

RAČUNSKO SODIŠČE
REPUBLIKE SLOVENIJE



Audit report

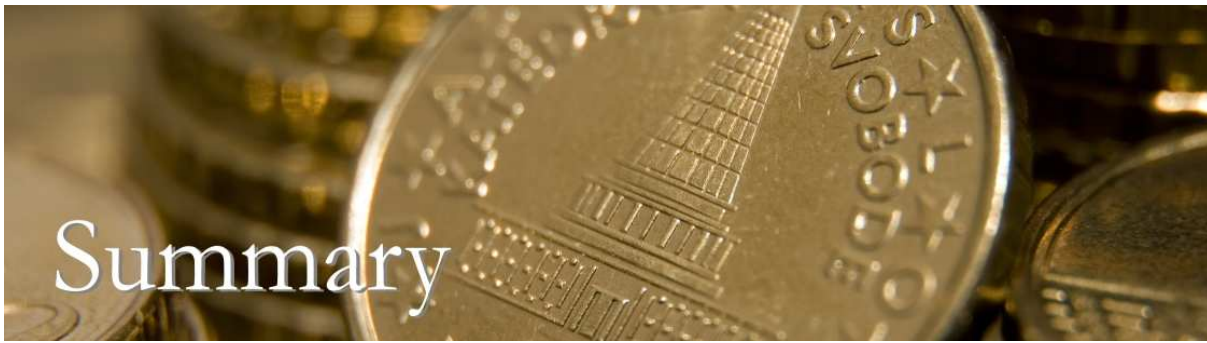
Efficiency of VAT collection
in the Republic of Slovenia

Poslanstvo

Računsko sodišče pravočasno in objektivno obvešča javnosti o pomembnih odkritjih revizij poslovanja državnih organov in drugih uporabnikov javnih sredstev ter svetuje, kako naj državni organi in drugi porabniki javnih sredstev izboljšajo svoje finančno poslovanje.

Audit report

**Efficiency of VAT collection
in the Republic of Slovenia**



The Court of Audit audited the performance of the Ministry of Finance (hereinafter: the MF), the Tax Administration of the Republic of Slovenia (hereinafter: TARS), the Customs Administration of the Republic of Slovenia (hereinafter: CARS) and the Statistical Office of the Republic of Slovenia (hereinafter: SORS) to answer the question *whether the collection of value added tax in the Republic of Slovenia is efficient or not*. It checked whether the volume of losses of value added tax (hereinafter: VAT) in the Republic of Slovenia is known at all and assessed the activities and measures carried out by TARS, CARS and the MF to reduce VAT losses.

During the audit procedure the Court of Audit found out that *the volume of VAT losses* in the Republic of Slovenia *is not known*. In the period covered by the audit it was only SORS that regularly and systematically produced calculations of the theoretical VAT and the scope of VAT evasions as a predominant share of total VAT losses. Already during the audit, CARS joined the estimation of VAT losses by having prepared, for the segment of collection falling within its competence, the first trial estimate based on the extrapolation of results of supervisions within the framework of the bottom-up method, as well as by having calculated VAT losses for 2007. In the period covered by the audit, TARS and the MF did not produce any estimates of VAT losses.

Neither TARS nor CARS *carried out individual analyses or estimated the volume of VAT losses* within the framework of the bottom-up method for individual elements, therefore the main risks for the occurrence of VAT losses by causes, types of activities, size of taxable persons and types of imported goods were not established.

Based on the data about the results of inspections for 2006 submitted by TARS, the Court of Audit produced an estimate of VAT losses in the segment covered by TARS by using the bottom-up method. Considering both calculations of VAT losses, one carried out by CARS within the framework of the segment it covers and the other by the Court of Audit for the segment of VAT collection that falls within the competence of TARS, the Court of Audit estimated that *VAT losses in 2006 amounted to 44,174 million SIT* (184 million EUR) which is 6.4 % of the total VAT income in 2006, if the total income is also considered to include the estimated VAT losses.

To be able to give its opinion about the VAT collection system, the Court of Audit checked the operation of the MF, TARS and CARS, particularly in the field of planning and implementing activities in connection with the reduction of VAT losses and with the related analysis of the initial and planned balances regarding the collected VAT, records keeping and attainment of the objectives set in the field of VAT.

It was not possible to assess the performance of the MF operation (whether it reached the set objectives or not) because the MF failed to set objectives in the field of VAT collection or reduction of VAT losses for the period covered by the audit. The goals set by TARS and CARS are not related to individual types of taxes or duties. The Court of Audit believes that VAT is such an important source for covering budget expenditure that when planning individual measures and activities it would be reasonable to set objectives that are exclusively focused on the field of VAT collection. TARS in some cases failed to reach the planned objectives.

Within the framework of the European Commission, the MF participates in the expert group on combating tax fraud but it has not yet addressed the coordination of competent bodies for regular and continuous analyses of the outputs of the implementation of possible measures that are already being implemented in some Member States of the European Union (reverse charge system for some activities, joint and several liability system, security for identification number allocations, system of mandatory reporting of lawful VAT circumvention schemes, introduction of fiscal cash registers and studies into the scope of shadow economy).

The Court of Audit found out that *sufficient information, education and advice are available* to taxable persons as well as employees in tax and customs administrations, which can be deemed an *effective* measure ensuring a timely assessment and payment of the correct VAT amount by taxable persons. TARS and CARS also carry out *investigative activities*, assessed as *efficient* by the Court of Audit, which is reflected in the volume of the additionally assessed VAT on the request of investigation departments.

The main weaknesses detected in the VAT collection system at TARS as well as CARS predominantly relate to *deficient VAT records*. Monitoring the situation of the assessed and actually collected VAT pursuant to various criteria is *not yet satisfactory*. The TARS and CARS records provide individual information on the additionally assessed VAT during controls and inspections but fail to ensure accurate and complete data by individual elements of the VAT assessment (e.g. the additionally identified VAT liabilities by types of activities and by causes for VAT losses within the framework of individual activities), therefore the risk exists that the data available cannot be used to the most efficient extent possible for the analyses on the basis of which individual risks could be defined and more precisely focused activities reducing VAT losses carried out.

At TARS and CARS inspections are carried out by inspectors who cover all kinds of duties and are not particularly specialised in VAT. The Court of Audit believes that it would be possible to achieve *better efficiency* in detecting irregularities and reducing VAT losses by *specializing* a certain number of inspectors only in the field of VAT and within it in particular causes for the occurrence of VAT losses.

The Court of Audit notes that the VAT collection system in the Republic of Slovenia is satisfactory but it also believes that it would be possible to additionally limit the possibilities for the occurrence of VAT losses by eliminating the weaknesses and deficiencies stated in the audit report, particularly by:

- determining clear and measurable objectives in the field of VAT collection;
- continuously estimating the total VAT losses;
- estimating VAT losses and carrying out analyses by typical individual causes for their occurrence as a starting point for detecting concrete risks and taking adequate action;
- continuously analysing the foreseen outputs of potential measures to increase the efficiency of VAT collection or limit the possibilities for VAT evasion;

- more adequately planning and implementing individual measures and activities;
- improving VAT records used as a basis for planning, analysing and implementing individual measures;
- coordinating all necessary activities of TARS, CARS and the MF and
- promptly and continuously exchanging information, data, views and know-how between TARS, CARS, the MF and SORS.

In accordance with the above stated, in the audit report the Court of Audit produced concrete recommendations for TARS, CARS and the MF that have already been, to a large extent, considered during the implementation of the audit.

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1. AUDIT PRESENTATION

The audit of the efficiency of VAT collection in the Republic of Slovenia was placed on the agenda of the Work Programme for Exercising Audit Powers of the Court of Audit of the Republic of Slovenia in 2006. The decision on carrying out the audit was issued on 8 May 2006.

The legal basis for carrying out the audit is vested in the Court of Audit Act¹ (hereinafter: the ZRacS-1) and in the Rules of Procedure of the Court of Audit of the Republic of Slovenia².

The audit was carried out in accordance with the international standards on auditing stipulated in Instructions for Conducting Audits³, with particular stress laid on standard 41 "Performance Audit" of the European Implementing Guidelines for the INTOSAI Auditing Standards⁴ which defines the course of performance audits.

When carrying out the audit we also relied on the materials gathered during the activities of the Court of Audit of the Republic of Slovenia (hereinafter: the Court of Audit) within the framework of the working group of courts of audit of the EU Member States (hereinafter: the VAT Working Group) whose goal was to find solutions to increase the efficiency of VAT collection. Among other objectives the VAT Working Group also set itself a task to develop and test an internationally comparable methodology for estimating losses of tax revenues when collecting VAT. In their efforts to achieve this objective, members of the VAT Working Group cooperate by presenting already used methods for estimating VAT losses and comparing them, examining advantages and disadvantages of individual methods as well as searching for solutions to design a common or uniform methodology that would enable comparisons of estimated VAT losses between individual Member States of the European Union.

1.1 Audit subject and scope

The audit examined the VAT collection system in the period from 1 January 2002 until the date of issuing the draft audit report, with particular stress laid on 2007.

The key question that we wanted to answer in the audit report was *whether VAT collection in the Republic of Slovenia is efficient or not*.

¹ Official Gazette of the RS, no. 11/01.

² Official Gazette of the RS, no. 91/01.

³ Official Gazette of the RS, no. 41/01.

⁴ Revizor, no. 7-8/99.

1.2 Auditees

The auditees are the Ministry of Finance, the Tax Administration of the Republic of Slovenia, the Customs Administration of the Republic of Slovenia and the Statistical Office of the Republic of Slovenia. When selecting auditees we took into consideration that:

- pursuant to the provisions of Article 29 of the Public Administration Act⁵ (hereinafter: the ZDU-1), the MF⁶ is responsible for carrying out tasks in the field of tax and customs systems, particularly for drafting tax and customs legislation;
- pursuant to the provisions of Article 3 of the Tax Administration Act⁷ (hereinafter: the ZCS-1) or Article 3 of the Customs Service Act⁸ (hereinafter: the ZCS-1), TARS and CARS are directly responsible for implementing tax or customs legislation and
- pursuant to Article 7 of the National Statistics Act⁹ (hereinafter: the ZDSta) and provisions of the Commission Decision no. 94/168/EC¹⁰ (hereinafter: the Decision no. 94) and the Commission Decision no. 98/527/EC¹¹ (hereinafter: the Decision no. 98), SORS estimates the value of VAT tax evasions¹² that are a part of the total VAT losses.

The efficiency of VAT collection is also influenced by the activities of other state authorities, such as the Police in the field of detecting VAT evasions and the Office of the State Prosecutor General of the Republic of Slovenia when prosecuting criminal acts in the field of VAT, that were not selected as auditees because of the purpose of this audit.

⁵ Official Gazette of the RS, no. 113/05-UPB4.

⁶ The audit report examines the MF without bodies affiliated to the ministry.

⁷ Official Gazette of the RS, no. 1/07-UPB2.

⁸ Official Gazette of the RS, no. 103/04-UPB1.

⁹ Official Gazette of the RS, nos. 45/95, 9/01.

¹⁰ Official Journal of the European Communities, no. 77/51, as of 19 March 1994.

¹¹ Official Journal of the European Communities, no. 234/39, as of 21 August 1998.

¹² In the audit report the term "evasion" is understood in a broader sense, not just as a criminal act.

1.2.1 Key tasks of TARS, CARS, the MF and SORS related to the field covered by the audit

Table 1 shows the tasks of TARS, CARS, the MF and SORS in the field covered by the audit which we believe are of crucial importance for an efficient VAT collection.

Table 1: Tasks of auditees in the field covered by the audit

Activity	MF	TARS	CARS	SORS
Calculation of VAT losses	x ¹³	x	x	x
Drafting and implementation monitoring of regulations in the field of VAT	x	x	x	
Analyses in the field of VAT	x	x	x	x
Registration of taxable persons for VAT purposes		x		
VAT assessment		x	x	
Control of taxable persons		x	x	
Investigation		x	x	
Recovery		x	x	
Imposing sanctions on taxable persons		x	x	
Education of taxable persons		x	x	
International cooperation	x	x	x	
Decision-making on tax procedure at the second instance	x			

1.2.2 Responsible persons at TARS, CARS, the MF and SORS

In the period covered by the audit, responsible persons at the MF were:

- Dr Dušan Mramor, minister from 1 January 2002 to 2 December 2004, and
- Dr Andrej Bajuk, minister from 3 December 2004 onwards.

In the period covered by the audit, responsible persons at TARS were:

- Stojan Grilj, director general from 1 January 2002 to 15 June 2004,
- Zvezdana Gržina, director general from 16 June 2004 to 31 December 2005, and
- Ivan Simič, director general from 1 January 2006 onwards.

¹³ The MF has no primary data for calculating VAT losses therefore it is of paramount importance for it to participate in preparing the methodology and analysing VAT losses.

In the period covered by the audit, responsible persons at CARS were:

- Franc Košir, director general from 1 January 2002 to 30 September 2007,
- MSc Stanislav Mikuž, deputy director general from 1 October 2007 to 22 November 2007, and
- Rajko Skubic, director general from 23 November 2007 onwards.

In the period covered by the audit, responsible persons at SORS were:

- Tomaž Banovec, director general from 1 January 2002 to 31 May 2003, and
- MSc Irena Križman, deputy director general from 1 June 2003 to 19 November 2003, director general from 20 November 2003 onwards.

1.3 Audit objectives

The audit objective was to issue an opinion on the efficiency of VAT collection in the Republic of Slovenia. To be able to issue an opinion on the efficiency of the entire VAT collection system, we have set the following sub-objectives:

- to check the existence and adequacy of estimates of VAT losses¹⁴ and
- to assess the efficiency of measures and activities (TARS, CARS and the MF) to reduce VAT losses.

The foreseen outputs¹⁵ of the audit are:

- introduction of a basic model for producing estimates of VAT losses and establishment of an appropriate environment for its upgrading (on the basis of international guidelines¹⁶ and models of good practice for all four auditees);
- regular production of reliable estimates of VAT losses or evasions in the Republic of Slovenia (carried out by SORS, TARS and CARS) and
- available basic set of initial systemic (legislative and legal) and operative (actually implemented) solutions for reducing the volume of VAT losses and an established system of their continuous improvement and amendment (at the MF, TARS and CARS).

The audit report also includes recommendations to eliminate deficiencies recognized in the field of assessment as well as guidelines for actions to reduce VAT losses. Conclusions were formulated in cooperation with TARS, CARS and the MF.

¹⁴ A VAT loss is the difference between the theoretical VAT liability (i.e. the VAT that ought to be collected if all taxable persons charged and paid VAT in accordance with regulations) and actual VAT receipts.

¹⁵ The planned outcomes are not only related to the mere fact of issuing the audit report but also to long-term results that will come to existence as a consequence of the audit procedure, issued audit report, given recommendations and, of course, activities of auditees.

¹⁶ "Guidance for the auditing of value added tax systems: A common understanding of the EU VAT Working Group", adopted by the EU Member States Contact Group in Luxembourg, December, 2004.

1.4 Audit implementation method

When searching for answers to the questions posed, qualitative and quantitative methods and techniques of auditing were used, such as the method of examining and analysing regulations and available literature, and particularly the method of examining the entire procedure of VAT collection and the tools used as a basis for its implementation. The interview and questionnaire completion methods were also extensively used.

In February 2007, representatives of TARS, CARS, the MF, SORS and the Court of Audit paid a professional visit to the National Audit Office (hereinafter: the NAO) in London. The goal of the meeting was to present to the representatives of TARS, CARS, the MF and SORS the methods for estimating and measures for preventing or reducing VAT losses in Great Britain used by Her Majesty Revenue & Customs (hereinafter: the HMRC) as well as to introduce the NAO audit approach in this field to the auditors of the Court of Audit.

During the visit held within the framework of a twinning project between the supreme audit institutions of Great Britain and the Republic of Slovenia, representatives of the HMRC presented their findings regarding VAT evasions in Great Britain, estimates of VAT losses as well as strategies used to reduce the volume of VAT losses and problems encountered in practice. The NAO experts presented their approach to auditing the VAT system and main conclusions. Within the framework of auditing, this visit was the first step made towards improving the VAT collection system in the Republic of Slovenia because the representatives of TARS, CARS, the MF and SORS as well as auditors of the Court of Audit were directly presented the subjects that were particularly helpful during the audit procedure when:

- establishing coordination and cooperation between individual players competent for reducing VAT losses,
- drafting the basis for designing the methodology for producing estimates of VAT losses in the Republic of Slovenia and
- forming the basis for drafting solutions to reduce VAT losses in the Republic of Slovenia.

During the audit we also took into consideration findings, analyses and recommendations of the VAT Working Group regarding the estimation of VAT losses that are stated in the continuation of the audit report.

2. ABOUT VAT

VAT is an obligatory form of taxing turnover of goods and services in the EU Member States. The basic characteristic of VAT is taxation of every phase of trading in goods and provided services. A taxable person does not pay the charged VAT in the amount declared on issued invoices, but only the difference between the charged output tax on sold goods or provided services and the paid input tax on purchased goods or ordered services.

2.1 VAT in the European Union and the Republic of Slovenia

On 1 July 1999 the Value Added Tax Act¹⁷ (hereinafter: the ZDDV) introduced a system of mandatory VAT payment in the Republic of Slovenia. Pursuant to the new Value Added Tax Act¹⁸ (hereinafter: the ZDDV-1) a taxable person is any person who, independently, carries out in any place any economic activity, whatever the purpose or results of that activity. The Act provides for two rates of taxation, i.e. the general one at 20 % and the reduced one at 8.5 %. Taxable persons shall be exempt from accounting VAT providing that in the last twelve-month period their taxable turnover has not exceeded or is unlikely to exceed EUR 25,000. Exemption from accounting VAT shall also apply to the supply of goods and services within the basic agricultural and the basic forestry activity as defined by income tax legislation where the income for such activity is not established on the basis of actual revenues and expenses or actual revenues and normalised expenses and where the cadastral income of all members of an agricultural household in the past calendar year does not exceed EUR 7,500.

At the end of 2006 the VAT registry kept by TARS included 90,430 VAT taxable persons¹⁹.

VAT has a leading role in budget revenues of the EU Member States. In 2005 the share of the collected VAT ranged from 5.9 % (Luxembourg) to 12.4 % (Bulgaria) of the gross domestic product (hereinafter: the GDP); in 2005 its share in the Slovenian GDP was 9.0 %²⁰.

In 2006 the VAT collected in the Republic of Slovenia amounted to 650,858 million EUR²¹ which is a 36.7 % share of central government budget revenues (1,772,491 million SIT). A similar share was also

¹⁷ Official Gazette of the RS, nos. 89/98, 30/01, 67/02, 101/03, 45/04, 114/04 and 108/05.

¹⁸ Official Gazette of the RS, no. 117/06.

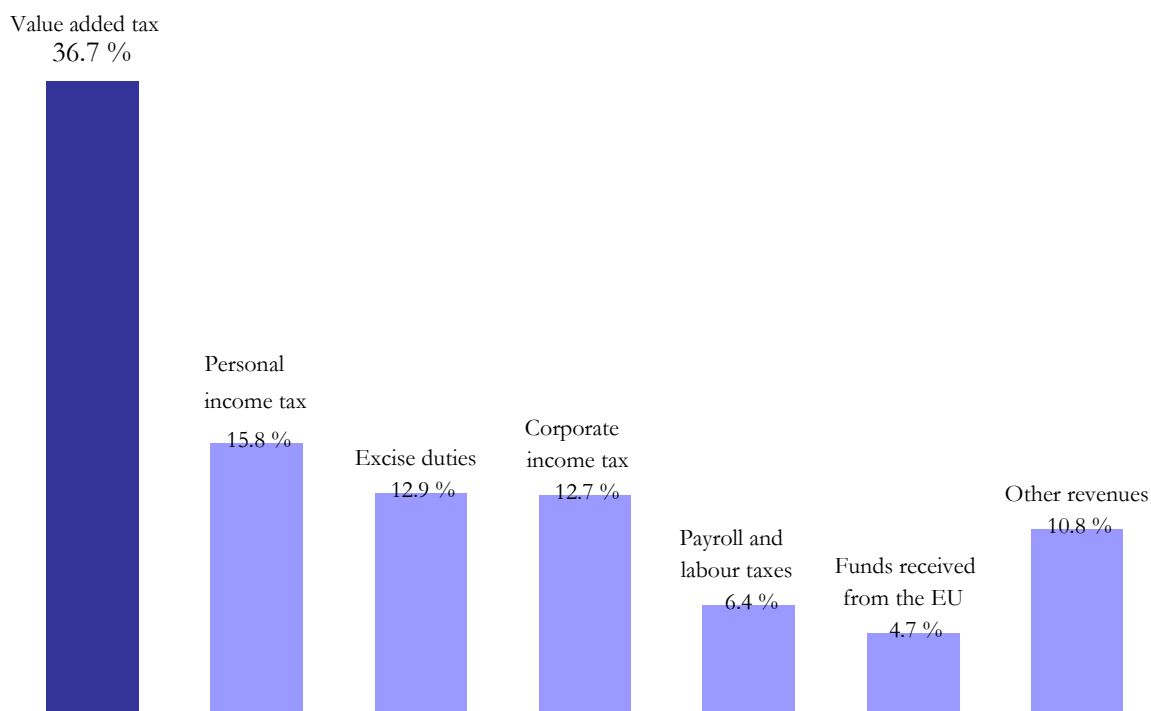
¹⁹ Report on the activities of the Tax Administration of the Republic of Slovenia in 2006.

²⁰ Statistics in focus, Economy and Finance, 31/2007, Eurostat
[URL: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-07-031/EN/KS-SF-07-031-EN.PDF].

