law on Inspection Oversight prescribes the obligation to use checklists within regular inspections, whereas their use is not mandatory for special supervision. Therefore, within the procedure of special supervision, the checklists can, but do not have to be used. Namely, the nature of the regular supervision is such that it should be a planned, systematic, comprehensive endeavour aimed at forming a complete picture of the state of affairs and determining the degree of risk; for this purpose, checklists are used. On the other hand, the nature of special supervision, as a rule, is thematic and aimed at neutralizing a concrete hazard, in a situation in which the risk is increased, etc. However, despite the fact that the use of checklists in special

supervision is not mandatory, we are of the opinion that it is possible, suitable and useful to use them.

The entity being inspected can submit a self-check report to the Inspection, on meeting the requirements from the checklist and on risk self-assessment conducted in line with the items of the checklist and the risk assessment rules. Along with this report, the supervised entity also submits the pertinent documentation, or other materials (photographs and such) that corroborate the findings in the report.

Prevention

The Law on Inspection Oversight prescribes that, in order to fulfil the objectives of inspection, the Inspection is obliged to act preventively. Preventative action of the Inspection is accomplished through transparency, especially: by publishing relevant legislation, inspection plans and checklists; by informing the public on amendments to the legislation and rights and obligations of the entities subject to inspection that stem from such amendments; by informing the public that the inspection has learned of serious risks to human life or health, valuable property, environment or flora and fauna and of the measures and actions undertaken to neutralise or mitigate such risks; by providing expert advice and support to the entity undergoing inspection or to a person seeking to materialise their rights within, or pertaining to, the entity undergoing inspection, including by issuing documents on the application of the legislation and by official advisory visits; by undertaking preventative inspections and other activities aimed at encouraging and supporting the legality and safety of business activities and at preventing the occurrence of harmful consequences to goods, rights and interests protected by law or other regulations, especially when the early signs that these are likely to occur have been observed.

The positive examples of preventative action of the Tax Administration include the publication of the Guide to Value Added Tax (VAT), publication of the explanations pertaining to the control of software legality, invitation of the taxpayers that have failed to file tax returns for a certain period, to file such returns in line with the legislation, etc.

The Law on Inspection Oversight defines official advisory visits as a form of preventative action. Establishing the practice of Tax Administration advisory visits, primarily to micro, small and medium enterprises, in order to acquaint them with their tax obligations, is envisaged in the Corporate Strategy of the Tax Administration for the 2013-2018 period and in the National Programme for the Suppression of Grey Economy from 2015. In addition, the Tax Administration Transformation Programme for 2015-2020 pays significant attention to the activities aimed at encouraging voluntary compliance of taxpayers with tax legislation. If the inspection observes, during their advisory visit, an omission, shortcoming or irregularity in business activities or actions of the visited business, it shall, within eight days of the visit, elaborate and submit to this business a letter comprising the recommendations on how to rectify the said omission, shortcoming or irregularity, to ensure legal and safe business activities and conduct, and the time period in which this correction needs to be made. The business then informs the inspection on whether – and how – it has acted on these recommendations, within the deadline prescribed in the letter.

Conclusion

Fiscal consolidation is going in the right direction, but the macroeconomic stability is not guaranteed in the medium and long term. The results achieved in the field of public finance will depend on cost-limiting reforms (expenditures for public enterprises, pensions and salaries) and on the public revenue collection dynamic. Serbia's experience over the last ten years indicates a pronounced instability of public revenue, i.e. a trend independent of macroeconomic fundamentals and tax rates. Tax collection and the scale of grey economy depend on the work of the Tax Administration. The fiscal results will depend on its capacity and ability to tackle future challenges. In addition to active field controls, future operation of the Tax Administration will also depend on the reforms of this institution itself. Serbia has a small number of tax officers per capita, the salaries in the Tax Administration are not competitive compared to the private sector and the institution is burdened with a large number of non-

tax competencies. The organisational structure of the Tax Administration should be modified (network of offices), the educational and age structures of the staff should be improved and an integrated information system needs to be developed, to allow for efficient resource management and identification of tax evasion based on risk assessment. The Law on Inspection Oversight regulates the content, types and procedures of inspection, competencies and obligations of the participants in the inspection process and other issues relevant for the subject matter of inspection. This is an “intermediate level” law, between the Law on Tax Procedure and Tax Administration, as a special law, and the Law on General Administrative Procedure, as a general law. The inspection publishes the list of the entities undergoing inspection which have been found to have achieved the highest level of compliance of business practices with the legislation, as well as the list of those that have not made their business practices and operations compliant at all. Tax control is performed based on an annual plan and a special plan, which are grounded in the assessment of the tax significance and the tax risk of the individual taxpayers. The Minister of Finance prescribes the frequency of inspections based on risk assessment, but the appropriate regulation (Rulebook) has not been adopted yet. To reduce the arbitrary character of control, we believe it would be suitable and useful to use checklists (lists of critical issues to check) in instances of special supervision as well. More weight should be

given to preventative measures. Even with the good examples of preventative actions implemented by the Tax Administration (publication of the Guide to Value Added Tax, publication of explanations pertaining to the control of software licences, for example), the development of a partnership with the business sector requires stronger preventative action (advisory visits would be one possible form of cooperation).

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