²¹ Bulletin of Government Finance, Central Government Budget 1992-2007, the MF
[URL: http://www.mf.gov.si/slov/tekgib/bilten/Drzavni_proracun_1992-2007.xls].

achieved before 2006. Figure 1 presents the share of individual budget revenues of the Republic of Slovenia in 2006 clearly showing the biggest share of revenues collected through VAT.

Figure 1: Share of individual budget revenues of the Republic of Slovenia in 2006



Source: Bulletin of Government Finance, Central Government Budget 1992–2007, the MF.

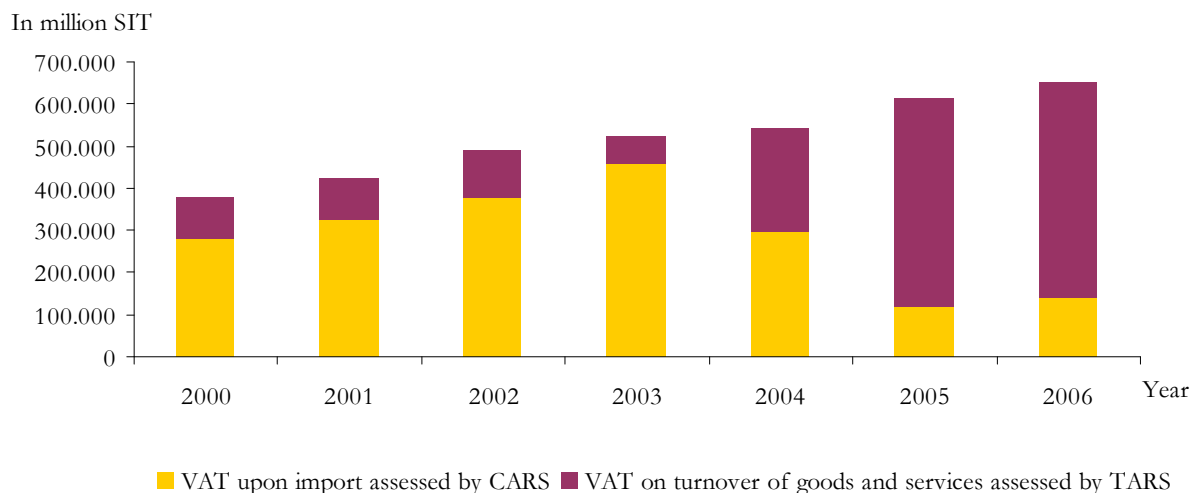
The collection of VAT charged and paid on supplied goods and provided services by a taxable person in the territory of the Republic of Slovenia falls within the competence of TARS and the collection of VAT charged and paid on goods imported to the Republic of Slovenia within the competence of CARS. After Slovenia entered the European Union in 2004 and the border control with the EU Member States was abolished, the share of the VAT collected by TARS after 2004 has increased whereas the share of the VAT collected by CARS decreased. Table 2 and Figure 2 show the total assessed VAT in the period from 2000 to 2006, breaking down the VAT amounts assessed by TARS and the VAT amounts assessed by CARS.

Table 2: Presentation of VAT assessed by CARS and TARS in the period from 2000 to 2006 in million SIT

Year	Assessed VAT – total	VAT upon import assessed by CARS	VAT on turnover of goods and services assessed by TARS	Share of VAT upon import assessed by CARS in %	Share of VAT on turnover of goods and services assessed by TARS in %
2000	375,940	280,067	95,873	74.5	25.5
2001	425,713	326,397	99,316	76.7	23.3
2002	487,931	376,911	111,020	77.2	22.8
2003	524,689	458,802	65,887	87.4	12.6
2004	540,851	294,874	245,977	54.5	45.5
2005	613,019	121,695	491,324	19.9	80.1
2006	650,911	141,173	509,738	21.7	78.3

Source: Information on VAT returns for 2006, TARS, May 2007.

Figure 2: Distribution of the assessed VAT share between CARS and TARS in the period from 2000 to 2006



Source: Information on VAT returns for 2006, TARS, May 2007.

Experiences of the EU Member States (15 countries before the enlargement on 1 May 2004) show that after the integration into the EU their tax revenues from VAT significantly dropped because of the aggravated monitoring of goods traffic (abolition of border controls) and provisional operation without the VAT charged (in the time span from the moment of sale of goods to another EU Member State to the

moment of VAT remittance from the buyer in that country). In some Member States of the European Union VAT losses were estimated to amount up to 10 % of net revenues from VAT²².

A benchmark of calculations of VAT evasions as a share of the total VAT losses for 2002, 2003 and 2004, produced by SORS on the basis of Article 7 of the ZDStA, shows that the scope of VAT evasions in 2004 decreased in relative terms compared to 2002 and 2003, i.e. from 1.9 % or 2 %, respectively, to 1.8 % of the actual VAT receipts (in connection with Chapter 3.5). SORS has not yet produced the estimation of VAT evasions for 2005 therefore it is not yet possible to provide the information about the change in the scope of VAT evasions due to the integration of the Republic of Slovenia into the European Union.

We also asked TARS and CARS whether there were any changes in the volume of VAT losses detected before and after the integration of the Republic of Slovenia into the European Union and, if yes, what these changes were.

Explanation by TARS

TARS explained that in general the data about the tax paid on the basis of VAT returns, together with the data about VAT paid to CARS upon import, shows no significant loss (reduction) of VAT after the integration of the Republic of Slovenia into the European Union. Compared to 2003, in 2004 total revenues from VAT only increased by 3.1 % (the inflation rate in that period was 3.6 %), however in 2005 revenues from VAT increased by 13.3 % compared to the previous year (the inflation rate in that period was 2.5 %).

Explanation by CARS

There were no significant changes pertaining to the VAT share falling within the competence of CARS because the VAT collection system upon import to the Republic of Slovenia differs from the most of the EU Member States. The ZDDV-1 stipulates that VAT on imported goods shall be paid as an import duty which means that the collateral-based VAT payment deferral may only be approved if so prescribed by the customs legislation. Thus, VAT is charged and collected upon the import of goods, which is not the case in other EU Member States where importers may chose when VAT will be paid, which opens new possibilities of VAT losses.

Conclusion

During the audit it was not possible to obtain documents from TARS and CARS that would show the results of estimates of VAT losses before and after the integration of the Republic of Slovenia into the European Union. Therefore it is not possible to present a comparison that would clearly confirm the influence of the integration of the Republic of Slovenia into the European Union on the volume of VAT losses.

2.2 VAT losses

Like other taxes, VAT is subject to risks arising from tax errors and evasions that reduce the scope of the declared, accounted for and collected tax. Besides, because of systemic deficiencies due to insufficiently developed control mechanisms for free movement of goods and services in the European Union, VAT is also subject to additional risks.

²² Report from the Commission to the Council and the European Parliament on the use of administrative cooperation arrangements in the fight against VAT fraud, Brussels, 16 April 2004
[URL: http://eur-lex.europa.eu/LexUriServ/site/en/com/2004/com2004_0260en01.pdf].

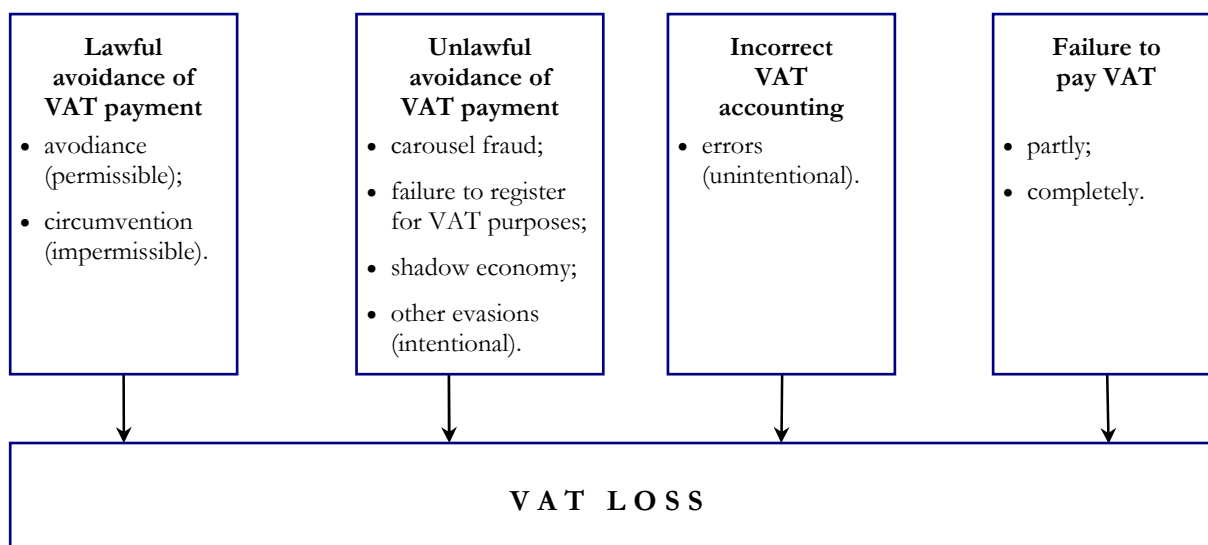
From the legal aspect, the intentional acts of a taxable person carried out to reduce tax liability can be classified in the following ways²³:

- *lawful (permissible) tax avoidance or circumvention* which includes tax relieves, direct reduction of tax liability (change of activity, residence or registered seat of a taxable person) and indirect reduction of tax liability, particularly by changing the taxable person's status (divorce, marriage, merger of companies or changed legal form) and
- *unlawful (impermissible) tax avoidance or evasion* which is a criminal offence against tax legislation through which taxable persons would like to completely or partly avoid tax liabilities (tax evasion of the type "missing trader or carousel fraud", failure to register for VAT purposes and shadow economy, incorrect VAT accounting, if intentional, etc.).

Therefore, VAT losses may be a consequence of lawful and unlawful cases of avoiding VAT payment as well as of tax errors.

The main reasons for the occurrence of VAT losses are stated in Figure 3 and presented in greater detail in the continuation of the audit report.

Figure 3: Main reasons for the occurrence of VAT losses



2.2.1 Lawful cases of avoiding VAT payment

VAT circumvention

Tax circumvention²⁴ particularly means abuse of legal vacuums in tax regulations (a legally permissible action) which is not a tax offence but contravenes the meaning of the institute of taxes. In practice, the division between tax avoidance and tax circumvention is very unclear, however, theoretically speaking, the first term denotes a legal (lawful) and legitimate (justified) avoidance of tax payment while the second term denotes a legal (lawful) but illegitimate (unjustified) avoidance of tax payment. If a taxable person abuses

²³ Criminal Law Aspects of Avoiding Tax Payment, Dr Liljana Selinšek, Revizor 7-8/03 (pp. 73-107).

²⁴ Criminal Law Aspects of Avoiding Tax Payment, Dr Liljana Selinšek, Revizor 7-8/03 (pp. 73-107).

legal vacuums or uses the law in such a manner that completely other goals are achieved than the ones planned by the legislator, the change of regulations must be considered.

Conclusion

Based on the interview method and the examined documentation we have established that TARS and CARS do not follow systematically the VAT circumvention as an institute through which a taxable person, on the basis of a tax regulation, intentionally avoids the VAT payment or illegitimately reduces the VAT obligation. However, during procedures of tax inspections (hereinafter: TIs) the TARS tax inspectors have detected individual cases of lawful circumvention of the VAT payment on the basis of which TARS is preparing proposals for amending the legislation²⁵.

Recommendation

We recommend TARS and CARS to start disclosing individual forms of illegitimate but lawful avoidance of the VAT payment if detected (in connection with Chapter 5.4) and to promptly inform the MF about their findings. These findings shall be examined by the MF and appropriately integrated into the legal framework.

2.2.2 Unlawful cases of avoiding VAT payment (tax evasions)

A tax evasion is an act committed by a taxable person contrary to the law to avoid tax payment or to reduce tax liability and thereby to increase property gain. Due to tax evasions, tax evaders not only unjustifiedly increase property compared to other service providers in the same branch but also become more competitive. Pursuant to the provisions of Articles 12 to 15 of the Criminal Liability of Legal Entities Act²⁶ (hereinafter: the ZOPOKD) criminal acts committed by legal entities may be sanctioned by a fine, forfeiture or even winding up a legal entity. Pursuant to Article 254 of the Criminal Code²⁷, tax evasions enabling significant property gain may even be sanctioned by imprisonment.

2.2.2.a Missing trader or carousel fraud

The most important unlawful VAT evasion is the one of the type Missing Trader Intra-Community or carousel fraud²⁸ (hereinafter: the MTIC) which is an organized crime attack on the tax system aimed at property gains. An evasion of the MTIC type is a systemic evasion with a series of purchases and sales (real or fictitious) between cooperating taxable persons where, as a rule, at least one participant comes from another EU Member State. It is based on the principle of VAT refund claims for the tax that has actually never been paid in the supply chain. Participating taxable persons can be real or fictitious companies or a mixture of both of them.

In the case of a tax fraud of the MTIC type, an economic operator gets registered for VAT purposes with a fraudulent intention of buying goods or services within the European Union (or simulating the

²⁵ Example: draft amendment to the ZDDV-1 introducing Article 36.a that in individual concrete cases defines market value as tax base, submitted to the MF on 20 March 2008.

²⁶ Official Gazette of the RS, no. 98/04-UPB1.

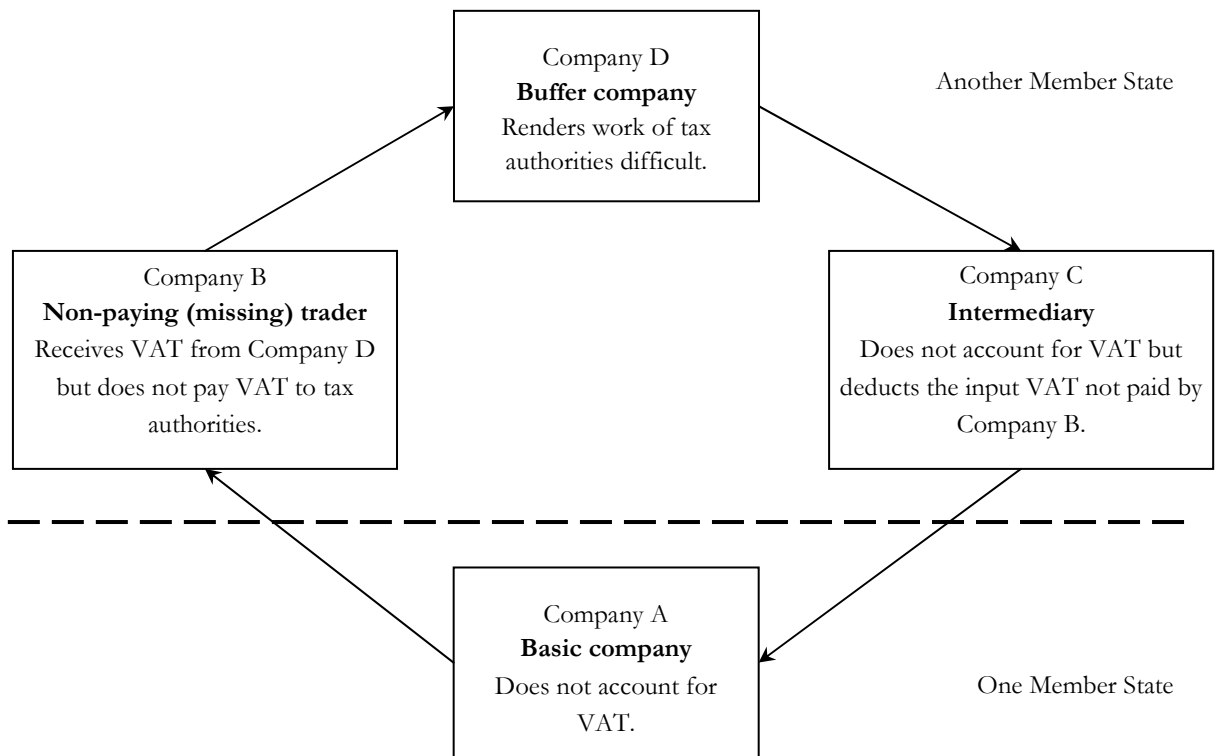
²⁷ Official Gazette of the RS, no. 95/04-UPB1.

²⁸ Handbook on conducting rapid VAT inspections of goods traffic within the EU, TARS.

purchase) without VAT charged and delivering or selling them with VAT charged, but subsequently disappearing without any payment of VAT due to the tax authority. In the Commission Regulation (EC) No 1925/2004 of 29 October 2004 laying down detailed rules for implementing certain provisions of Council Regulation (EC) No 1798/2003 concerning administrative cooperation in the field of value-added tax²⁹ such company is called a missing trader. In the chain of purchases and sales at least one of the companies is always a missing trader that is of crucial importance for this type of evasion.

In the tax evasion of the MTIC type there is no ceiling for VAT losses because they are being added up as long as the carousel fraud mechanism is functioning, i.e. as long as the missing trader has a valid VAT identification number. The above type of tax evasion usually relates to goods characterised by a high value compared to their weight or volume and by appropriately low transport costs, such as mobile phones or computer parts. The scheme of tax evasion of the MTIC type is presented in Figure 4.

Figure 4: Basic scheme of a tax evasion of the MTIC type



Source: Handbook on conducting rapid VAT inspections of goods traffic within the EU, TARS.

The mechanism of the MTIC-type evasion functions in such a way that Company B (missing trader) accounts for VAT on sales to Company C (intermediary) but fails to pay the charged VAT into the budget. Subsequently, the track of Company B or its legal representatives gets lost. Company C that carries out the delivery within the European Union to the basic Company A in the first EU Member State deducts the input VAT from its purchases from Company B that was not paid by Company B. Thus, VAT losses due to evasion equal the amount of VAT paid by Company C to Company B or claimed as input VAT refund.

²⁹ Official Journal L 331, as of 5 November 2004.

To disguise the connection between Companies B and C, Company D is often introduced to the carousel as an interim link or a so-called buffer company whose only purpose is to aggravate the work of investigators. Such a delivery goes indirectly through a buffer entity, Company D.

The basic company (Company A) carries out another delivery within the European Union to Company C (through Companies B and D or other similar buffer companies in another Member State) and this pattern repeats infinitely, as well as VAT losses, because the goods sold are the one and the same. Irrespective of the fact that the basic company (Company A) appears in the first EU Member State, VAT losses actually occur in the other EU Member State where the missing trader has its registered office.

In practice, carousel fraud evasions are not that simple as in the presented example because they often involve several companies in several EU Member States. Possibilities and combinations of carousels are only limited by inventiveness and imagination of fraud participants.

2.2.2.b Failure to register for VAT purposes and shadow economy

If a taxable person who carries out an activity and whose taxable turnover in the period of the last 12 months exceeded EUR 25,000 or EUR 7,500 of cadastral income fails to register as a taxable person for VAT purposes, this is a case of an unlawful failure to register for VAT purposes. Illegal provision of activities or shadow economy is also deemed as an unlawful failure to register for VAT purposes.

Reasons for the occurrence and existence of shadow economy are mostly of an economic character. Most often they include unlawful tax avoidance or tax evasion, improvement of social situation of individuals, evasion from commercial legislation caused by the burden of high labour costs, avoidance of bureaucracy as well as abuse of social security rights so that persons providing undeclared work could keep various kinds of social relief, unemployment benefit in particular.

On the basis of surveys and the labour market method used, the scope of shadow economy is assessed to span from 7.3 % to 11.8 % of GDP; according to other analyses carried out as GDP audits for the period from 1995 to 2002, the scope of shadow economy amounted to approximately 6.5 % of GDP³⁰.

2.2.3 Incorrect VAT accounting

In the case of incorrect VAT accounting individuals account for insufficient output or excess input VAT. Usually, it is difficult to determine whether this is an intentional VAT evasion or just an error in VAT accounting.

2.2.4 Failure to pay VAT

Failure to pay VAT includes cases when taxable persons account for VAT but fail to pay it entirely or do not pay it at all. Reasons for failing to pay VAT can, among other things, be found in the lack of financial

³⁰ Report on activities for and effects of preventing undeclared work and employment for 2005, April 2006, Ministry of Labour, Family and Social Affairs, Commission of the Government of the Republic of Slovenia for Detection and Prevention of Undeclared Work and Employment.

discipline and in global, national or regional economic influences due to which many newly established companies go bankrupt. A company in bankruptcy, compulsory settlement or winding-up proceedings often fails to completely settle its liabilities, among them also the liability to pay VAT.

2.3 Dealing with infringements of tax regulations

In compliance with the legal framework, infringements of legislation in connection with VAT are treated either as minor offences or as criminal offences, which is presented in the continuation.

2.3.1 Minor tax offence

In the Minor Offences Act³¹ (hereinafter: the ZP-1) a minor offence is defined as an action which means violation of a law, a government decree or a decree of a self-governing local community, which is defined as a misdemeanour in itself and for which a sanction for a misdemeanour is prescribed. Penalties provided for minor offences are fines that may be prescribed in a certain range or in a certain amount. Types of minor tax offences and respective assessed amounts of fines are regulated in the Tax Procedure Act (hereinafter: the ZDavP-2)³² and the ZDDV-1, in penal provisions. For minor offences in the field of taxes and customs duties a fine may be legally prescribed in a multiple amount or as a percentage of the tax or customs duty that should have been paid, or as a percentage or multiple amount of the value of the item which was the subject of the misdemeanour; however it may not exceed the highest sum of a fine stipulated in Article 17 of the ZP-1.

2.3.2 Criminal offence

The most frequent criminal offence in the field of VAT is concealment of financial liabilities. Pursuant to Article 254 of the Criminal Code, a criminal offence of concealment of financial liabilities occurs when the perpetrator – so that he himself or anybody else could fully or partly avoid payment of taxes, contributions or any other prescribed liabilities of natural or legal persons – provides false data on legally gained income, costs, objects or any other circumstance that influences the declaration of taxes and other prescribed liabilities, or deludes in any other way the authority competent to assess and control accounting and payment of such liabilities, whereby the liabilities avoided present a significant property gain.

Conclusion

TARS and CARS estimate that it would be possible to further increase the efficiency of sanctioning perpetrators for minor and criminal tax offences by providing additional know-how on tax evasions to public prosecutors and judges.

Recommendations

To reach the objectives of "increasing mutual cooperation between institutions combating commercial criminality in detecting and sanctioning commercial criminal offences, improving the efficiency of detection, prosecution and sanctioning of commercial criminality, as well as accelerating criminal proceedings", as defined in the Resolution on National plan on the Prevention and Combating of Crime

³¹ Official Gazette of the RS, nos. 3/07-UPB4, 17/08 and 21/08.

³² Official Gazette of the RS, no. 117/06.

for the Period 2007-2011³³ (hereinafter: the ReNPPZK0711), we recommend TARS and CARS to examine the possibility of an improved cooperation with public prosecutors, by ensuring mutual education and cooperation with the Office of the State Prosecutor General of the Republic of Slovenia already in the phase of drafting criminal complaints as well as by monitoring criminal proceedings.

Explanation by CARS

During the audit, on 11 June 2008, CARS explained that it had already agreed with the Office of the State Prosecutor General of the Republic of Slovenia³⁴ on holding a lecture at the meeting of public prosecutors in November 2008 and on organizing education of public prosecutors on the topic of customs and excise duty legislation in the second half of 2008 or in 2009.

Explanation by TARS

TARS explained that it organized lectures during Public Prosecutors' Education Days³⁵ covering the topic of VAT evasions.

³³ Official Gazette of the RS, no. 40/07.

³⁴ The CURS minutes of the meeting held on 18 April 2008.

³⁵ Programme of "14th Public Prosecutors' Education Days 2007, 28–30 November 2007".

3. ESTIMATING VAT LOSSES

Estimation of VAT losses is an important tool for their detection and prevention as well as for collection of the right sums of VAT in the right time. The volume of VAT losses due to tax evasions and errors is estimated on the basis of two methods:

- the method "from the top to the bottom" (hereinafter: the top-down method) and
- the method "from the bottom to the top" (hereinafter: the bottom-up method).

3.1 Estimating the volume of VAT losses

3.1.1 The top-down method

According to the top-down method³⁶ the volume of VAT losses equals the difference between the theoretical VAT liability and actual VAT receipts. The theoretical VAT is the calculated value of VAT that ought to be received in the accounting period if all taxable persons accounted for and paid VAT in compliance with the valid legislation. The actual value of the received or paid VAT differs from the theoretical one because of intentional or unintentional errors in payments that contribute to the total VAT losses. Based on the results of the top-down method, a country can assess the trend of the volume of VAT losses and, by using a single methodology and databases, the results can also be compared internationally. The main weakness of this method is the fact that it does not disclose any details about the character of or individual reasons for VAT losses. The deficiency of this method can also be seen in a wrong interpretation of the result when failing to consider the effects of delayed payments (VAT payments pertaining to the previous or following accounting year) on the changed volume of VAT losses.

3.1.2 The bottom-up method

The bottom-up method³⁷ is based on operational data as well as on other sources of information used to produce estimates of the volume of VAT losses in specific areas or for different reasons. Within the framework of this method the data is predominantly provided on the basis of consumer surveys, market research, statistical analyses of data as well as modelling and extrapolating the results of controls of taxable persons. The bottom-up method is more complex and less precise than the top-down method, however, it offers the advantage of searching for direct causes of VAT losses in individual fields and presents an

³⁶ Report of the core group of the European VAT Working Group, Annex A – Estimating VAT losses: Top-down (macroeconomic approach).

³⁷ Report of the core group of the European VAT Working Group, Annex A – Estimating VAT losses: Bottom-up (microeconomic approach).

appropriate basis for drafting strategies to reduce VAT losses within individual segments, thereby enabling a more adequate distribution of resources when taking measures to reduce VAT losses. An important weakness of this method is also presented in the fact that, if tax authorities do not know all possible causes and areas within the framework of which VAT losses occur, it does not provide a final estimate of the volume of VAT losses. The results of this method are also not applicable for international comparisons if countries use different (incompatible) methodologies.

3.1.3 Importance of using both methodologies when estimating VAT losses

Importance of using a combination of both methods is shown at several levels. The top-down method provides an aggregate estimate of the total VAT losses but fails to present individual key elements of VAT losses, such as VAT losses due to evasions of the MTIC type. Thus, it is not possible to develop effective strategies to combat individual causes for the occurrence of VAT losses only on the basis of this estimate. Therefore it is important for the EU Member States to cooperate when developing the bottom-up method of estimating VAT losses. Namely, this method provides a set of various analyses showing the most important risks (e.g. the share of VAT losses by types of activities in the total volume of VAT losses) and enabling competent authorities to take appropriate measures. The bottom-up method can also be used to confirm estimates of VAT losses produced on the basis of the top-down method, and vice versa. It is necessary to stress the importance of the top-down method because in the case of a VAT loss, even when the results of analyses of all possible causes for the occurrence of this loss within the framework of the bottom-up method are added up, this method does not necessarily provide the right estimate or the total volume of VAT losses.

The VAT Working Group believes that the responsibility for estimating the volume of VAT losses on the basis of the bottom-up method must be defined, whereby every individual EU Member State must appoint the most appropriate body to produce these estimates. The VAT Working Group proposes to include both tax and statistical administrations when estimating the VAT gap³⁸.

In its efforts to establish solid grounds for estimating VAT losses, the VAT Working Group emphasizes the importance of producing a single method for estimating VAT losses because of tax evasions of the MTIC type. Namely, such estimates would enable benchmarking of results between individual EU Member States.

In the Republic of Slovenia it is only SORS that continuously produces estimates of VAT losses in the part pertaining to VAT evasions, i.e. by using the top-down method. During the audit, CARS also produced a trial estimate of VAT losses for its segment which was based on the extrapolation of findings of conducted ex-post controls of taxable persons.

In the continuation we present the methods used for producing estimates of VAT losses and the reasons why VAT losses are not being estimated. We also provide an example of estimating VAT losses for the segment covered by TARS. The estimate was produced by the Court of Audit within the framework of the bottom-up method based on the extrapolation of results of TIs carried out by TARS inspectors.

³⁸ Draft report of the core group (measuring VAT gap) of the European VAT Working Group (3 September 2007).

3.2 Does TARS estimate the volume of VAT losses

We have found out that TARS neither produces estimates of VAT losses nor analyses such losses by causes for occurrence and types of activities. TARS also failed to produce benchmarks of estimates of VAT losses with other EU Member States.

In the Questionnaire of the European Commission³⁹ TARS explained that it does not produce estimates of VAT losses because the data on liabilities additionally identified during TIs does not relate to a random sample, but to a sample of risky taxable persons that were defined as such by TARS on the basis of pre-specified criteria.

For the needs of a trial calculation of VAT losses, we asked TARS during the audit to provide data on the sum of the additionally charged VAT based on a random sample of taxable persons that were subject to TIs in 2004, 2005 and 2006. The data delivered by TARS originated from its database on carried out TIs, however, it turned out that this data, otherwise generally available, were extracted for the first time by an IT expert. TARS particularly ensured⁴⁰ that the data delivered included an extract of additionally identified VAT liabilities from the annual plan (VZR001 – Annual Plan) which only covers randomly sampled taxable persons without pre-specified selection criteria (this reason for inspection never covered taxable persons that have already been considered a possible risk and the data was not obtained on the basis of ex-ante analyses). Taking into account the stated facts and additional explanations by TARS we have found out that TARS has had its records on findings of TIs available already since 2004, however, they were not structured in such a way that they would ensure accurate and complete data on TIs carried out exclusively on a random sample of taxable persons (the records on TIs carried out on the basis of a random sample were not kept separately but together with the data on TIs introduced on the basis of certain selection criteria). In the recent years TARS has improved the entry of stated data so that the data on TIs carried out in 2006 already presents an appropriate basis for assessing VAT losses on a random sample of taxable persons.

Based on the answers received within the framework of the questions and interview method as well as on other qualitative techniques of data collection at TARS, we assess that the records on performed TIs provide the data needed by TARS to estimate the VAT gap by extrapolating the results of TIs carried out on a random sample of taxable persons.

Recommendation

We recommend TARS to update the existing records on TI findings so that they will also provide accurate and complete data on the additionally charged VAT by types of activities or causes for VAT losses. By doing so it will be able to regularly produce estimates of VAT losses by individual causes or activities, to even further improve planning of individual TIs on the basis of the analysis of obtained data and to contribute to a more efficient reduction of the volume of VAT losses.

³⁹ Questionnaire no. BUDG/2007/172/00-00-EN(or), 6th Commission Report, Article 12 of the Council Regulation no. 1553/89, European Commission Budget, Own resources, evaluation and financial programming, Control of VAT and GNP resources and ACOR secretariat (hereinafter: the Questionnaire of the European Commission), submitted to the MF on 20 April 2007 (point 3.2.1, p. 22).

⁴⁰ Explanation of TARS as of 9 August 2007.

Focused on precise monitoring of irregularities and the additionally charged VAT by types of activities, we recommend TARS, with regard to established irregularities pertaining to the activity that was carried out but not registered as a core activity by a taxable person, to establish a system for capturing data on additionally identified VAT liabilities in the part of the activity where VAT was evaded and not in the part of the activity for which a taxable person is primarily registered. Therefore we recommend TARS to examine the possibility of introducing a procedure that would enable taxable persons to currently report on the activity to which the achieved turnover predominantly pertains (e.g. reporting within the framework of a monthly VAT return or a quarterly VAT report). By doing so TARS will be able to more appropriately analyse the irregularities within the actually performed activities and consequently to more appropriately plan new TIs.

As the first step in estimating VAT losses covered by TARS, the continuation of the report presents one of the possible ways of estimating VAT losses, i.e. the extrapolation method within the framework of the bottom-up approach. The calculation is based on the findings of TIs conducted in the field of VAT in 2006 on a random sample of taxable persons selected by TARS (within the framework of the annual plan of TIs).

Based on 331 TIs in the field of VAT conducted on a random sample of taxable persons selected by TARS, additionally identified VAT liabilities amounted to EUR 616,801⁴¹. This means that an average additionally identified VAT liability per TI conducted in 2006 amounted to EUR 1,863⁴².

The number of all taxable persons for VAT purposes in 2006 was 90.430. Supposing that for every taxable person VAT liabilities amounting to EUR 1.863 were additionally identified, the total sum of additionally identified liabilities would amount to EUR 168,471,090⁴³.

Considering the fact that in 2006 the net VAT assessed by TARS (VAT payments – VAT refunds) amounted to EUR 2,127,097,730 and the estimated VAT losses amounted to EUR 168,471,090, we establish that within the framework of VAT assessed by TARS the VAT losses in 2006 amounted to 7.3 % of potential (net assessed VAT, increased by the estimate of VAT losses) revenues from VAT⁴⁴.

Recommendation

We recommend TARS to, besides the presented method, also examine other methods used in practice by EU Member States, select the most suitable one and start estimating VAT losses pursuant to the bottom-up method as soon as possible. We particularly recommend TARS to precisely define tasks related to estimating VAT losses and persons responsible for this exercise.

When introducing a regular and continuous practice of estimating VAT losses, TARS shall continue updating the already established records on findings of conducted controls and TIs that will provide precise and usable data on the basis of which individual analyses will be carried out. We advise TARS to

⁴¹ The data is taken from the extract of additionally established liabilities for VAT in the TARS annual plans for 2004, 2005 and 2006, as of 9 August 2007, and from the report on the TARS activities in 2006.

⁴² 616,801 EUR: 331 TIs carried out = 1,863 EUR.

⁴³ 1,863 EUR x 90,430 of all taxable persons in 2006 = 168,471,090 EUR of assessed additional liabilities arising from VAT.

⁴⁴ $168,471,090 \text{ EUR of additionally established liabilities for VAT} : (2,127,097,730 \text{ EUR of total central government budget revenues from VAT} + 168,471,090 \text{ EUR of additionally established revenues from VAT}) \times 100 = 7.3 \%$.

examine in details which data will be needed for analysing VAT losses (e.g. the amount of additionally identified VAT liabilities by types of conducted TIs, types of activities, types of tax evasion or other causes for the occurrence of VAT losses; the amount of additionally identified VAT liabilities in a certain year for the previous year and other data) as well as to duly consider these findings when upgrading the information system.

3.3 Does CARS estimate the volume of VAT losses

CARS did not produce any estimates of VAT losses before the beginning of this audit. The first rough estimate of VAT losses in the segment it covers was produced during the audit on the basis of the existing data for 2006. In the continuation the accounting method used by CARS is presented.

CARS first calculated the percentage of taxable persons regarding which ex-post controls revealed errors and afterwards VAT was collected, which it did by dividing the number of taxable persons regarding which ex-post controls revealed errors by the number of all taxable persons that were subject to ex-post controls⁴⁵.

Based on the extrapolation of findings of ex-post controls (the total number of taxable persons engaged in import procedures was multiplied by the share of taxable persons regarding which errors were detected in ex-post controls), CARS calculated the potential number of taxable persons regarding which errors would be detected in ex-post controls if these were conducted for all taxable persons⁴⁶.

The average VAT amount collected during ex-post controls from individual taxable persons where irregularities were detected was calculated by dividing the value of VAT collected during ex-post controls by the number of taxable persons from which VAT was subsequently collected⁴⁷.

Based on the findings of ex-post controls, CARS estimated VAT losses by multiplying the average VAT amount collected during ex-post controls from individual taxable persons regarding which irregularities were detected by the potential number of taxable persons regarding which errors were expected to be detected in ex-post controls⁴⁸.

Comparison of the estimate of VAT losses with the potentially collected VAT upon import shows that the share of potential VAT losses in the segment covered by CARS amounts to 2.6 %⁴⁹.

Conclusion

The main deficiency in calculating the volume of VAT losses known to CARS particularly relates to the records that do not enable an automatic extract of data about the number of inspections and ex-post controls in the field of VAT or about the scope of the additionally charged VAT within the framework of

⁴⁵ 211 taxable persons: 247 taxable persons = 85.4 %.

⁴⁶ 6,480 taxable persons x 85.4 % = 5,536 taxable persons.

⁴⁷ EUR 603,180: 211 taxable persons = EUR 2,859 per taxable person.

⁴⁸ 5,536 taxable persons x EUR 2,859 taxable person = EUR 15,827,424.

⁴⁹ EUR 15,827,424: EUR (588,988,197 + 15,827,424) x 100 = 2.6 % (harmonization of the CARS taxation method with the taxation method of the Court of Audit – the divisor is increased by the calculated VAT loss).

conducted inspections and separately within the framework of post-clearance controls of customs declarations; moreover, the data on VAT accounting within the framework of conducted investigations is not separately recorded. We have found out that, when calculating the volume of VAT losses, instead of considering the paid VAT CARS considered the charged one. Besides, already during the audit implementation CARS pointed out that the sample of taxable persons subject to inspection was determined on the basis of a risk analysis (size of imports, not yet controlled taxable persons and other) and not randomly therefore it is possible that the extrapolation of findings pertaining to risky taxable persons on the entire population of taxable persons shows a higher share of VAT losses in the total VAT charged than it would be the case if CARS randomly selected taxable persons subject to inspection and considered the amounts of the charged VAT, instead of the paid one, when producing the calculations.

Recommendation

CARS shall continue upgrading, developing and documenting estimates of VAT losses pursuant to the bottom-up method. In its calculation it shall particularly consider the scope of the charged instead of the paid VAT; for the purpose of representativeness it shall also produce an estimate of VAT losses based on a random sample of taxable persons. For the needs of individual analyses within the framework of the bottom-up method, it shall continue upgrading the existing records of data originating from conducted inspections by collecting it pursuant to individual parameters for which it believes that could substantially contribute to a more efficient VAT collection (connection with Chapters 4.2.3 and 4.2.4).

Measures by CARS

CARS explained that with regard to estimating VAT losses it:

- *established a working group engaged in specifying the method for estimating the value of VAT losses;*
- *the Plan for Implementing the Development Strategy of the Customs Service by 2010 formulated the objective for the period 2008–2009 "Efficient collection of mandatory duties presenting a budget revenue of the Republic of Slovenia and partly of the European Union by monitoring indicators, detecting losses in the collection of duties, searching for reasons and taking appropriate measures as well as increasing the efficiency of recovery" and concrete activities in the field of VAT (stated in point 4.2.1) and*
- *produced a new methodology for estimating VAT losses and calculated VAT losses for 2006 and 2007 on the basis of that methodology⁵⁰.*

3.4 Does the MF perform the activities necessary to ensure a comprehensive and credible estimate of VAT losses

By using various qualitative techniques of data collection we have established that the MF does not monitor the theoretical VAT but only the scope of the charged VAT on the basis of which budget revenues are planned. It monitors the scope of the theoretical VAT and tax evasions assessed by SORS, but fails to participate in estimating VAT losses according to the bottom-up method (or it does not do it by itself).

⁵⁰ Methodology for estimating VAT losses in CARS, no. 423-11/2008-4 as of 16 May 2008.

Recommendation

We recommend the MF, as a body which is also in charge of planning budget revenues of the Republic of Slovenia from VAT, to actively cooperate with TARS and CARS when examining different approaches and determining the most appropriate method or a combination of methods for estimating VAT losses and individual analyses of VAT losses within the bottom-up method as well as when producing regular estimates.

3.5 Does SORS estimate the volume of VAT losses

SORS implements the Decision no. 98 under which the EU Member States must calculate the value of VAT evasions without complicity or consent. This pertains to the part of VAT evasions by sellers that is not known to purchasers. The second type of VAT evasion is evasions with consent where purchasers and sellers agree to skip the tax. The value of VAT evasions without consent must be explicitly calculated because they must be included in the calculation of the added value of the economy or GDP and gross national income. In accordance with the Decision no. 98, countries can calculate VAT evasions without consent by using various methods. At SORS, VAT evasions without consent are calculated in the process of annual GDP assessment and tax evasions with consent as a difference between the theoretical and accounting value of VAT and tax evasions without consent. Theoretical VAT liability is calculated on the basis of all taxable purchases or expenditures and final VAT payers in the economy, whereupon the calculation is carried out on the basis of tax rates applicable for such transactions. VAT evasions without consent are explicitly calculated by using applicable tax rates on corrections to cover production in those industries for which tax evasions without consent have been assessed as characteristic on the basis of the type of activity. These are industries where the share of cash operation with final consumers prevails.

SORS calculates the theoretical VAT in parallel with drafting data on the weighted rate of VAT within the framework of the Report on VAT for determining the own resources of the European Union. This methodology of calculation stipulates that the data from national accounts for the year n-2 shall be used for the weighted rate because more or less final data on aggregates of national accounts is available for the stated year. In the process of its work, SORS audits the aggregates of national accounts from the first to the final assessments to update them with available data sources (administrative and statistical research).

SORS explained that calculation of VAT evasions on the basis of the Decision no. 98 has not yet been subject to controls of EU authorities.

Table 3 presents the calculation of the theoretical VAT and VAT evasions for 2002, 2003 and 2004 in greater detail.

Table 3: Calculation of the theoretical VAT and VAT evasions for 2002, 2003 and 2004

	2002	2003	2004	2002	2003	2004
	in mio SIT			in % ⁵¹		
A THEORETICAL VAT	484,041	522,478	563,840	101.9	102.0	101.8
1. Final consumption by households	297,883	328,758	363,455	62.7	64.2	65.6
2. State	76,212	80,026	86,345	16.1	15.6	15.6
2.1 Intermediate consumption	45,080	42,957	44,440	9.5	8.4	8.0
2.2 Product transfers in kind	5,872	6,532	6,930	1.2	1.3	1.3
2.3 Gross investment in fixed assets	25,260	30,536	34,975	5.3	6.0	6.3
3. Non-profit institutions serving households	7,627	7,195	7,198	1.6	1.4	1.3
3.1 Intermediate consumption	6,582	6,180	6,215	1.4	1.2	1.1
3.2 Gross investment in fixed assets	1,044	1,015	982	0.2	0.2	0.2
4. Other exempt sectors and products	87,836	91,026	91,515	18.5	17.8	16.5
4.1 Intermediate consumption	50,829	48,827	48,000	10.7	9.5	8.7
4.2 Gross investment in fixed assets	37,008	42,199	43,515	7.8	8.2	7.9
5. Business expenditure on cars	14,483	15,474	15,327	3.1	3.0	2.8
B VAT evasions without consent	5,859	6,459	7,337	1.2	1.3	1.3
C VAT evasions with consent	3,343	3,603	2,377	0.7	0.7	0.4
ACTUAL VAT RECEIPTS (A - B - C)	474,839	512,415	554,126	100	100	100

Source: Calculation of the theoretical VAT 2002–2004, SORS, as of 27 August 2007.

Conclusion

SORS calculates VAT losses due to VAT evasions⁵² for the year n-2 therefore the estimate of the volume of VAT losses for 2005 has not yet been produced when this report was being drafted and will be available no later than 31 July 2008⁵³. In the period 2002–2004 the scope of VAT evasions in the Republic of Slovenia calculated by SORS by using the top-down method amounted to approximately 2 % of the actual VAT receipts.

⁵¹ Share with regard to actual VAT receipts.

⁵² VAT evasion is just one of the reasons for the occurrence of VAT losses which means that the total VAT losses exceed the scope of VAT evasions calculated by SORS.

⁵³ Council Regulation (EEC, Euratom) no. 1553/89 as of 29 May 1989.

In 2006 and in the first half of 2007, with the intention of strengthening the use and control of TI results to account for activities that were not covered due to an intentional failure to report or activities that were evaded, SORS obtained some data resulting from inspections from TARS, but it was not detailed enough and its form did not enable an appropriate estimate of the scope of VAT evasions. Although the obtained data resulting from inspections was not appropriate for SORS (the TI sample was not statistically representative), SORS analysed this data and compared it with the current corrections of data capture in GDP by individual activities. SORS will consider the results in the future estimates of VAT evasions or corrections of data capture.

Recommendation

We recommend SORS to participate in the reform of existing TARS records by submitting to TARS a detailed explanation as to which data on performed TIs and the additionally charged VAT by various parameters it needs to calculate VAT evasions pursuant to the top-down method.

3.6 Establishing a model for estimating VAT losses

In the Republic of Slovenia the annual estimates of VAT evasions that represent the predominant part of VAT losses are produced by SORS pursuant to the top-down method. In the period covered by the audit, TARS and the MF have not yet started producing or actively participating in the production of estimates of the volume of VAT losses, whereas CARS started estimating VAT losses for its segment during the audit by using the bottom-up method and drafted the first trial estimate of VAT losses for 2006 by extrapolating findings of ex-post controls. In the period covered by the audit, none of the auditees carried out individual analyses within the framework of the bottom-up method therefore they failed to specify the main risks for the occurrence of VAT losses by causes and activities or types of taxable persons as well as types and departure points of imported goods. We believe that it is not possible to ensure a high-quality planning of appropriate solutions to reduce VAT losses without the above estimates and results of individual analyses.

Based on the estimate of VAT losses produced by the Court of Audit by using the data obtained from TARS and on the estimate of VAT losses produced by CARS, we calculated the total VAT gap in the Republic of Slovenia for 2006 that amounted to EUR 184,298,514⁵⁴. The estimated VAT gap for 2006 represents a 6.4 % share in potential revenues from VAT in 2006 (EUR 2,716,085,927)⁵⁵.

To check the sensitivity of the calculation to input parameters, we carried out an additional simulation of deviations of VAT losses with regard to the changed additionally identified VAT liabilities per control performed or per taxable person, i.e. we produced calculations for deviations presenting a 10, 20 and 30 % share on the positive and negative sides. Thus, for the 30 % average increase or decrease of the additional VAT per taxable person (at CARS and TARS) the estimate of the total VAT losses ranged between 4.5 and 8.1 %. Based on the above result we believe that the produced calculation of VAT losses is insensitive enough to changes in input variables and represents an acceptable estimate of VAT losses.

⁵⁴ Estimated losses for the segment covered by TARS amounting to EUR 168,471,090 + estimated losses by CARS amounting to EUR 15,827,424 = estimated VAT losses in the total amount of EUR 184,298,514.

⁵⁵ $184,298,514 : (2,716,085,927 + 184,298,514) \times 100 = a\ 6.4\ \%$ share.

Conclusion

The estimate of evasions produced by SORS is substantially lower not only compared to the calculations of VAT losses in some EU Member States (10 %), but also compared to the estimate of VAT losses produced by the Court of Audit (6.4 %).

Explanation by SORS

Among the reasons for smaller VAT losses in the Republic of Slovenia compared to other EU Member States, SORS stated the fact that Slovenia is a small country which is easier to control by tax authorities and that the threshold for entering the VAT system is low therefore not many entities are not covered by it. VAT is still a relatively new duty which is, according to TARS, the reason why tax evasion systems are not yet highly developed (e.g. frauds of the MTIC type).

Already during the audit, the Court of Audit forwarded to TARS, CARS and the MF all important materials obtained at the meetings of the VAT Working Group which show the positions of this group with regard to estimating VAT losses as well as present some estimation methods and possible activities for increasing the efficiency of VAT collection.

To make estimating of VAT losses a standard procedure as well as to highlight the importance of being aware of the existence of VAT losses and to start searching for solutions for their reduction, already during the audit the Court of Audit stimulated TARS, CARS and the MF to cooperate when producing estimates of VAT losses. For this purpose, it organized a common meeting on 22 October 2007 where the auditees agreed to establish an interdepartmental working group under the auspices of the MF to ensure continuous cooperation when producing regular and updated estimates of VAT losses as well as when implementing activities to reduce these losses.

Measure of the MF

On 17 December 2007 the Minister of Finance appointed⁶⁶ a working group for monitoring efficiency and effectiveness of VAT collection (hereinafter: the working group for VAT) and on 8 January 2008⁶⁷, upon the initiative of the Court of Audit, he defined its tasks in even greater detail. We have found out that tasks were defined and representatives of the MF, TARS, CARS and SORS appointed to the Working Group for VAT in accordance with the agreement.

Recommendation

When developing and using a methodology or a combination of methodologies for calculating VAT losses, we suggest the working group for VAT and representatives of TARS, CARS, the MF and SORS responsible for ensuring regular estimates of VAT losses to establish connections with tax administrations of other EU Member States that have already produced estimates of VAT losses or to examine already tested methods, such as the Iceberg method (Belgium), the extrapolation method or the method of interview and research conducted with taxable persons (Italy). As a starting point to start regularly estimating VAT losses we suggest to examine the estimate of VAT losses for 2006 produced by the Court of Audit for the field covered by TARS on the basis of the extrapolation of the results of TIs performed on a random sample of taxable persons.

We recommend the MF, TARS, CARS and SORS, when defining concrete tasks of members of the working group for VAT, to also draft a time schedule of activities including deadlines for the

⁶⁶ Decision no. 60-5/2006/14 as of 17 December 2007 and Decision no. 60-5/2006/43 as of 4 June 2008.

⁶⁷ Decision no. 60-5/2006/16 as of 8 January 2008.

implementation of individual tasks. Due to the ever increasing number of the MTIC frauds and the importance of the scope of such frauds compared to other causes for the occurrence of VAT losses, we particularly recommend to set the priorities of the working group for VAT when defining its tasks which include estimates and common planning of relevant activities intended to prevent or reduce VAT losses due to the MTIC-type evasion. The working group for VAT shall also examine the possibility to implement a study into the scope of shadow economy in the Republic of Slovenia and to start proceedings to appoint a body responsible to carry out this study. Members of the working group for VAT shall provide for a regular exchange of all data, information and know-how that individual bodies might find useful for analysing risks and that might prevent from the possibility for the occurrence of VAT losses.

Measures of the MF

The MF explained that within the framework of the working group for VAT two meetings were held in January and March 2008⁵⁸ where the representatives of auditees defined a framework time schedule and reported on the activities already carried out in the field of estimating VAT losses. Besides the working group for VAT, on 20 May 2008 the Minister of Finance also appointed⁵⁹ members and defined tasks of the working group responsible for simplifying the system of accounting and paying taxes, contributions, other compulsory charges and general government revenue.

⁵⁸ Minutes no. 60-5/2006/19 as of 15 January 2008 and Minutes no. 60-5/2006/25 as of 12 March 2008.

⁵⁹ Decision no. 42-240/2006 as of 20 May 2008.

4. MEASURES AND ACTIVITIES TO REDUCE VAT LOSSES

4.1 Are TARS measures to reduce VAT losses efficient

4.1.1 Definition of objectives and measures to reduce VAT losses

Based on its Business Strategy for 2005–2008⁶⁰ (hereinafter: the Strategy for 2005–2008), defining "the highest possible level of settling tax liabilities" as the most important strategic objective, the following strategic objectives were defined in the explanations of financial plans of TARS for 2006 and 2007 within the sub-programme *02041601 – Tax Administration*:

1. the highest possible level of settling tax liabilities by:
 - promoting voluntary settling of tax liabilities by ensuring high-quality services for taxable persons and by simplifying tax procedures,
 - achieving the highest possible level of payment of tax liabilities,
 - preventing and detecting criminal offences of tax evasion and other infringements of tax legislation and
 - maintaining effective programmes to ensure settlement of tax liabilities, including fiscal control;
2. an efficient, flexible and successful organization as well as a reliable and safe information system and
3. a successful cooperation of tax administration with other public administration institutions and expert public.

The explanation of financial plans of TARS for 2006 and 2007 shows annual implementation goals listing the indicators used by TARS to measure the accomplishment of objectives. This can be seen from the following examples:

- processed (input and output) documents with regard to the annual plan: target value is 100 %;
- share of taxable persons subject to TIs: target value is 3 %;
- share of TIs without detected irregularities: target value is 45 % for 2006 and 40 % for 2007;
- share of direct liabilities in planned general government revenue additionally identified during TIs: target value is 1 %, and
- average number of education days per employee: target value is 3.2 % for 2006 and 3.5 % for 2007.

⁶⁰ [URL: http://www.durs.gov.si/si/o_davcni_upravi_rs/poslovna_strategija_za_obdobje_2005_2008/].

Conclusion

We have found out that TARS set some objectives for 2005 (better efficiency of tax collection, active participation when drafting tax regulations, simplification of tax procedures, improvement and introduction of new methods of fiscal control and recovery) without stating the indicators for measuring the level of fulfilment of these goals, however, it stipulated more concrete goals for 2006 and 2007 by successfully listing the indicators for assessing the level of fulfilment. Despite the above improvement in defining objectives we have found out that the goals stipulated by TARS for 2006 and 2007 pertain to the collection of all duties and not more concretely to individual fields of data collection.

Recommendation

We recommend TARS to examine whether it would be reasonable to define even more concrete and narrowly focused objectives, such as to define an implementation goal only in the field of VAT within the framework of the strategic goal "to achieve the highest possible level of settling tax liabilities" (e.g. "the number of TIs carried out in the field of VAT"). We particularly recommend TARS to analyse the current situation and the envisaged effects of planned activities on the improvement of the current situation and to use the results of this analysis as a basis for setting objectives.

Measure by TARS

During the audit, TARS explained that the Tax Inspection Plan, which is a part of the TARS Annual Plan for 2008, includes objectives specifically pertaining to the field of VAT (the goal of additionally identified VAT liabilities in 2008 amounting to EUR 27,455,105⁶¹, the goal of carrying out TIs in the field of VAT in the scope of 55 % of all TIs⁶²).

4.1.2 Employees at TARS

Within TARS, in the General Tax Office six employees deal exclusively with VAT, in centralized tax offices the field of VAT is covered by 552 employees⁶³ and in tax offices in charge of inspections by 409 employees (334 active inspectors). The segment of VAT collection employs 302 employees, of which 118 for on-site recovery and 184 for administrative recovery, who beside VAT also cover all other types of taxes and charges. Detection of concrete cases of VAT evasion involves 6 persons from the Department for Investigation and Analysis, 3 from tax offices, 7 from inspection services specialized in VAT issues and one from the Control Department of the General Tax Office.

Because of the lack of human resources, TARS inspectors are not exclusively specialized in VAT and individual types of causes for the occurrence of VAT losses, however, TARS introduced specialists in individual fields of VAT within the General Tax Office who are in charge of educating and consulting inspectors in individual fields.

Conclusion

Causes for the occurrence of VAT losses are specific and complex by their nature and taxable persons constantly search for new possibilities of lawful or unlawful avoidance of VAT payment. VAT evasions may involve huge amounts of money. Despite the possibility of getting advice from a specialized inspector, an individual tax inspector who is not specialized in VAT could find it difficult to detect some

⁶¹ Plan of additionally identified liabilities for 2008 as of 13 June 2008.

⁶² Directions and starting points for producing the plan for 2008, no. 061-105/2007 as of 26 October 2007.

⁶³ As at 3 April 2007.

more complex forms of VAT evasion as well as spend a disproportionate amount of time to carry out a TI.

The objective "to spend 1 % of total appropriations for staff expenditures on training and education" defined in the Strategy for 2005–2008 was not achieved in 2006 because out of the total appropriations for staff expenditures TARS only spent 0.5 %⁶⁴ on training and education of employees. On the other hand, TARS even exceeded by 0.3 of a day⁶⁵ the implementation goal pertaining to the average number of education days per employed public servant that was stipulated in the financial plan for 2006.

When the Republic of Slovenia joined the European Union, the border control between the EU Member States was abolished which is why TARS submitted to the Government Personnel Service a list of staffing requirements for the implementation of tasks in the field of European affairs where it expressed the need for additional 35 controllers and 55 inspectors; to the MF a list of justified staffing requirements for additional 47 inspectors was submitted. Following the reallocation of workers from CARS in 2004, the TARS staffing situation improved by 30 employees in the field of tax recovery and 29 controllers. Although TARS assessed that even more people are needed in the field of control because their number is decreasing, it failed to substantiate this estimate with a relevant analysis during the audit. TARS also failed to monitor the scope of additionally identified liabilities per employee in control and inspection.

Recommendation

We suggest TARS to prepare a detailed analysis of costs and effects showing the funds necessary for employing additional workers as well as to present the foreseen number of additionally executed controls and the planned scope of the additionally charged VAT only for the foreseen additional employments. To be able to carry out such an analysis, TARS shall within the framework of existing records ensure monitoring of the additionally charged VAT per employee responsible for VAT. Due to the complexity of causes for the occurrence of VAT losses, we recommend TARS to consider, on the basis of the experience and results gathered from already executed TIs, the relevance of specializing individual inspectors exclusively in VAT and, within the framework of VAT, the relevance of specializing in individual types of causes for the occurrence of VAT losses.

4.1.3 TARS information system

When monitoring procedures related to VAT at TARS, the information support is mostly provided by the integrated tax information system (hereinafter: iDIS), Register of taxable persons, application supporting inspectors (hereinafter: SysInfo), VAT Information Exchange System (hereinafter: VIES), information system of the minor offence authority (hereinafter: ISPO), Pajek application (hereinafter: Pajek) and Audit Command Language software package (hereinafter: the ACL software package). Beside the already existing applications, TARS also plans to introduce a central computer-assisted risk analysis (hereinafter: CAT).

⁶⁴ 69.8 million SIT for education/total appropriations for wages (14,636.1 million SIT).

⁶⁵ The actually reached goal pertaining to the average number of education days per employee at TARS was 3.5 days (figure from the Report on the Work of Tax Administration of the Republic of Slovenia for 2006) – the financial plan stipulated an average of 3.2 education days per employee at TARS.

4.1.3.a Integrated tax information system

iDIS is an application used by TARS as a basis for keeping records on VAT collection. The key elements of iDIS are registration for VAT, assessment of VAT and provision of analytical records. Booking of entries in iDIS is based on:

- payment transactions data provided by the Public Payments Administration of the Republic of Slovenia (hereinafter: the PPA) that is booked automatically pursuant to a package principle (all or nothing),
- manual booking (entry and clearance of VAT returns carried out by controllers),
- booking of individual documents by submitting data via eTaxes,
- booking of a package of scanned documents and
- internal underlying documents used to post decisions of inspectors and write-offs of claims.

4.1.3.b Register of taxable persons

The Register of taxable persons is a database of taxable persons. It is connected with the systems that are primary sources of registration particulars (Central civil register at the Ministry of the Interior, registers of the Surveying and Mapping Authority of the Republic of Slovenia, registers of the Health Insurance Institute of the Republic of Slovenia, Register of transaction accounts of the Bank of Slovenia, Register of companies and Business register) and with the registers of other organizations whose primary data source is the Register of taxable persons (CARS, the Bank of Slovenia and similar). Aside from the links with other organizations, the Register of taxable persons is also connected to other application systems operational in TARS (DDV, DP1, DP2, PS, Profil DZ and SysInfo). The contents and method of administrating the Register of taxable persons are defined in the ZDS-1.

4.1.3.c Information system of the minor offence authority

ISPO is an independent application system supporting the operation of TARS when in the role of a minor offence authority. According to TARS, ISPO is obsolete and needs reconstruction.

4.1.3.d SysInfo

The SysInfo application is an information system intended for inspectors that includes individual data on taxable persons:

- about registration,
- from submitted VAT returns,
- from the Register of taxable persons,
- about previous inspections and findings,
- about corporate tax,
- about income from pursuing an activity for natural persons,
- from balance sheets obtained from the Agency of the Republic of Slovenia for Public Legal Records and Related Services,
- from CARS on imports and exports (on a monthly basis),
- from issued invoices and
- from the Profil DZ application that is a component part of the SysInfo application.

Using the entered data on taxable persons obtained from the first or integrated TI according to pre-defined criteria, on the basis of a point model the risk level for the occurrence of VAT losses is calculated for a taxable person which can be extreme, high, moderate or low. These results are used by TARS when selecting taxable persons for TIs.

Conclusion

During the presentation of operation of the Profil DZ application we have established that it lacks individual data from already executed TIs. TARS confirmed that not all inspectors consistently enter data into the system. We believe that the inconsistent data entry and subsequently deficient records increase the risk of a failure of the Profil DZ application to ensure effective support to TARS when selecting taxable persons for TIs.

Recommendation

TARS shall promptly and consistently monitor and, if necessary, update and upgrade the criteria for defining risky taxable persons in the Profil DZ application. It shall see to it that all inspectors promptly and consistently enter the TI data into the Profil DZ application as well as that all inspectors also have the insight into databases when working in the field. In this way the procedure of searching and collecting individual data on taxable persons will be shorter and thereby the work of inspectors more effective.

Measure by TARS

During the audit TARS already started implementing the recommendation of the Court of Audit by stressing, within the framework of regular monthly meetings of heads of departments for tax inspections at tax offices, the importance of a comprehensive, correct and up-to-date entry of the results of supervision into the information support system. Thus, heads of departments are in charge of and responsible for exerting control over entering data into the application.

4.1.3.e VIES

VIES is an information system for exchanging data on VAT for the purpose of fiscal control that is based on the aggregate data on supplies between the EU Member States. Every EU Member State is obligated to keep an electronic database and to also enable access to this data to other EU Member States. The system is composed of two key modules:

- data capture from quarterly reports obtained from taxable persons and
- data exchange with other countries in several directions and modes.

In accordance with the Council Regulation (EC) No 1798/2003 of 7 October 2003 on administrative cooperation in the field of value added tax the responsibility for international cooperation within TARS was allocated to the Central Liaison Office whose main tasks are international exchange of information (automatic, spontaneous (without a previous request) and upon request) as well as examination and verification of data from the VIES system. Assisted by the VIES system, among other things, also discrepancies between monthly VAT returns and quarterly VAT reports are detected. TARS found out that TIs carried out on the basis of identified discrepancies within the VIES system are not effective because these discrepancies are usually a consequence of a delay in reporting periods or errors in completing quarterly reports or VAT returns. To manage risks in the field of VIES discrepancies, the Central Liaison Office now composes a list of ten taxable persons with the biggest discrepancies (plus or minus) and submits it to tax offices into detailed examination to find out the causes for such discrepancies.

TARS stated that the VIES system operates slowly. A quarterly reporting and preparation period available to EU Member States to submit data into the system is too long from the aspect of controlling VAT evasions of the MTIC type. It is true that the system enables detection of evasions, but often too late to recover the lost VAT. The speed in the phase of control (preventive action) is most important for an efficient prevention of this kind of systemic VAT evasions because repayment or recovery of evaded VAT is not efficient in such cases. Because of long reporting periods not even a good system of risk analysis to detect the causes for the occurrence of VAT losses helps or is efficient enough because taxable persons from which VAT is expected to be recovered practically no longer exist. TARS suggests to speed up the VIES system by harmonizing reporting periods with the period of submitting VAT returns (monthly reporting) and it is aware that the European Union already endeavours to shorten the quarterly period of reporting on the supplies of goods to the VIES system.

TARS participates in the EUROCANET project in which contracting states monthly exchange certain data on transactions of goods within the European Union. For the time being, the Republic of Slovenia only participates as a recipient of information.

4.1.3.f Pajek

Pajek is an application providing the most complete review of the network of business connections of natural and legal persons (related persons). It is the only provider of information on managerial staff, relations between companies, ownership structure, participation and groups. Pajek also provides information on connections of the search item (person), ownership, origin of capital and transaction accounts. The Pajek application can be accessed by all inspectors. In the period from January to September 2007 the application saw 46,870 enquiries.

4.1.3.g ACL software package

The ACL software package is a tool for electronically supported inspections used by TARS pursuant to Article 38 of the ZDavP-2 for analysing databases and generating audit reports. In inspection procedures the ACL software package is used in such a way that an inspector captures the relevant data of a taxable person in an electronic form (files) and transfers it to his own computer where it is further processed or directly connects to the data system of the inspected person. The ACL software package also enables a fast and simple comparison of the inspected person's data with the TARS data or any other official data (e.g. comparison with the data from the Register of taxable persons, comparison with the CARS data and comparison with the VIES data) as well as a cross-comparison with the data of other taxable persons.

In 2006 TARS had 105 ACL licenses of which 101 were used for carrying out TIs. In 2006 the ACL software package was used for inspections by 125 inspectors and altogether 282 inspections were carried out on the basis of it. In 2008, TARS plans to buy additional 105 licenses.

Conclusion

In 2006 only 30.2 %⁶⁶ of all inspectors carried out TIs by using the ACL software package which means that the objective set in the Strategy for 2005–2008, pursuant to which all inspections should be using the ACL software package by the end of 2006, was not achieved. Bearing in mind that TARS only plans to

⁶⁶ 125 inspectors out of the total of 414 inspectors employed with TARS as at 31 December 2006.

purchase additional 105 licenses in 2008 we conclude that there is a risk that this objective would also not be reached in 2008.

Recommendation

We recommend TARS to examine whether the objective set in the Strategy for 2005–2008 with regard to using the ACL software package was feasible and to analyse which inspectors actually need this tool and in what scope the use of the ACL software package actually increases the efficiency of VAT collection as well as to take appropriate measures on the basis of the obtained results.

Explanation by TARS

At the clearance meeting held on 11 June 2008, TARS explained that the objective to have all inspectors using the ACL software package by the end of 2006 set in the Strategy for 2005–2008 was too ambitious. In tax administrations of the EU Member States electronic inspection tools (ACL, IDEA or SESAM) are used by 10–50 % of all inspectors. The real goal of TARS for the period 2008–2011 is to have approximately 40 % inspectors using the ACL software package.

4.1.3.h Central computer-assisted risk analysis

Within the reform of the tax information system, TARS plans to implement the CAT application that will connect the data of all existing applications already available to inspectors at TARS and to produce a more complete risk assessment of taxable persons on this basis. The use of CAT will enable a simplified and shortened procedure of selecting taxable persons and preparing for TIs (inspectors), a more complete risk assessment regarding individual taxable persons and more effective TIs.

Final conclusions regarding the TARS information system

We have found out that some applications have limited possibilities with regard to various extracts for users. The assistance of an IT expert is often necessary to produce extracts directly from the database. Not all inspectors have access to all key databases when working in the field and automatic links between individual key databases are not established which boosts time consumption when searching for information and increases the risk of lower work efficiency.

Measure by TARS

During the audit, on 14 December 2007, TARS issued a public tender to set up a tax information system for the Tax Administration of the Republic of Slovenia (hereinafter: the public tender for eDis) which also included the system for identifying the risk level of taxable persons.

Recommendation

Due to some deficiencies and incomplete interconnection of existing applications in the field of procedures related to VAT, we recommend TARS to examine the possibility of providing better direct support of the IT Department (so far only occasional support of one IT expert was provided with regard to extracts from the SysInfo application). TARS shall also carry out an analysis of estimated costs necessary to ensure access to all data bases and intranet to all inspectors when working in the field as well as an analysis of envisaged effects of the respective measure. It shall take appropriate measures on the basis of the results of analyses.

4.1.4 VAT collection procedure

The VAT collection procedure predominantly includes allocation, refused allocation and termination of a VAT identification number, receipt and control of VAT returns, inspections, tax investigation, tax execution, assistance to inspectors and taxable persons, and, only from the point of substance but not formally, also the minor offence and criminal procedure. The above procedures can only be effectively implemented if appropriate analytical records on VAT are available. In the continuation, the audit report presents individual procedures within the framework of VAT collection.

4.1.4.a Allocation, refused allocation and termination of a VAT identification number

Allocation and refused allocation of a VAT identification number

The procedure for allocating a VAT identification number is regulated by the ZDDV-1 and the Rules on the Implementation of the Value Added Tax⁶⁷ (hereinafter: the Rules on VAT). A person who pursues an activity and whose taxable turnover exceeds the statutory prescribed limit must register as a taxable person for VAT purposes. The statutory procedure for allocating a VAT identification number (submission of the request of a taxable person to be allocated a VAT identification number, examination of the request and allocation of the VAT identification number) may be used as a tool to prevent from VAT evasions of the MTIC type because this procedure enables TARS to verify the intention of the applicant and the particulars stated in the request before a VAT identification number is actually issued.

Measure by TARS

In the past, TARS only refused the allocation of a VAT identification number if the request for the allocation of a VAT identification number was formally incorrect (non-fulfilment of conditions), however, during the audit in 2007 it introduced the possibility to refuse a request for the allocation of a VAT identification number on the basis of a reasonable cause for suspicion that the person submitting the request does not perform or has no intention of performing the activity.

Conclusion

Pursuant to Article 78 of the ZDDV-1, every person shall notify the tax authority about the commencement of his activity as a taxable person and shall submit a request to be issued a VAT identification number and pursuant to Article 79 the tax authority shall ensure that persons stated in that article are identified by an individual VAT identification number. The ZDDV-1 and the Rules on VAT do not regulate the measures to be taken by TARS in the case the allocation of a VAT identification number is refused, therefore we believe that TARS has no relevant legal basis available regulating this allocation procedure in greater detail.

Recommendation

Considering the fact that the MF did not receive a proposal to amend⁶⁸ the existing ZDDV-1 and the Rules on VAT with the regulations on the procedure, method and reasons for refusing the allocation of a VAT identification number, if it is found out that the applicant has already taken part in organized tax evasions in any way⁶⁹, we recommend TARS and the MF to jointly examine the possibilities of establishing a legal basis that would as soon as possible regulate the procedure for refusing the allocation of a VAT identification number.

⁶⁷ Official Gazette of the RS, no. 141/06, 52/07.

⁶⁸ Letter of TARS addressed to the MF, as of 6 April 2006.

⁶⁹ Completed questionnaire of the MF, as of 3 October 2007, reply no. 16.

Ex officio termination of a VAT identification number

An ex officio termination of a VAT identification number is an instrument of tax authorities particularly intended to combat tax evasions of the MTIC type or carousel frauds. When TARS finds out that a taxable person is a missing trader, it shall pursuant to Article 80 of the ZDDV-1 and Article 132 of the Rules on VAT start the proceeding for an ex officio termination of a VAT identification number thereby preventing tax evasion of a group of companies. Under Article 2(3) of the ZDavP-2, a VAT identification number shall be terminated according to the administrative procedure rules. On average, the decision on terminating a VAT identification number becomes final within 40 days. TARS believes that the lengthy procedure of an ex-officio termination of a VAT identification number could enable additional VAT evasions before the procedure is over.

Conclusion

The TARS proposal⁷⁰ for a respective amendment of the existing ZDDV-1 and the Rules on VAT regulating the procedure for terminating a VAT identification number in such a way that based on the obtained data TARS would only ex officio enter the changes and thereby the termination of a VAT identification number into the records of taxable persons for VAT purposes and notify taxable persons in writing about it, but not issue decisions, was not adopted as an appropriate solution at harmonization meetings held between TARS and the MF. This was justified by the fact that if a decision is issued about the right to enter the VAT system, a decision must also be issued about the termination of a VAT identification number or exit from the VAT system. The MF and TARS agree that in procedural regulations for these decisions it would be more appropriate to also use the suspensive effect of a decision as stipulated in Article 87 of the ZDavP-2 for income tax assessments. By doing so the deletion of a taxable person from the VAT records would no longer be tied to the finality of a decision. Taking into account the simplification of serving such decisions, already in force since 1 January 2007 based on Article 85 of the ZDavP, comparable effects would be achieved to the ones from the TARS proposal.

Recommendation

We recommend the MF and TARS to propose as soon as possible a suitable legal solution for shortening the procedure for terminating a VAT identification number regarding those taxable persons for which it was established that they took part in tax evasions, particularly in MTIC.

Measure by TARS

On 20 March 2008 TARS submitted to the MF the proposal for amending the ZDDV-1 by introducing Article 80(2) stipulating that an appeal against the decision on the cessation of identification for VAT purposes does not stay its execution.

4.1.4.b Control of VAT returns

Control of VAT returns includes entry, processing and control of submitted VAT returns, quarterly reports, forms for flat-rate compensation, forms for VAT refund in passenger traffic, requests for VAT refund to taxable persons not established in the Republic of Slovenia, special VAT returns for taxable persons not established within the European Union and providing electronic services to persons not liable to VAT as well as requests for exemption from duties for diplomatic representations.

⁷⁰ Letter of TARS addressed to the MF, no. 01053, as of 14 November 2006 (Remarks to the draft Rules on VAT).

Approximately 28 %⁷¹ of all VAT returns are submitted to TARS in an electronic form. An electronic submission of VAT returns is currently only obligatory for medium-sized and large companies; however, after 2009 it will also be obligatory for all taxable persons pursuing an activity.

Controllers check all VAT returns for which they receive an error notification from the application with logical and arithmetic controls built in. A controller first checks the accuracy of the entry and then, if it is not logical, invites the taxable person to provide additional data or explain and correct the error. If, on the basis of relevant explanations, a controller decides that an on-site inspection is necessary to examine certain data, a TI is proposed. Beside controls carried out on the basis of a notification from the iDIS application, a controller may on his own discretion decide to examine the VAT return from the aspect of substance. This decision is mostly made in the case of a newly registered taxable person requiring refund for the first time or if a taxable person declares high purchase costs of fixed assets and asserts high amounts of the related input VAT, and similar.

In 2006, control procedures revealed irregularities in 4,745 cases, of which 2,829 pertaining to the DDV-O form, 1,807 to requests for VAT refund to taxable persons not established in the Republic of Slovenia and 109 to requests for VAT refund in passenger traffic.

Table 4 shows the amounts or shares of VAT additionally assessed during control procedures in the total sum of VAT assessed in the period 2003–2006.

Table 4: VAT additionally assessed during control procedures in 2003–2006

Year	Total sum of assessed VAT in mio SIT	Sum of VAT additionally assessed during control procedures ⁷² in mio SIT	Share of VAT additionally assessed during control procedures in the total sum of assessed VAT in %
(1)	(2)	(3)	(4)=(3)/(2)*100
2003	65,887	1,188	1.8
2004	245,977	2,312	0.9
2005	491,324	2,615	0.5
2006	509,738	1,868	0.4

Source: Information on VAT returns for 2006, TARS, May 2007.

Conclusion

We have found out that the total sum of VAT assessed during control procedures in the period covered by the audit increased year by year while the share of VAT additionally assessed during control procedures in the total sum of the charged VAT respectively decreased. Since the VAT collection system changed after the Republic of Slovenia joined the European Union (1 May 2004), the comparability of sums of VAT assessed during control procedures is only ensured for 2005 and 2006. In 2006 the share of VAT

⁷¹ Estimate as at 29 September 2007.

⁷² Effect of increase (decrease) for the entire VAT segment.

additionally assessed during control procedures in the total sum of assessed VAT as well as the absolute share of VAT assessed during control procedures decreased.

Explanation by TARS

TARS explained that the prevailing reasons for the detected decrease in VAT additionally assessed during control procedures in 2005 and 2006, with the simultaneous increase in the total sum of the charged VAT, are the following:

- *better fiscal culture (a bigger scope of voluntary as well as correct and timely discharging of tax liabilities),*
- *increased number of self-declarations – the sum of the subsequently charged VAT is not recorded as a result of control procedures (from 1 January 2005 to 31 December 2006 eight VAT returns in the form of self-declaration were submitted for control in which taxable persons additionally charged VAT in the amount of 91 million SIT) and*
- *increasing number of VAT returns submitted electronically (eTaxes) which due to arithmetic and logical controls built in the application contained no errors that would otherwise only be detected during control procedures.*

In its Strategy for 2005–2008, TARS set an objective to have 80 % of tax declarations and returns of legal entities submitted electronically by the end of 2008, but it did not stipulate the implementation goal for an individual year within the period covered by the audit or for VAT returns only. Therefore it was not possible to confirm that the strategic objective was achieved. It was also not possible to determine whether the goal for 2007 was achieved by having 28 % of VAT returns of taxable persons in 2007 submitted electronically.

Recommendation

We recommend TARS to start producing a detailed analysis of causes for the decreasing share of VAT additionally assessed during control procedures in the total sum of assessed VAT and, if necessary, to take measures on the basis of this analysis.

In May 2007, TARS awarded a contract⁷³ on providing services of optical data capture from VAT forms for the period of 24 months in the total framework value of EUR 67,944, VAT included. During the audit, it was not possible to assess whether the solution of optical data capture from VAT returns was appropriate with regard to the costs of manual entry and recording of such data because in that period the data on time utilisation rate and efficiency of additional work of inspectors, who were able to carry out other tasks in the phase of controlling VAT returns because of the introduction of optical data capture from VAT forms, was not yet available. The analysis⁷⁴ that stimulated TARS to introduce optical data capture shows that the estimate of time spent by controllers to enter VAT returns was only carried out on the basis of experiences of controllers and not on the basis of measurements. Besides, the calculated average number of entered VAT returns per controller in individual tax offices differs very much and is difficult to compare (160 documents in the Tax Office Hrastnik, 294 in the Tax Office Ljubljana and 724 in the Tax Office Maribor) which opens the question of a balanced distribution of work of individual controllers in individual tax offices.

Explanation by TARS

TARS explained that the introduction of optical data capture decreased the scope of work in the main office as well as the scope of data entry in the Control Department (what is left is the entry of corrections of VAT returns and of returns which

⁷³ Contract on providing services of optical data capture from VAT forms no. 1612-07-000089 as of 18 May 2007.

⁷⁴ Establishment of a centre for forms-based optical data capture – Feasibility assessment, version 3, as of 5 January 2007.

the scanning provider could not optically read because of obvious deficiencies). Considering the estimate that it takes four minutes to enter and record an average VAT return, in August 2007 only in the field of control 2,535 hours or 362 man-days were spared because of optical capture, if a working day consists of seven hours. TARS estimated that EUR 2,452 charged by the scanning provider for the service in August 2008, compared to additional time savings in the main office because of scanning, justify the introduction of optical data capture.

Recommendation

We recommend TARS to as soon as possible precisely define the tasks that controllers will carry out instead of entering VAT returns. It would be particularly recommendable to use the analysis of the past work of controllers to define, through concrete activities of controllers, the foreseen volume of VAT additionally charged in control procedures in a certain time period that should be currently monitored by TARS by using pre-specified indicators and determining the reasons for the deviation of realised results from the planned ones.

Explanation by TARS

At a clearance meeting held on 11 June 2008 TARS explained that in spite of the smaller number of manual entries of VAT returns the scope of tasks of controllers did not decrease because the sphere of work of controllers substantially expanded in accordance with the changed method of work (control is organized at the location of tax offices) and the modified system of control (a single controller controls all types of taxes for one taxable person).

Self-declaration

Pursuant to Article 55 of the ZDavP-2, a taxable person may at any time, but no later than when the decision on commencing a TI is served or minor offence or criminal procedure initiated, submit a tax return or a corrected tax return in which incorrectly charged taxes are declared together with default interest and pay the sum of VAT thus declared.

Self-declaration is intended to stimulate taxable persons to notify tax authorities about any possible subsequently detected irregularities in tax returns and declarations. In such a case, a taxable person is not responsible for the minor offence, however, the real tax liability must be met which means that default interest will have to be paid. Thus, the default interest rate will also depend on the time elapsed from the deadline for submitting tax return or declaration until the notification of tax authorities about irregularities. Different interest rates are intended to stimulate taxable persons to notify tax authorities about irregularities as soon as possible after their detection. Self-declaration is possible for offences under the ZDavP-2 and in some cases also for minor offences regulated by taxation laws. A taxable person may also use this institute in the case of a failure to submit a tax return or declaration at all. A taxable person cannot submit a new self-declaration with regard to liabilities that were already covered by a previous self-declaration. Self-declaration is a reasonable solution throughout the limitation period for the prosecution of the committed minor offence.

In the period from 1 January 2005 to 31 December 2006 TARS received 29 self-declarations amounting to EUR 1,159,727 of assessed VAT and in the first three months of 2007 already 23 self-declarations amounting to EUR 102,458 of the charged VAT.

Conclusion

The increasing number of self-declarations proves the efficiency of introduction and implementation of this institute. We believe that this measure is appropriate because it enables taxable persons to subsequently settle their tax liabilities in the case of errors without being sanctioned and simultaneously stimulates them to be honest when settling tax liabilities.

4.1.4.c Tax inspection

A TI is intended to detect whether duties have been correctly and timely accounted for and to prevent taxable persons from avoiding their tax liabilities.

TARS carries out the following types of TIs:

- an integrated TI covering all fields of operation or all types of taxes for one or several tax periods;
- a partial TI covering individual fields of operation or limited to one or several types of taxes or tax periods;
- a rapid TI covering examinations of the current year liabilities for a larger number of taxable persons that can be planned in advance and
- actions representing shorter TIs that are predominantly preventive and cover the current period of operation of a taxable person.

When selecting taxable persons for TIs, TARS mostly considers:

- risk indicators pertaining to performance, where data from the balance sheet and profit and loss account is used by comparing similar taxable persons with each other or a single taxable person in different period of business operation (balance-sheet measures);
- risk indicators pertaining to a taxable person, where data from the database is used to establish to what extent taxable persons meet or fail to meet prescribed tax liabilities (fiscal measures) and
- special risk indicators, where variables acquired from other institutions and third persons are considered.

TARS additionally increases the efficiency of TIs by:

- implementing the first TIs;
- carrying out pre-planned swift actions in cooperation with other authorities (the police, public prosecution offices, inspection bodies);
- using Manual on Implementing Rapid TIs (carousel fraud), Single Instructions on Implementing VAT Controls, Manual on Inspecting Newly Registered Taxable Persons and Manual on EU-VIES Inspections;
- focusing on the most risky activities pursuant to the Special Programme for Supervising VAT by Risky Activities in 2007 which is a component part of the annual plan;
- implementing TIs on the basis of findings from the control procedure, risk analysis of individual taxable persons and detected differences from the VIES system;
- considering current situation, initiatives and trends when adapting the annual plan of TIs and
- using security regarding higher requests for VAT refund when TARS does not collect enough evidence until the deadline to refuse the refund, but there is a suspicion about the eligibility of a taxable person to VAT refund.

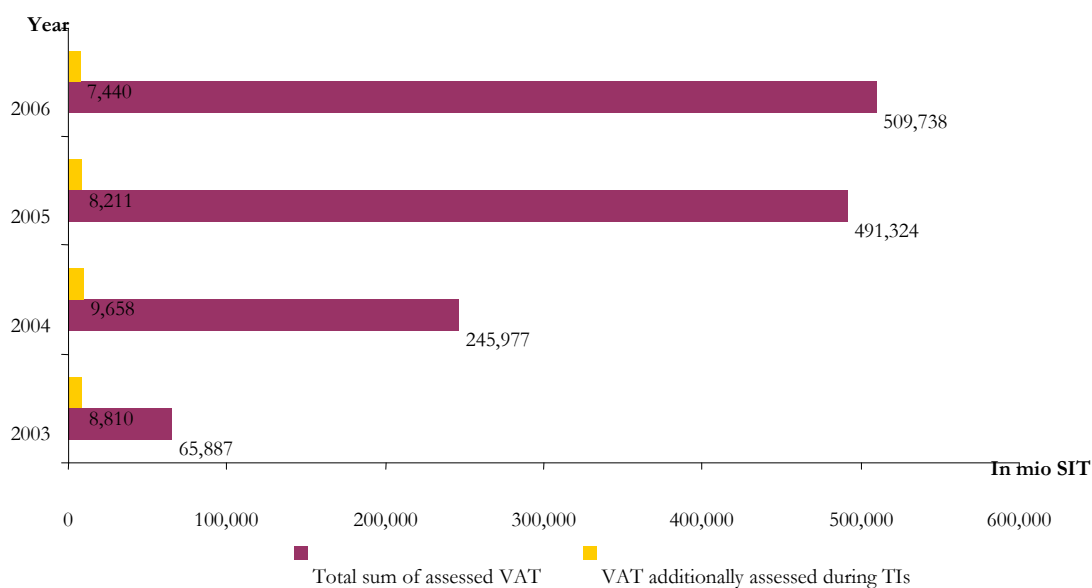
Table 5 and Figure 5 show the sums or shares of VAT additionally assessed during TI procedures in the total sum of assessed VAT in the period from 2003 to 2006.

Table 5: VAT additionally assessed during TI procedures in the total sum of VAT in 2003–2006

Year	Total sum of assessed VAT in mio SIT	Sum of VAT additionally assessed during TI procedures in mio SIT	Share of VAT additionally assessed during TI procedures in the total sum of assessed VAT in %
2003	65,887	8,810	13.4
2004	245,977	9,658	3.9
2005	491,324	8,211	1.7
2006	509,738	7,440	1.5

Source: Information on VAT returns for 2006, TARS, May 2007.

Figure 5: VAT additionally assessed in TI procedures compared to the total sum of assessed VAT in 2003–2006



Source: Information on VAT returns for 2006, TARS, May 2007.

Conclusion

We have found out that the share of VAT additionally assessed during TI procedures in the total sum of the charged VAT decreases year by year; compared to the previous three years, the volume of VAT additionally charged for during TIs also diminished in absolute terms. TARS failed to substantiate the reasons for the respective situation by stating relevant sums.

Explanation by TARS

According to TARS, the comparison of shares of VAT additionally assessed during TIs in the total sum of assessed VAT with regard to the total sum of assessed tax only gives a real picture for 2005 and 2006 (changes because of joining the European Union). TARS also

indicated that preventive inspections at newly registered taxable persons and procedures for withdrawing the VAT identification number from potential participants in the MTIC-type evasion simultaneously result in a lower number of implemented integrated and partial TIs in the field of VAT. Besides, integrated and partial inspections of the participants in the MTIC-type evasion are very time consuming because of a high number of engaged related persons and difficulties when proving joint and several liability because of the fictitious operation and issuing of invoices. The sum of VAT assessed during TIs is also influenced by repeated procedures that as a rule end in reversing the excessively assessed VAT.

Recommendation

We recommend TARS to start analysing the decreasing trend of the volume of VAT additionally assessed during TI procedures in the total sum of assessed VAT after the integration into the European Union. On the basis of such findings it shall be further examined which activities are needed to reverse the trend upwards, in absolute as well as in relative terms. We particularly recommend an established system for measuring the effects of preventing the potential VAT losses by carrying out TIs in which VAT is not additionally assessed but VAT losses are nevertheless prevented (particularly the first TIs and TIs in which tax evasions of the MTIC type are detected). We also recommend TARS to start producing analyses of TIs which detected excessive or irregular additional accounting of VAT and to take measures in accordance with the findings.

Measures by TARS

TARS explained that it took measures within the framework of the document Guidelines and Starting Points for Producing a Plan for 2008⁷⁵ (hereinafter: the Guidelines for 2008) intended to increase the effectiveness of TIs in the sense of increasing the volume of the additionally assessed VAT by having:

- *submitted to the MF the proposals for amending the legislation in the sense of a more efficient fight against VAT evasions;*
- *introduced project management of TIs⁷⁶ in the most risky spheres of activity (trading in motor vehicles⁷⁷ and construction industry⁷⁸);*
- *drafted detailed instructions for inspecting VAT evasions⁷⁹ and*
- *ensured the participation of inspectors in the pre-registration VAT control.*

The efficiency of TIs stipulated in the annual plan and in the special programme of control is monitored on the basis of indicators by the Division for Planning, Analysis and Statistics (hereinafter: the DPAS) where five reporting modules are considered (statistics, monitoring of tasks implementation per cases and inspectors, internal supervision of work, monitoring of cases per individual parameters and external reporting). On this basis, the DPAS produces monthly, semi-annual and annual information that is discussed by TARS at the meetings of heads of inspections.

⁷⁵ No. 061-105/2007 as of 26 October 2007.

⁷⁶ Minutes of the workshop "A project in civil engineering", no. 061-21/2008 (01053-02), as of 13 February 2008.

⁷⁷ A project of introducing fiscal and inspection control in trade in motor vehicles bearing the DIN MV mark, as of 1 February 2008.

⁷⁸ A project of introducing fiscal and inspection control in civil engineering bearing the DIN GRADB mark, as of 1 February 2008.

⁷⁹ Letter of TARS addressed to all tax offices on appointing inspectors for rapid reaction inspection units exerting control over "missing traders" no. 061-68/2008-1 (1053-02), as of 9 April 2008, Instructions about the taxation method in the case of VAT evasions of the "carousel fraud" type, as of 29 May 2008.

In the Special Programme for Supervising VAT by Risky Activities in 2007 (hereinafter: the Special Programme 2007) TARS planned to introduce VAT inspections in 60 % of all TIs, and within this also TIs for risky activities and risky taxable persons by types of TIs. The Special Programme 2007 defines detected risks, directions as well as techniques and methods of TIs. The special programme is a basis for monitoring the quality of selection and supervising the implemented TIs.

In the Report on the Realization of the Plan of Inspections and Additionally Identified Liabilities during Inspection Procedures in January–December 2005⁸⁰ (hereinafter: the Report on TIs 2005) TARS found out that less than a half of planned TIs in the field of VAT were carried out therefore the plan of preventive inspections in 2006 mostly included VAT inspections emphasizing the examination of discrepancies in intra-Community transactions⁸¹ in the VIES system.

In the Plan of VAT-related Tax Inspections for 2006 (hereinafter: the Plan of TIs for 2006) TARS only envisaged inspections by types of TIs (annual inspection of VAT, inspection of VAT returns and rapid inspection of VAT labels) but not by risky activities, types of causes for VAT losses, size of taxable persons, share of non-inspected taxable persons, share of newly registered or randomly selected taxable persons, share of taxable persons selected on the basis of a report, TIs because of discrepancies in the VIES system, etc.

The Report on the Realization of Planned Tax Inspections and Additionally Identified Liabilities during TI Procedures in 2006⁸² (hereinafter: the Report on TIs in 2006) does not show that when carrying out TIs TARS mostly focused on intra-Community transactions in the VIES system, as announced in the Report on TIs in 2005. In the Report on TIs in 2006 TARS presented the data about the number of planned and implemented TIs by types of TIs (integrated, partial, rapid, actions), by individual tax offices, size and status of taxable persons, activities, reasons for inspections, additionally identified direct and indirect liabilities per number of implemented TIs by causes for TIs, and by types of liabilities, but it failed to separately present the data in the field of VAT. In the Report on TIs in 2006, TARS only stated with regard to VAT that in 2006 it carried out 1,262 TIs or 31.1 % less than 1,832 TIs planned in the field of VAT and found out that the number of controls of VAT returns and rapid inspections of VAT labels was too low and the rate of realization of annual VAT controls too high (the number of realized TIs exceeded the number of planned ones by 312.7 %).

Explanation by TARS

Lower realization than planned regarding the number of TIs in the field of VAT predominantly resulted from the change of focus of tax offices to more demanding TIs in the field of VAT covering risky taxable persons as well as from simultaneously carried out TIs covering VAT and tax on income from pursuing an activity. Such TIs are more lengthy and demanding than TIs only controlling VAT returns or VAT labels (where no preliminary preparation of inspectors is necessary). The lower number of implemented TIs was also influenced by the fact that in 2005 6.3 % less inspectors were employed than in 2004. The decreasing trend in the number of inspectors also continued after 2005.

⁸⁰ As of 16 January 2006.

⁸¹ Transactions in goods and services between the EU Member States.

⁸² As of 5 February 2007.

Recommendation

Considering the fact that the comparison between the number of TIs realized in 2006 and the number of TIs planned in 2005 shows considerable differences in the total number of TIs in the field of VAT as well as in individual types of TIs, we recommend TARS to approach annual planning by taking into account the perceived risks and findings from already implemented TIs by individual parameters that demonstrate risks with regard to types and sizes of taxable persons, types of activities, types of TIs, types of causes for the occurrence of VAT losses, etc. By doing that it shall ensure current monitoring of any deviations of the realized number of TIs compared to the planned one, determine reasons for such deviations and strive for realistic planning on the basis of the analysis of deviations within the framework of available resources.

Measure by TARS

TARS explained that it already started implementing the recommendation by having introduced to inspection records new possibilities for a more detailed monitoring of manifestation forms of tax evasions or irregularities in the field of VAT which can be seen from the delivered Report on the Realization of the Planned Number of TIs and Additionally Identified Liabilities in TI Procedures in the Period from January to April 2008⁸³ (monitoring by manifestation forms).

Conclusion

One of the risk indicators is surely the data on the volume of the additionally charged VAT on the basis of already implemented TIs by activities, which is, nevertheless, not available to TARS. Therefore, we believe that planning of TIs is not really appropriate because TARS does not take into account all available risk indicators and this increases the possibility of a relative failure of planned TIs (the number of TIs without detected additional liabilities for VAT purposes).

Recommendation

When planning TIs, TARS shall consider the available data from already implemented TIs and see to it that the data captured is structured in such a way that the records provide reliable and accurate information on the sum of the additionally charged VAT by different useful parameters. We particularly advise TARS to examine the possibility of capturing data on detected irregularities pertaining to the activity actually pursued by a taxable person in a concrete tax period and not to the activity that was registered as the main activity.

Measure by TARS

Already during the audit, TARS started implementing the recommendation by having introduced to inspection records new parameters for a more detailed monitoring of manifestation forms of evasions or irregularities in the field of VAT. With regard to irregularities by individual activities, it stipulated in the Methodological Manual for Tax Inspection⁸⁴ that tax inspectors are obligated to compare the data from the tax register with the data gathered in the field and to inform the competent tax registration units at tax offices about any discrepancies.

The first TI

One of the efficient measures used by TARS to prevent VAT losses is the first TI carried out with newly registered taxable persons for VAT purposes, i.e. within the first year since the day of registration for VAT purposes or within the first two years if a decision on terminating the registration for VAT purposes has already been issued in this period, or for taxable persons that have not yet been subject to TI. The first

⁸³ Reference no. DT 061-63/2008-3(01053-03) as of 12 May 2008.

⁸⁴ Version 3.0, update as of 10 April 2008, Ljubljana, July 2007.

TIs carried out with newly registered taxable persons are intended to ensure the comparison between the actual state of affairs and the one in TARS records, examine the taxable person's capacities and acquire other data on the basis of which the risk pertaining to this taxable person can be assessed by TARS. The first TIs are only carried out by TARS with regard to risky taxable persons and they are selected on a quarterly or semi-annual basis, the main risk factor being failure to submit VAT returns.

Considering the limited number of inspectors, a part of control is executed by sending a special questionnaire which must be completed and returned by a taxable person by hand or by mail. Replies of taxable persons to the TARS questionnaires are not treated as the first TIs but only as additional pieces of information therefore they are not recorded among the data and findings of the first TIs.

The data from the VAT records shows that from 2002 to 2006 the average number of newly registered taxable persons for VAT purposes amounted to 625 per month; in this period TARS carried out 424 TIs⁸⁵ with newly registered taxable persons. The implementation of the first TIs depends on the available resources and other priority tasks.

Conclusion

According to TARS, an average of 7500 taxable persons are newly registered for VAT purposes on an annual basis; in the period 2002–2006 TARS carried out the first TIs with 85 newly registered taxable persons per year which means that, on average, it inspected 1.1 % of newly registered taxable persons per year.

Recommendation

TARS shall estimate the efficiency of the first TIs in comparison with the efficiency of other types of TIs and use the analysis of these results to plan the scope of the first TIs. Within the framework of the first TIs, TARS shall also raise the awareness of newly registered taxable persons for VAT purposes about positive effects of collecting VAT for the Republic of Slovenia and its citizens, provide information on liabilities towards TARS as well as present the forms and means of access to the assistance provided by TARS to taxable persons to discharge their tax liabilities.

Measure by TARS

During the audit TARS produced special brochures that are delivered to taxable persons during the first TIs and are also available at the TARS website⁸⁶.

Simultaneous international TIs

Simultaneous international TIs can be an effective tool for eliminating the consequences of systemic evasions in the field of VAT. They are usually carried out in connection with other taxes, particularly with the corporate income tax. This type of TIs is particularly necessary when supervising multinational companies regarding the distribution of profit and determination of the appropriate level of tax liability arising from the corporate income tax and VAT in an individual EU Member State. Such controls are complex and lengthy because all procedures must be started and completed simultaneously and all activities

⁸⁵ 3 in 2002, 175 in 2003, 151 in 2004, 19 in 2006 and 76 in 2006.

⁸⁶ Value added tax and tax on insurance services, Ljubljana, June 2007
[URL:http://www.durs.gov.si/fileadmin/durs.gov.si/pageuploads/Brosure_in_zlozenke/Davek_na_dodano_vrednost_in_davek_od_prometa_zavarovalnih_poslov.pdf].

duly coordinated. The experience of other tax administrations shows that such cooperation also leads to harmonization of control procedures and exchange of good practice between the EU Member States.

TARS explained that it has not participated in simultaneous international inspections before 2007, however, in 2007 it proposed a simultaneous international TI in the field of transactions in used cars to tax administrations of Germany, Austria, Italy and Netherlands. These countries confirmed their cooperation (inspectors met on 20 and 21 September 2007). TARS also received an invitation to participate in an international TI from the tax administration of Germany (the meeting for the selection of risky taxable persons was held on 13 and 14 September 2007). Both aforementioned international TIs were underway in the period of drafting the audit report.

Recommendation

Considering the number of detected tax evasions of the MTIC type we recommend TARS to use the analysis of costs and foreseen benefits (additionally assessed and collected VAT, prevention of tax loss, participation in an international TI where the Republic of Slovenia had no direct benefits with regard to additional VAT assessment) as a basis to examine the possibility to, in cooperation with the EU Member States already proficient in international TIs, perform the activities that will ensure the conditions for regular implementation of simultaneous international TIs.

4.1.4.d Tax investigation

Pursuant to Article 131 of the ZDavP-2, TARS may instigate a tax investigation if there are reasons for a suspicion that a criminal act has been committed whereby taxation regulations were violated or because of implementing actions to ensure mutual assistance to bodies of the European Community, of the EU Member States or of third countries. After a tax investigation, a tax inspector shall produce a final investigation report and propose the introduction of a TI if there are substantiated reasons for the suspicion that taxation regulations were violated.

TARS started carrying out investigation activities already in 2004, i.e. in the part pertaining to the analysis of data obtained from other public authorities and individual data from internal databases.

On 20 April 2007, to be more efficient in detecting tax evasions, TARS introduced a free anonymous telephone number⁸⁷ that individuals can use to communicate in full confidentiality any information pertaining to tax irregularities. TARS assesses every report by analysing the data from the Register of taxable persons, the data from inspection records, the data from the data repository, databases of registered motor vehicles, database of PSO TYPE APPROVAL, land survey data as well as business information. Based on the results of the performed analysis, the Department for Investigation and Analysis decides whether to introduce a TI or not. In the period from 20 April to 30 August 2007 TARS received 496 calls of which 62 were treated in greater detail; TIs were proposed in seven cases.

TARS submitted the data on the sums of subsequently assessed liabilities during TIs that were carried out upon the request of the Department for Investigation and Analysis on the basis of the findings of investigative and analytical activities by individual years (Table 6).

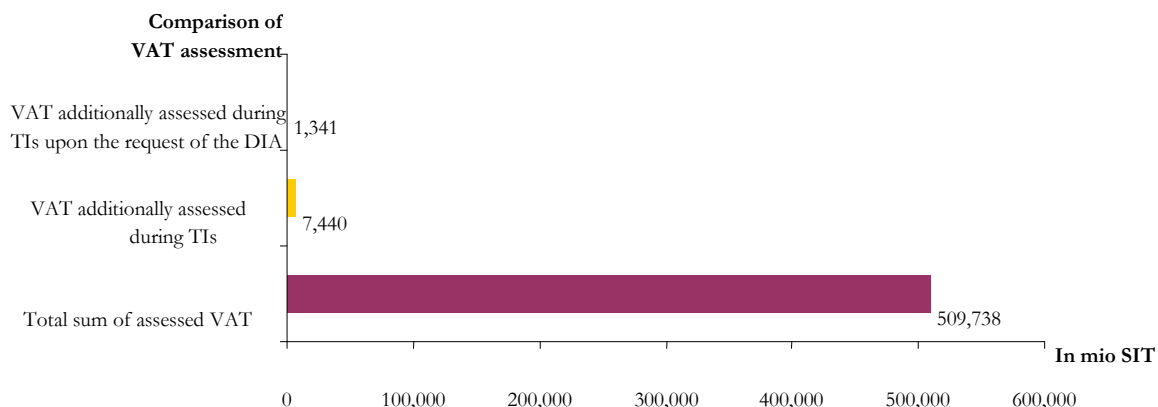
⁸⁷ [URL: http://www.durs.gov.si/fileadmin/durs.gov.si/pageuploads/Sporocila_za_medije/070420-anonimne_prijave_davcnih_utaj-1.doc], as of 20 April 2007 (Anonymous telephone number 080 30 60).

Table 6: VAT additionally assessed during TIs introduced upon the request of the Department for Investigation and Analysis (the DIA) in 2003–2006

Year	Total sum of assessed VAT	Sum of VAT additionally assessed during TIs	Sum of VAT additionally assessed during TIs upon the request of the DIA	Share of VAT additionally assessed during TIs upon the request of the DIA in the total sum of assessed VAT in %	Share of VAT additionally assessed during TIs upon the request of the DIA in VAT additionally assessed during TIs in %
(1)	in mio SIT (2)	in mio SIT (3)	in mio SIT (4)	(5)=(4)/(2)*100	(6)=(4)/(3)*100
2003	65,887	8,810	-	-	-
2004	245,977	9,658	752	0.3	7.8
2005	491,324	8,211	281	0.1	3.4
2006	509,738	7,440	1,341	0.3	18.0

Source: Information on VAT returns for 2006, TARS, May 2007. Data on additionally identified liabilities for VAT purposes based on the reason for inspection: VZR017 – investigations; TARS, as of 8 October 2007.

Figure 6: VAT additionally assessed during TIs introduced upon the request of the Department for Investigation and Analysis (the DIA) in 2006



Source: Information on VAT returns for 2006, TARS, May 2007. Data on additionally identified liabilities for VAT purposes based on the reason for inspection: VZR017 – investigations; TARS, as of 8 October 2007.

Conclusion

Despite the generally decreasing trend of additionally identified liabilities for VAT purposes during TI procedures we have found out that the volume of VAT additionally assessed during TI procedures introduced on the request of the DIA in 2006 increased when compared to 2004 and 2005. The data shows that in 2006 no less than 18 % of VAT additionally assessed during TI procedures can be attributed to the initiatives of the DIA to carry out a TI.

It can be concluded that, by having introduced investigations as a part of the control system, TARS met the goal from the Strategy for 2005–2008 with regard to increasing the level of disclosed tax evasions. Thus, TARS was successful in reaching the objective and thereby also efficient which can be seen from the share of VAT additionally assessed during TIs upon the initiative of the DIA.

4.1.4.e Tax execution

In the case tax is not paid within the prescribed deadline, TARS is entitled to initiate tax execution pursuant to Article 143 of the ZDavP-2 by issuing a decision on tax execution.

On average, TARS carries out 80,000–110,000 procedures of tax execution per year, including all decisions on tax execution pertaining to cash receipts, cash with banks or savings banks as well as debtor's claims, movable property and securities.

The VAT application enables an extract of statistical reports on the number and amount of issued and paid for decisions on tax execution according to different criteria (by individual desk officers and tax offices, at the TARS level, together and separately for natural and legal persons). It shows that 10,685 decisions on tax execution were issued in 2006, however, this number does not include tax executions pertaining to movable property and securities because they are not registered in the VAT application by TARS.

According to TARS, the reasons for non-payment of claims arising from VAT can also be found in the bad payment discipline in the Republic of Slovenia which is, among other things, the consequence of lengthy executive proceedings before courts.

Recommendation

We recommend TARS to examine whether it would be reasonable to update the existing records on implemented TIs with the records on tax executions related to VAT. The information on the cases in which an individual tax execution was fully completed, the time needed or the reasons for lengthy executive procedures could in our opinion be used by TARS already in the phase of planning TIs in the field of VAT.

4.1.4.f Minor offence and criminal procedure

Minor offence

On 1 January 2005, based on Article 215 of the Minor Offences Act⁸⁸, TARS became a minor offence authority. Minor offences that were most often detected in control procedures by TARS included: failure to submit a VAT return, late submission of a VAT return and failure to disclose prescribed data; in TI procedures minor offences were most often detected in connection with the failure to issue invoices. The most frequent reason for issuing a decision on a minor offence is an incorrectly calculated amount of the input VAT.

Table 7 shows the number of cases treated by TARS in the role of a minor offence authority and the sum of fines charged in the field of VAT in the period 2005–2007.

⁸⁸ Official Gazette of the RS, no. 7/03.

Table 7: The number of cases treated by TARS in the role of a minor offence authority and the sum of fines charged in the field of VAT

Year	Number of issued payment orders	Number of issued decisions	Total sum of fines imposed for minor offences (in EUR)
2005	1026	8	872,144
2006	863	150	953,223
2007*	500	153	672,798

* Data up until 23 August 2007.

Source: Data of the minor offence authority in the field of VAT, code 42904-28/2007-01132-01, as of 23 August 2007.

Criminal offence

TARS keeps records on infringements of tax regulations with the character of a criminal offence (data on filed criminal complaints and charges as well as pronounced judgements) pursuant to provisions of Article 31 of the ZDS-1 and Article 7 of the Rules on the Records of Infringements of Tax and Other Regulations within the Competence of the Tax Service and on Handling Data Removed from the Records⁸⁹. These regulations do not impose recording of data on criminal complaints by individual types of tax liability (e.g. VAT) therefore it was not possible to obtain the data from TARS about the number of filed criminal complaints and issued final decisions because of VAT evasions in the period covered by the audit. Regarding individual criminal complaints, TARS only keeps records according to the statutory denotation of a criminal act by indicating the article and paragraph of the applied law.

Recommendation

We recommend TARS to examine whether it would be reasonable, within the framework of existing records, to capture data on filed criminal complaints and pronounced judgements separately, by types of taxes. We namely believe that such data could be well used when planning individual controls and inspections and that, by publishing the data on the number of final judgements pronounced on the basis of criminal complaints, TARS would indirectly exert a positive influence on the tax culture of taxable persons.

TARS stated that the current Criminal Code is not appropriate for all types of tax evasions, the example of this being the case of an unduly returned tax in the Republic of Slovenia or other EU Member States which is not considered a criminal offence. It also expressed the opinion that the unjustified request to be returned VAT is the key part of tax evasions of the MTIC type.

Measure by TARS

During the audit, TARS proposed the MF to modify Article 254 of the Criminal Code by amending or adjusting the definitions of acts of concealing financial liabilities or avoiding tax payment to also include the cases of unduly returned tax and to tighten the sanctions for taking part in a criminal act (related tax schemes). Article 249 of the new Criminal Code entering into force on 1 November 2008 defines tax concealments, among them also the unduly recovered tax in the Republic of Slovenia or other EU Member States.

⁸⁹ Official Gazette of the RS, no. 38/06.

4.1.4.g Assistance to inspectors and taxable persons

In accordance with the goal of achieving better quality, improving voluntary payment of taxes and ensuring harmonized operation of the tax authority, TARS provides education not only for inspectors but also for taxable persons. Quality and harmonization of conducted procedures are ensured by composing working groups (inspectors are provided with guidelines and professional support), issuing manuals, organizing workshops, publishing explanations and instructions on the internet and intranet as well as by holding monthly meetings of inspection heads. Besides, regarding taxable persons, TARS also endeavours for a higher level of awareness in the field of VAT and the highest possible level of voluntary discharging of tax liabilities by providing:

- telephone information given by controllers on a daily basis;
- information on the TARS website (given by the virtual tax assistant named VIDA) and on the eAdministration portal;
- answers to questions via email or ordinary mail as well as directly from employees at tax offices;
- binding information sent to a taxable person by TARS, upon request and against payment pursuant to Article 14 of the ZDavP-2, that is intended to stimulate taxable persons to correctly discharge their tax liabilities and to harmonize the operation of tax authorities or promote equal treatment of taxable persons,
- instructions and information in various publications (Davčni bilten, Denar, Davčno-finančna praksa, GV, Obrtnik) and other media.

Conclusion

We believe that TARS has a good quality and efficient system for providing assistance and information to inspectors and taxable persons.

4.1.4.h Analytical records on VAT

In the Strategy for 2005–2008, TARS planned to develop and launch a computerized tax accountancy system by the end of 2006.

Conclusion

Based on the TARS explanations and the examination of the operation of the tax accountancy system we have found out that by the end of 2007 TARS failed to achieve the objective from the Strategy 2005–2008 on launching a computerized tax accounting system.

Pursuant to Article 6 of the Accounting Act⁹⁰ (hereinafter: the ZR), budget spending units must keep their accounting books (basic and auxiliary ones) according to the double entry method.

Conclusion

Pursuant to Article 26(1)(2) of the ZDS-1 and to the Rules on the Form and Method of Keeping Accounting Records at the Tax Administration of the Republic of Slovenia⁹¹ (hereinafter: the TARS Rules), within the iDIS application TARS established the analytical system of keeping accounting records on VAT assessment, payments and refunds (hereinafter: the analytical records on VAT). Based on the

⁹⁰ Official Gazette of the RS, no. 23/99.

⁹¹ Official Gazette of the RS, no. 66/05.

explanations by TARS and on the examined operation of the tax accountancy system we have found out that TARS does not consider the principles of the double entry accounting method because this is not enabled by the current software; TARS also stresses⁹² that when recording assets and liabilities it does not use the double entry method pursuant to accounting rules because claims to taxable persons do not represent the assets of TARS. The Court of Audit has already exposed the absence of comprehensive accounting records of TARS in three audit reports⁹³.

Activities carried out by TARS to reform tax accountancy

In 2005, within the framework of the central tax accountancy (hereinafter: the CTA) project substantive requirements for introducing the CTA pursuant to the rules of the double entry method were drafted. Within the same exercise a bookkeeping model⁹⁴ was prepared in accordance with the single chart of accounts for the budget and budget spending users (hereinafter: the SCA) according to which TARS must introduce receivables and payables by types of taxes and contributions to taxable persons as well as receivables and payables by recipients of funds (central government budget, municipal budget, the Pension and Disability Insurance Institute of the Republic of Slovenia and the Health Insurance Institute of the Republic of Slovenia).

Substantive requirements to introduce the CTA pursuant to the rules of the double entry method and in accordance with the SCA were updated in 2007 and included in the tender (investment) dossier for building an integrated tax information system (the new DIS).

Conclusion

We have found out that the analytical records on VAT still fail to include VAT returns and refunds for taxable persons not established within the Republic of Slovenia as well as VAT returns and refunds in passenger traffic and for consular representatives⁹⁵. These records are kept manually by the General Tax Office in excel tables separate from the analytical records on VAT. The above requests and refunds are included into the report "A1 Review by Sub-accounts of General Government Revenue" by the General Tax Office, but they are not included in the aggregate review of transactions and balance on the VAT sub-accounts and off-balance-sheet records of receivables from taxable persons (hereinafter: the A1 Review – VAT). Since the A1 Review – VAT is not comprehensive, the balance of debits and payments as well as the final balance of receivables and payables regarding VAT differ in both reports; aside from that TARS also fails to ensure a separate treatment of reports via an explanatory note in the title about included or excluded types of entries. The above stated weakness may be seen as a possible risk that the indicated receivables from VAT are not accurate and thereby that TARS does not use the right baseline situation of collected VAT or receivables from VAT when planning annual measures to reduce VAT losses.

⁹² Explanations of the MF, DURS and CURS as of 3 October 2007.

⁹³ Audit reports no. 1202-1/96-44, 1202-1/96-51 as of 10 September 1997, no. 1202-5/2002-31 as of 11 April 2003 and no. 1202-3/2006-18 as of 6 February 2007.

⁹⁴ Bookkeeping information from the system of central tax accounting (CTA) with the TARS supervisor – double entry method, code 46401-138/2005 as of 26 October 2006 (DK_01645_1_GR).

⁹⁵ Returns pursuant to Articles 54, 74 and 75 of the ZDDV-1.

Measure by TARS

During the audit, the Division for Tax Accountancy and Enforcement⁹⁶ submitted to the Information Technology Department (hereinafter: the IT Service) the request to upgrade the VAT-records application with the proposals of solutions with regard to entering VAT requests and refunds for foreigners and consular representatives as well as in passenger traffic.

Besides, TARS also drafted the report "Review A1 – VAT for the Period from 1 January 2007 to 30 November 2007" which shows that VAT refunds in passenger traffic, to foreigners and consular representatives are not included. This will explain the difference in the balance of VAT debits and payments detected when comparing both reports.

Conclusion

The A1 – VAT Reports (at the period as well as the annual levels) collected by TARS at the General Tax Office and falling within the competence of directors of tax offices, who pursuant to the TARS Rules keep the analytical records of payments and refunds of taxes, were not signed by responsible persons. In accordance with the Slovenian accounting standard no. 22⁹⁷ these reports shall be signed by directors of tax offices⁹⁸ responsible for the authenticity and veracity of these reports. Only such bookkeeping documents may be used for the accounting treatment of data and only such documents ensure a credible basis for identifying the opening balance of VAT claims and payments as a basis for planning measures to reduce VAT losses.

Measure by TARS

During the audit, TARS stipulated in the Manual on Finalizing VAT Accounting Records⁹⁹ that a tax office shall control and approve the Review A1 – VAT report which shall be signed by the director of the tax office or an authorized person; the report thus signed shall be submitted to the General Tax Office. Besides, with a circular letter dated 11 December 2007, TARS informed all tax offices and the Special Tax Office that the Review A1 – VAT report must be submitted to the General Tax Office and defined deadlines for the delivery of monthly and annual reports.

Conclusion

Under Article 3 of the TARS Rules, TARS should collect the data in accounting tax records by taxable persons as well as by types of taxes on the accounts stipulated in the chart of accounts for accounting taxes and other duties. We have found out that in the analytical records on VAT TARS does not capture data by accounts, but by types of transactions that were only defined for the needs of using the analytical records on VAT. TARS failed to define the rules on recording entries by types of transactions in an internal act.

Measure by TARS

During the audit, TARS submitted the document titled "VAT – Connection between Types of Transactions and Accounts"¹⁰⁰ which shows connections between types of transactions and respective accounts for VAT.

⁹⁶ Request to update the VAT application from the aspect of bookkeeping in the analytical bookkeeping records of requests and returns of VAT in passenger traffic, returns of VAT to foreigners and consular representatives no. 4290/2007-1 (01061-01) – internal as of 11 December 2007.

⁹⁷ Official Gazette of the RS, no. 118/05.

⁹⁸ Cleared books of account shall be signed by authorised persons (point 22.18, third paragraph).

⁹⁹ Version 2.0, November 2007, TARS.

¹⁰⁰ Version 1.3 (received on 1 February 2008).

Explanation by TARS

At the clearance meeting held on 11 June 2008, TARS explained that, before the "VAT – Connection between Types of Transactions and Accounts" document was produced connections between the type of transaction and the relevant column were presented in the A1 Review – VAT document.

Conclusion

In the VAT application entries are recorded in two ways: manually and automatically. A manual entry is carried out by controllers and desk officers at bookkeeping departments of tax offices as well as by desk officers of the Division for Tax Accountancy and Enforcement at the General Tax Office on the basis of the original or derived bookkeeping documents. If carried out automatically, entries are generated on the basis of the processing launched in the IT Service. When verifying the work of a controller selected on the basis of risk analysis, we established that this person had access to all entries; however, in practice the possibility of accessing automatic and corrective entries was not realized. We believe that controllers should know the contents of all types of entries for an individual taxable person.

Explanation by TARS

At the clearance meeting held on 11 June 2008, TARS explained that the controllers' occasional lack of knowledge about all types of entries results from the fluctuation or redistribution of workers to other working places therefore it will devote more attention to more frequent education.

Conclusion

In the database of the analytical records on VAT data is kept in different tables. We have checked the data from the table where internal underlying documents are kept. It was established that person who issued, examined, approved and posted transactions were explicitly indicated with regard to every underlying document. Since in the above table 21.9 % of entries (3636 out of 16634) pertain to invalidated or corrective entries, we estimate that the risk exists that preventive controls set up with regard to examining and approving a transaction before it is entered into the analytical record are not successful enough to prevent from erroneous entries.

We have obtained the list of persons entitled to work with the application (analytical records on VAT) and checked the data in the table under "Transactions"¹⁰¹ for 2006 where all posted payment transactions and accounting data are kept. In the "Transactions" table 46 % of transactions were entered by a person from the Development Department¹⁰² (within the IT Section) who is not defined as a user having access to data. Until the end of the first quarter of 2007 this person entered 37 % of all transactions posted in the "Transactions" table.

Explanation by TARS

TARS explained that after August 2007 regular processing no longer included posted transactions entered by the person from the Development Department.

We have also found out that the list of persons having access to the data in the production database of the analytical records on VAT also included persons from the Development Department (within the IT Service) who, in accordance with the work tasks defined in the job classification, had no competences for

¹⁰¹ The table includes all booked transactions (payment transactions, VAT returns, internal underlying documents).

¹⁰² Most of transactions conducted by the Development Department pertain to automatic booking.

performing tasks in the field of posting transaction pertaining to VAT. In our opinion TARS should clearly define in internal documents the tasks related to entering data into the analytical records on VAT in accordance with the principles of segregating tasks and competences.

Additionally, we have found out that the "Transactions" table also included entries pertaining to a test taxable person regarding which we received no data from the Register of taxable persons for VAT purposes. These entries were posted by the "Internal User from the IT Service". For this reason the risk exists that unauthorized employees could post entries for non-registered taxable persons. The existence of such entries is also in contradiction with Article 7 of the TARS Rules according to which posting of changes in accounting records of taxes shall be done on the basis of a bookkeeping document.

Recommendation

We recommend TARS to as soon as possible establish a system ensuring that the data is only entered into the analytical records on VAT by persons who are appointed users of the application for keeping records on VAT in accordance with the job classification.

Measure by TARS

During the audit, TARS delivered a work sheet of an employee from the Tax Accountancy Department with a detailed description of tasks, responsibilities and competences connected with VAT bookkeeping.

Explanation by TARS

At the clearance meeting held on 11 June 2008, TARS explained that the test taxable person was a part of a pilot exercise on the occasion of introducing some complex changes after which the person who carried out the testing also reversed all entries.

Conclusion

We have obtained data of all posted transactions in the analytical records on VAT in 2006. To be able to confirm the accuracy of the result with regard to debits and payments in the current year, we used the A1 algorithm¹⁰³ to recalculate the balance of debits and payments for VAT purposes for 2006 and compared it to the balance stated in the final report "A1 Review – VAT by Sub-accounts of General Government Revenue for the Period from 1 January 2006 to 31 December 2006" (hereinafter: A1 Review – VAT 2006). The sums thus calculated differ from the sums in the A1 Review – VAT 2006 report by SIT 5,085,000 on the debits side and by SIT 5,158,000 on the payments side. After a recalculation¹⁰⁴, the same sums of discrepancies were also established by TARS. The stated differences in the sums of debits and payments occurred because TARS used the data from the "Transactions" table to draft a special table for the A1 Review – VAT 2006 where data on five taxable persons were not captured. TARS failed to explain the reasons for the above differences in its documentation. During the audit, the explanation of the above changes was only received for one taxable person¹⁰⁵; because of the lack of time and the complexity of procedure and in agreement with the representatives of the Court of Audit, TARS did not finally examine the reasons for changes with regard to the remaining taxable persons during the audit, however, we advised TARS to do it as soon as possible.

¹⁰³ Annual accounts for 2006, algorithm A1 for the needs of annual and monthly reporting, version 1.0 as of 19 October 2007.

¹⁰⁴ TARS established differences already before the audit was introduced.

¹⁰⁵ An explanation of an employee at the IT Service.

In the past years, TARS was not in the habit of finalizing the analytical records on VAT at the end of the year; for the first time this was partly done for 2005¹⁰⁶. In accordance with the Slovenian accounting standards, TARS finalized the records on VAT for the first time in 2007 because of the Euro turnover. To confirm the accuracy of the opening balance of payments and refunds as well as of the surplus without refunds for 2007 stated in the report titled "A1 Review – VAT from 1 January 2007 to 31 March 2007", we used the A1 algorithm to calculate the opening balance for 2007. Since we have not checked the accuracy of the opening balance in 2006, we also did not check the accuracy of the entries in the final balance for 2006. We received the data on transactions in the first quarter of 2007 and eliminated the entries related to the opening balance in 2007. We have found out that the sum of payments after the recalculation differs from the sum stated in the report "A1 Review – VAT from 1 January 2007 to 31 March 2007" by EUR 215.58. The explanation of the difference was drafted by a person from the Development Department (IT Service) who, with regard to job classification and rules on segregating tasks, in our opinion should not have been granted access to the data from the records on VAT. Substantive explanations should have been provided by a person responsible for bookkeeping and attached to the report.

Verifying the entries, we found out that 1331 of them were related to one and the same taxable person, of which 71 % were invalidated and reversed. We asked for associated bookkeeping documents but did not receive all of them. Regarding the same taxable person it was also established that a very high incorrect sum was entered in the records that was later reversed. A tax office representative explained that, among other things, errors in posting also occur because of the "Serbian keyboard setting when using other applications".

Since the software solution operates in such a way that upon certain changes in data all previous entries are reversed and since 15 % of all entries in the entire "Transactions" table were reversed, we believe that there is a risk of a failure of the software solution.

Explanation by TARS

At the clearance meeting held on 11 June 2008, TARS explained that reversed entries, that are based on new facts originating from the newly submitted bookkeeping document and necessary to establish an updated and correct balance in the analytical accounting records, ensure audit trail.

Recommendation

We recommend TARS to examine other reasons for the occurrence of errors as well as the possibilities for their prevention or reduction.

Conclusion

We have found out that the data from VAT returns, a limited set of data from the registered taxable persons for VAT purposes and the data on payment transactions is recorded in the data repository. The goal of data collection is not defined and there are no instructions for use. We have tried to carry out an enquiry with regard to the data prepared in advance, however, the enquiry option was not operative during the presentation.

¹⁰⁶ Explanations of items from the A1 Report – Accounting report on transactions and balance on sub-accounts of general government revenues by public finance budgets no. 426-internal/2007 0106-01 as of 4 October 2007, TARS.

Recommendation

We recommend TARS to define the objective of data collection and draft instructions for users accessing the data repository.

4.2 Are CARS measures to reduce VAT losses efficient

4.2.1 Definition of objectives and measures to reduce VAT losses

In the Development Strategy of the Customs Service by 2010¹⁰⁷ (hereinafter: the CARS Strategy), within the framework of the strategic field "Effective collection of duties and implementation of trade policy measures" CARS defined the following objectives:

- reinforcing the supervising mechanism (strengthening its role in ex-post control and inspection);
- application of risk analysis (introduction of common criteria and standards of operation as well as efficient exchange of data in this field within the framework of the EU Member States; special attention will be paid to highly taxable goods and goods subject to restrictions) and
- cooperation with the economic sector as well as other national authorities and inspection services.

In its financial plans for 2005, 2006 and 2007, within the sub-programme *02041602 – Customs Administration*, CARS defined its implementation goals that, among other things, also pertain to VAT collection. This can be seen from the following examples:

- participation of economic operators in law-making;
- improved quality and scope of supervision and control in the field of customs and excise duties;
- establishment of a uniform system of measures to ensure a rapid and effective mutual administrative assistance when recovering mandatory charges;
- better use of the risk analysis by introducing common criteria and standards as well as effective exchange of data;
- better cooperation of customs authorities with other bodies (tax service);
- greater reliability, availability, applicability and user-friendliness of the existing customs information system for a more efficient implementation of customs, excise and administrative procedures;
- on-time and quality development of new applications and upgrading of the customs information system owing to the amended legislation and integration in the European Commission projects and
- acquisition of additional competences by CARS.

In the CARS financial plan for 2007 implementation goals are for the first time equipped with indicators that were used by CARS when measuring the level of attainment, such as:

- the volume of collected charges falling within the competence of CARS shall increase in real terms compared to the previous year (with unchanged statutory competences in the field of tax collection), initial value: collected revenues in 2006, target value in 2008: increase by 2 %;
- the share of collected duties falling within the competence of CARS in the central government budget revenues of the Republic of Slovenia shall remain unchanged or slightly increase (with unchanged

¹⁰⁷ No. 013/55-3/2004 as of 3 November 2005,

[URL: http://www.carina.gov.si/fileadmin/curs.gov.si/pageuploads/O_nas/Strategija_CURS_2010.pdf].

statutory competences in the field of collection of duties), initial value: 22.94 %, target value in 2008: unchanged or increased by 1 % and

- the share of successfully recovered duties with regard to the total sum of duties subject to coercive recovery shall increase, initial value: 36.5 %, target value in 2008: 38 %.

Within strategic objectives in its Plan for Implementing the Development Strategy of the Customs Service by 2010 for the period 2006–2007 (hereinafter: the Implementation plan) CARS defined general activities with expected results in the period 2006–2007, however, they do not pertain to individual duties, e.g. to the field of VAT collection.

Explanation by CARS

CARS explained that the Implementation plan did not include activities or measures for every single duty individually because the upgraded system of risk analysis will not only improve the efficiency of VAT collection but also the efficiency of collection of customs duties, excise duties, charges and other duties. All measures from the Implementation plan have a direct or indirect impact on data collection and thereby on VAT.

Conclusion

CARS has already introduced relevant planning of individual objectives by presenting some concrete indicators in the financial plan for 2007 intended to measure the effectiveness of attainment of set goals. Nevertheless, we have found out that CARS only defined common goals with regard to all duties falling within its competence but failed to define objectives that are more narrowly focused on individual types of duties.

Recommendation

Regarding better efficiency of VAT collection we recommend CARS to examine whether it would be appropriate to define concrete goals only pertaining to VAT, such as the concrete number of inspections and the envisaged volume of the additionally charged VAT.

Measures by CARS

On 11 June 2008 CARS explained that in the Plan for Implementing the Development Strategy of the Customs Service by 2010 for the period 2008–2009 the goal »Efficient collection of mandatory duties presenting a budget revenue of the Republic of Slovenia and partly of the European Union by monitoring indicators, detecting losses in duties collection, searching for reasons and taking appropriate measures as well as increasing the efficiency of collection« was included and within it the following activities in the field of VAT:

- *"to upgrade the records on controls and investigations,*
- *to prepare a method for assessing VAT losses,*
- *to estimate VAT losses,*
- *to analyse the reasons for VAT losses and take measures for their elimination,*
- *to participate in the working group for VAT,*
- *to constantly monitor and analyse significant increases or decreases when collecting VAT and*
- *to include the results of changes in import duty collection, if the discrepancy within the framework of a 4-digit tariff subheading exceeds 10 % compared to the average, in monthly reports on the operation of the risk analysis system."*

4.2.2 Employees at CARS

At CARS 288 employees are active in the field of VAT, of which 111 in the Division for Investigations, 83 in Departments for Control Issues at customs directorates, 11 in the Sector for Customs and Tax Procedures (Department for Procedures and Department for Simplifications), 5 in the Sector for Finance and Purchasing (Department for Compulsory Levies), 10 in Services for General and Financial Affairs at customs directorates and 68 in Departments for Administrative Procedure, Offences and Recovery. The data on the number of employees¹⁰⁸ at CARS engaged in VAT is relative because the employees do not exclusively carry out the tasks related to VAT; these tasks are just a part of their job responsibilities.

Conclusion

The audit detected no significant risks with regard to the organization of work and staff in the field of VAT collection at CARS.

4.2.3 CARS information system

4.2.3.a Slovenian customs information system

Slovenian customs information system (hereinafter: SICIS) covers customs clearance of goods and enables customs supervision of goods as well as recording and accounting of duties.

4.2.3.b INFO.net

INFO.net is an intranet application which is used to exchange information within CARS and to which all customs authorities are connected. The system provides data on all infringements of customs regulations committed by individual taxable persons in the EU Member States, risk profiles and instructions for customs authorities explaining how to react in specific situations, together with descriptions of procedures and conclusions by CARS in individual cases. The system is regularly updated and, according to CARS, very useful.

4.2.3.c System of risk analysis

The system of risk analysis (hereinafter: SAR) is an application that provides instructions for selective implementation of controls in customs procedures on the basis of built-in profiles. It receives information from various sources (the European and national ones). On the basis of risk parameters entered by the Department for Analysis, SAR detects customs declarations that include risk parameters and requires the examination of documents or goods based on the automatic risk assessment. Before its application, every risk profile is tested by using real data for the previous month and assessed according to the 5 (source probability) x 5 (reliability of information) x 5 (confidentiality of information) system. After three months the profile is checked again and appropriately amended on the basis of an analysis. Every profile has its own risk assessment which can be low, medium or high. SAR includes risk indicators for goods and persons with regard to transport types as well as sub-indicators with regard to transport modes (maritime, air, road, railway or postal). It does not include separate indicators only for the field of VAT because the supervision is not related to individual duties, but to goods.

¹⁰⁸ As at 16 April 2007.

In its Implementation plan, within the framework of the strategic objective "Application of the risk analysis", CARS defined the activity "to upgrade SAR" with results and reporting. CARS explained that such results will also affect the field of VAT, however, these are not exclusively VAT-related measures.

4.2.3.d MEJA application

The Meja application is intended to support procedures in passenger and postal traffic and enables the implementation of the procedure for accounting duties with regard to goods declared orally in passenger and postal traffic, keeping records of cash and securities transfer, keeping records of VAT return forms in passenger traffic, issuing special permits for road transport, keeping records of data on penalty orders and records of claims as well as electronic transmission of individual data to other competent state authorities.

4.2.3.e TARIC

TARIC is a publicly accessible electronic database of all measures that must be implemented upon import or export of goods to or from the European Union. TARIC keeps and promptly enters all data on the regulations of the European Commission. Member States can also add to TARIC any national measures used when carrying out customs procedures.

4.2.3.f Intrastat

Intrastat is a statistical system intended to collect data on the exchange of goods between the EU Member States that was established in 1993 upon the introduction of the free movement of goods in the European Union. Companies (reporting units) operating within the European Union are obligated to report to this system about every dispatch or receipt of goods from or to another EU Member State.

4.2.3.g Financial bookkeeping module

Financial bookkeeping module is intended for recording financial bookkeeping data. Entries are generated automatically, on the basis of received and confirmed customs declarations and information of the PPA arising from payment transactions. The module consists of two applications. The principal one is located at the General Customs Directorate where entries of claims are automatically recorded and covers the claims where payment was postponed due to lodged security. The remaining individual entries are generated in the CU-KOD application administered by customs directorates.

Final conclusions regarding the CARS information system

The audit detected no significant deficiencies in the use of information system therefore we assess that it presents a good systemic basis for an efficient VAT collection.

4.2.4 VAT collection procedure

The VAT collection procedure predominantly includes control of customs declarations, inspection, customs investigation, recovery, assistance to taxable persons and, only from the point of substance but not formally, also the minor offence and criminal procedure. The continuation of the audit report presents individual procedures within the defined framework of VAT collection.

4.2.4.a Control of customs declarations

Customs declarations are automatically recorded in the SICIS application where the data from a customs declaration is verified via the built-in computer controls (the System of Business Rules; hereinafter: the SBR). The SBR is promptly updated and serves as a reminder to individual operative customs officers who are in charge of customs clearance of goods. Goods are only released for free circulation if the SBR detects no errors and the respective customs officer does not decide to examine the documents or goods on the basis of a risk analysis in the phase of customs clearance. The SBR already includes the instruction that only relates to VAT (e.g. that documents and/or goods shall be checked in the case of goods for which a lower VAT rate is prescribed if conditions are met).

In 2006 CARS received 571,876 import and 1,541,745 export customs declarations. In 2006, in the customs declaration phase 40 % of all customs declarations were examined of which 7.6 % were physical examinations of goods and 33 % examinations of documents.

In accordance with the strategic document of the European Union "The Future Role of Customs in the EU" and modern approaches to customs clearing also CARS adopted some measures. Among them was the redirection of controls from the transaction approach (examination of individual shipments) to the systemic one (inspections of participants and companies). Accompanied by risk management methods, this approach enables higher efficiency, better focused checks and faster flow of legal transactions.

In accordance with Article 78 of the Council Regulation (EEC) no. 2913/92 of 12 October 1992 establishing the Community Customs Code¹⁰⁹ (hereinafter: the Community Customs Code), classical post-clearance controls of customs declarations shall be carried out by customs inspectors from the Department for Control Issues after Release into Free Circulation to identify and eliminate any possible irregularities that were not detected during the customs clearing procedure (e.g. if a customs declaration has not been subject to examination at all). If irregularities are identified, the inspector shall table a proposal to remedy irregularities (additional payments or refunds) to the Department for Administrative Procedure, Offences and Recovery which shall issue a decision (Article 130 of the ZDavP-2).

CARS neither keeps separate records on the volume of VAT subsequently accounted for during procedures of post-clearance controls of customs declarations nor separate records on the volume of VAT subsequently accounted for during the inspection procedures; these two records are combined in the application. CARS explained that separate records are expected to be introduced when the "Records control" application is upgraded.

Recommendation

We recommend CARS to examine which data arising from control procedures could be beneficial for planning the activities to increase the efficiency of VAT collection and to consider these findings in the process of upgrading the "Records control" application.

¹⁰⁹ Official Journal of the European Communities, no. L302/1.

4.2.4.b Inspection

Pursuant to provisions of the ZDavP-2, inspection shall be carried out with regard to taxable persons or importers to identify and eliminate any possible irregularities that were not detected during the customs clearing procedure and to account for a correct sum of VAT. Inspection shall be carried out and tax assessments issued by a customs inspector authorized under the Inspection Act¹¹⁰ (an inspector who has passed the examination under the Inspection Act).

Findings of customs inspectors arising from inspections are entered into the "Records control" application. Next to partial and integrated inspections, inspectors also perform more complex preliminary ones. In the case of the latter, besides classical examinations (taxable person's business operation so far), inspectors also check computer records, the method of keeping records, knowledge of responsible persons, adequacy of the collateral, the method of archiving documents, permit for electronic exchange (whether preliminary testing was carried out) and similar.

Customs inspectors may be specialized in individual fields, such as the classification of goods in the Combined Nomenclature, origin of goods, defining the customs value and agricultural policy (depending on the number of employees and the organization of an individual department).

For 2007, CARS produced the annual plan of inspections based on risk indicators related to identified irregularities in the past, the size of a taxable person (with regard to the number of customs declarations and the value of imports or exports), the taxable person's risk assessment with regard to the frequency of occurrence in customs procedures, suppliers and recipients of goods as well as the type of goods. When producing the annual plan of inspections, CARS also considers mandatory periodical checks on the basis of issued permits and the time elapsed from the last inspection (every entity shall be inspected within a certain period; at least once in the period of three years when post-clearance collection is still possible).

CARS decides to carry out a post-clearance control, inspection or investigation in the field of VAT in the following cases:

- unjustified exercising of the right to be exempt from VAT;
- unlawful admission of goods (goods appear on the black market);
- unjustified enforcement of the reduced VAT rate (possibility of incorrect classification of goods);
- procedure 42 (release through a tax delivery to another Member State – the goods actually remain on the EU customs territory);
- unjustified indication of costs in the box no. 44 which reduce the tax base;
- the tax base does not include the value of transport to the first point of destination in the European Union (the border parity is used);
- the tax base does not include customs duties and other charges having equivalent effect that are paid upon import;
- deduction of the input VAT and subsequent refund of the overpaid VAT;
- unusual increase in exports of an unknown or small trader or producer (possibility of fictitious exports) and
- lacking quantity of exported goods at the moment of physical exit.

¹¹⁰ Official Gazette of the RS, no. 43/07.

Based on the above reasons, inspectors select taxable persons and analyse the possibility of irregularities. In the case the possibility of irregularities is high or medium and weighs out the planned costs of control and inspection procedures, a post-clearance examination or inspection shall be carried out.

CARS does not keep the records in such a way as to enable the data on the VAT that was additionally accounted for exclusively within the framework of carried out inspections. It does not have the data about the share of post-clearance controls and inspections introduced and carried out in the field of VAT on the basis of indicators, random selection or subjective discretion of a customs officer.

Recommendation

For the biggest possible contribution of inspections to an efficient VAT collection (in the sense of the volume of the additionally charged VAT), we recommend CARS to use the analysis of strengths and benefits to assess whether it would be reasonable to plan separate inspections for the field of VAT. It shall examine which data could be useful for planning, how findings from individual procedures should be captured within the framework of existing records to enable the automated printout of required data (e.g. data on the additionally charged VAT during post-clearance examinations of customs declarations, during inspections and during inspections introduced and carried out on the basis of the request of the Department for Investigation). It shall also examine whether it would be reasonable and possible to capture data on the additionally charged VAT within the framework of individual control procedures, i.e. with regard to the size of a taxable person, kind and value of imported goods, point of departure of shipment, type of the cause for the occurrence of VAT losses, etc. Thus, it would be possible to identify risks within individual parameters and to more properly plan new inspections. We also recommend CARS to examine whether it would be reasonable to capture the additionally assessed VAT by types of inspections (partial, integrated and preliminary) or findings from inspections introduced on the basis of indicators, random selection or subjective discretion of a customs officer. Thus, assisted by results of current analyses, CARS would be able to continuously assess in which cases the planning and implementation of supervision were most effective. Besides, it would also be able to assess the appropriateness of existing indicators (estimate volume of the additionally assessed VAT on the basis of indicators compared to other possibilities of selecting taxable persons for supervision).

We recommend CARS to use the analysis of costs and benefits to examine the possibilities for educating customs officers particularly in the field of VAT and, within the field of VAT, for individual types of causes for the occurrence of VAT losses.

Measure by CARS

During the audit, in October 2007, CARS set up a new Inspection Department within the Division for Investigations that will be in charge of inspections and will tightly cooperate with the Department for Analysis.

4.2.4.c Customs investigation

Pursuant to the provisions of Article 21(č) of the ZCS-1, customs investigation means the implementation of all activities and measures by CARS if there are reasons for suspicion that an act has been committed by which customs, excise and other regulations were violated that fall within the competence of CARS. Actions and measures of a customs investigation are carried out to prevent, investigate and detect infringements of regulations. A customs investigation shall be introduced when an investigator has reasons for suspicion (received information – anonymous notification or notification from other organizational units within CARS or other bodies, own perception and an implemented data analysis) that regulations were violated.

If an incorrect implementation of procedures is detected by a competent investigator during the customs investigation that could result in a post-clearance collection of VAT, under point 10 of the Instructions for Customs Investigation¹¹¹ the Department for Control Issues or the Department for Excise Duties shall be notified that shall conduct an inspection or implement any other appropriate measure for a post-clearance collection of duties.

The Division for Investigations annually defines priority areas on the basis of collected information on unlawful behaviour, CARS directions and identified risks, however, one cannot speak of a planned or pre-set sample of taxable persons who will be subject to the investigation measure.

When carrying out customs investigations, the Division for Investigations cooperates with the Police and the Office of the State Prosecutor General of the Republic of Slovenia. CARS believes that state prosecutors are not specialized enough in tax and customs issues which is why they lack sufficient knowledge about the topic. CARS offered them to hold a lecture (that will take place in November 2008 at the meeting of public prosecutors) and to organize training on customs and excise duties legislation for state prosecutors who need this kind of know-how.

CARS is drafting a single register on customs investigations and controls that will enable data collection in an electronic form¹¹².

Statistical data on the activities of the investigation service is presented in Table 8.

Table 8: Statistical data on the activities of the investigation service

Customs investigations	2005	2006	Index
Number of customs investigations	62	86	139
Value of identified outstanding duties (in SIT)	891,180,634	3,646,782,614	409
Value of seized goods (in SIT)	6,000,000	27,030,752	451
Number of detected minor offences	47	64	136
Number of filed criminal complaints	10	16	160
Number of notifications of suspected criminal acts	24	36	150

Source: Annual Report of the Customs Administration of the Republic of Slovenia for 2006.

Conclusion

Although it was not possible to obtain the data from CARS on the number of investigations pertaining specifically to VAT, we assess on the basis of the results of collected information and the data from Table 8 that activities of the investigation service are satisfactory because their added value can be noticed in the increasing number of customs investigations as well as in the increasing value of additionally assessed duties in 2006 compared to 2005.

¹¹¹ Number 6/2005.

¹¹² Minutes from the college meeting as of 28 August 2007 no. 900-87/2007-2, Decision no. 32/2006.

Recommendation

We recommend CARS, when upgrading the records on customs investigations, to examine whether it would be reasonable and possible to structure data in such a way as to enable a respective insight into the additionally assessed VAT because of the activities of the Division for Investigations as well as whether it would be reasonable to capture data by causes for the introduction of a customs investigation (anonymous notifications, information from CARS and information from other bodies) and to structure it in the manner recommended for inspections (Chapter 4.2.4) as well as to take appropriate measures in accordance with findings.

4.2.4.d Recovery

If payments of duties are not secured, goods shall only be released into free circulation after all duties have been paid. If a taxable person secures the payment of duties, goods shall be released into free circulation and the payment security instrument (a guarantee) liquidated after the deadline when a taxable person was supposed to pay the duty. Under Articles 63 and 64 of the Act implementing the customs regulations of the European Community¹¹³ (hereinafter: the ZICPES) duties must be paid within ten days, however, on the basis of an approved tax deferral a customs debtor may extend the payment term to 30 days. If the debt is settled after the relevant payment deadline, default interests shall be charged from the first day following the day when the debt falls due. Under Article 47 of the Rules Implementing the Tax Procedure Act¹¹⁴, submitted security instruments intended to secure payments of import, export and other duties payable upon the import of goods also secure the payment of default interests and costs of proceedings incurred because of untimely payment.

In the Register of recoveries for statistical purposes CARS keeps separate records on the data on import and excise duties therefore the desired VAT-specific data can only be obtained "manually", i.e. by entering enquiries at individual customs directorates. Since CARS is competent to supervise charging and payment of VAT upon imports of goods (Article 138 of the ZDDV-1), in the instrument permitting the recovery, as a rule, besides VAT also customs and/or other duties paid upon import shall be simultaneously charged. Thus, for all these import duties a single recovery procedure is conducted and for this reason its efficiency is established in statistical terms only with regard to the total charged principal value of import duties.

Conclusion

We find the recovery system implemented by CARS satisfactory because the mandatory security for claims prevents from significant risks of non-payment of VAT, unless VAT-related claims are additionally detected during inspections and controls of customs declarations.

4.2.4.e Minor offence and criminal procedure

In 2006 CARS introduced 848 minor offence procedures, of which 837 were completed. The share of decisions related to VAT in the total number of all decisions in the period 2002–2006 ranged from 20–30 %. The most frequent minor offences also related to VAT collection were failure to present customs goods, declaration of a lower value of customs goods, entry of hidden customs goods, failure to declare customs

¹¹³ Official Gazette of the RS, nos. 25/04, 111/07.

¹¹⁴ Official Gazette of the RS, nos. 141/06, 46/07, 102/07.

goods and entry of customs goods outside border crossing points. CARS has found out that a majority of "customs offences" pertain to the field of VAT.

CARS monitors the progress of proceedings related to filed criminal complaints by using feedback information obtained from the State Prosecutor's Office based on the requests attached to filed criminal complaints to be informed about the progress of further proceedings.

Recommendation

We recommend TARS to examine whether it would be reasonable to, within the framework of existing records, also separately capture data on filed criminal complaints and pronounced judgements for minor offences and criminal acts in the field of VAT.

Conclusion

In its work, CARS detects irregularities that are simultaneously also criminal acts. Pursuant to the ZKP it has no competences in the pre-trial criminal procedure therefore in the case of a suspected criminal act it can only file a criminal complaint to the State Prosecutor's Office.

Measure by CARS

During the audit, CARS has several times, for the last time in October 2006¹¹⁵ and February 2007, submitted the initiative to the Ministry of Justice to extend the powers of the customs authorities to also include the implementation of provisions of the ZKP. The Ministry of Justice published a draft proposal of the ZKP-1¹¹⁶ which in its Articles 150 and 151 provides for relevant powers to be conferred to tax and customs authorities to ensure a more effective detection and investigation of commercial crime.

4.2.4.f Assistance to taxable persons

CARS has a well developed help desk offering assistance to taxable persons at the General Customs Directorate as well as at individual customs directorates. Advisers are available to provide general information about the work of the Customs Administration and its services to their customers during working hours of individual customs directorates (in person, by telephone or electronically). According to CARS, taxable persons most frequently ask questions about import duties, rates of customs duties, VAT refund, rate of customs duties when importing certain products, foodstuffs and plants, and similar. Such questions and answers are published on the CARS website in the catalogue of information of public character and in various other publications (Davčni bilten, GV, etc.). Approximately twice a year CARS also presents novelties to taxable persons in the form of a free seminar.

Upon request, taxable persons are offered assistance to ensure correct classification of goods into customs tariffs (also defining the rate of VAT charged on goods) in the form of binding and non-binding tariff information.

¹¹⁵ Initiative to expand powers of customs authorities to implement provisions of the ZKP, code 007-32/2006-1 as of 11 October 2006.

¹¹⁶ [URL: http://www.mp.gov.si/fileadmin/mp.gov.si/pageuploads/2005/PDF/zakonodaja/2007_12_17_osnutek_ZKP.pdf], May 2008.

Conclusion

Based on the data collection method and explanations provided by CARS we assess that with regard to providing information and individual services to taxable persons the operation of CARS is appropriate. By ensuring assistance to taxable persons liable to VAT, CARS reduces the possibility of errors and irregularities and, indirectly, the risk for the occurrence of VAT losses.

4.3 Are the MF measures to reduce VAT losses efficient

4.3.1 Definition of goals and measures to reduce VAT losses

In the period covered by the audit the MF failed to set objectives particularly pertaining to the field of VAT collection or objectives to reduce the volume of VAT losses.

4.3.2 Monitoring the situation in the field of VAT collection

The MF does not systematically receive the data on implemented activities from the bodies in charge of operational activities related to VAT. Neither does it analyse the data or examine the efficiency of operation of the legislative framework that regulates VAT collection nor verify or assess the efficiency of tax legislation from the aspect of preventing tax losses.

4.3.3 Measures and activities carried out by the MF to reduce VAT losses

The MF explained that it does not coordinate the TARS and CARS measures to reduce VAT losses.

Conclusion

As a line body, the MF is responsible for drafting tax and customs legislation, i.e. also for producing legal bases for VAT collection, therefore we believe that it is also responsible for a systematic monitoring, continuous examination and analysis of the system in this field as well as for taking appropriate measures.

Recommendation

The MF shall, in cooperation with TARS and CARS as well as on the basis of findings of the working group for VAT, consistently and continuously analyse the operation of the current legal framework regulating VAT collection as well as the financial impacts of proposed tax and customs regulations and regulations in other fields of work that influence the system of efficient VAT collection. Within the framework of its tasks it shall define *clear and measurable objectives with regard to efficient VAT collection or reduction of VAT losses*.

4.3.4 Statement of receivables from taxable persons

The books of the central government budget of the Republic of Slovenia as the recipient of revenues from the collected VAT include no statement of receivables from taxable persons originating from the assessed but not paid VAT as at 31 December for any of the years within the period covered by the audit. We asked the MF for explanation which is presented in the continuation.

Explanation by the MF

Under Article 5 of the ZDS-1, TARS is in charge of collecting taxes presenting revenues of the central government budget, i.e. also VAT. In accordance with the ZDS-1 and the TARS Rules, TARS keeps analytical records by using continuously upgraded software. On a monthly basis, it provides aggregate data on receivables and payables by types of taxes and recipients of funds, also supported by manual entries. Using the same legal bases as stated in Article 35 of the ZCS-1, CARS also keeps records on VAT charged on imported goods. TARS and CARS forward the aggregate data to the MF (Directorate for Public Accountancy) on a monthly basis.

They also both keep records of receivables from taxable persons, however, if CARS uses the double entry method, TARS does not fully consider the principles of this method because this is not enabled by the current software. Here it must be stressed that TARS does not use the double entry method considering the bookkeeping rules of entering assets and liabilities (because these are not assets of TARS), but keeps analytical records on taxes by taxable persons and aggregate records by types of taxes.

Since all revenues falling within the competence of CARS are predominantly revenues of the central government budget (only later a part of customs duties is transferred from the central government budget to the budget of the European Community), only the consolidated report received from CARS, without the one received from TARS, is considered as a bookkeeping document by the MF (Directorate for Public Accountancy). Namely, these revenues can be revenues of the central government budget (e.g. VAT), local communities (e.g. charge for the use of building land), the Pension and Disability Insurance Institute of the Republic of Slovenia, the Health Insurance Institute of the Republic of Slovenia, several joint recipients (e.g. gambling tax), etc.

One of the objectives of the reform of tax information system was also to establish a system of recording receivables from non-paid taxes and contributions as well as of other general government revenues by individual types of such revenues. Therefore it is necessary to strike an agreement with all public finance budgets about a system of exchanging data necessary to ensure the accounting principles of integrality, transparency and regularity.

Namely, it is not realistic to expect that the recipients of general government revenues would manually enter the forwarded consolidated reports into their books because there is a risk of failing to enter all reports or making mistakes during the entry. For the time being a cross-comparison with the payment transactions data is not yet entirely possible. According to the provisions of the ZR, from the aspect of keeping accounting books for the budget and budget spending units at the state and local levels, it would only be right to record the receivables from unpaid taxes and contributions in the books of recipients of such revenues. But first an agreement must be reached with the recipients not only about the system of exchanging data but also about the system allocating taxes when a tax revenue is allocated to several recipients.

Conclusion

Receivables from taxable persons pertaining to the assessed but not paid VAT are not declared in the books of the central government budget of the Republic of Slovenia. Receivables from taxable persons originating from VAT are also not stated in the balance sheet of TARS. TARS explained that as a supervisor of general government revenues it is not obligated to state the receivables from taxable persons originating from VAT because these receivables are not deemed to be assets of TARS and moreover because the payments flow to the subaccounts of TARS and from thereon directly to the central government budget of the Republic of Slovenia. For this reason TARS only submits the consolidated report on receivables from VAT on the "Review A1 – VAT"¹¹⁷ form to be recorded by the MF.

¹¹⁷ See also findings in the sub-chapter 4.1.4.h "Analytical records on VAT".

In spite of the fact that the MF (Directorate for Public Accountancy) received the data on the volume of receivables from taxable persons on the Review A1 – VAT form and from CARS on the "booking order" form, it does not enter this data in the books of the central government budget of the Republic of Slovenia. According to the MF¹¹⁸, the Review A1 – VAT form presented by TARS compared to the form presented by CARS does not have the status of a bookkeeping document because it does not only relate to central government budget revenues but also to the revenues of other recipients of funds (other public finance budgets). Until now the MF took no appropriate measures and failed to establish a system of properly posting and stating central government budget revenues originating from receivables of taxable persons liable to VAT.

Recommendation

We recommend the MF to precisely define the Review A1 – VAT form, i.e. its components, so that it would be able to consider it as an authentic bookkeeping document, and TARS shall produce the form in accordance with this provision for 2007 or upon the next finalization of books. In our opinion this will ensure the necessary technical conditions for stating receivables from taxable persons pertaining to VAT in the books of the central government budget of the Republic of Slovenia.

¹¹⁸ Explanations of the MF, TARS and CARS as of 3 October 2007.

5. POSSIBLE MEASURES AND ACTIVITIES TO IMPROVE THE VAT COLLECTION SYSTEM

In the field of VAT collection some countries use a series of possible measures to further improve the VAT collection system. The set of potential solutions is presented in the continuation, however, their impacts on the increased volume of collected VAT have not yet been analysed.

5.1 Reverse charge system

In the reverse charge system the tax burden is transferred from the supplier to the recipient of goods or services.

According to TARS, the experience in the field of fiscal control shows that the construction industry is a sector with a high volume of the unjustifiedly deducted input VAT where the reverse charge system shifting taxation burden to the recipient could effectively solve the problem of unlawful deduction of the input VAT. TARS also believes that the reverse charge system should be extended to all service industries because the practice proves that the highest number of false documents pertain to the services regarding (which is difficult to verify during the ex-post supervision) whether they were actually carried out or not (advisory and research services). According to TARS, taxation pursuant to the reverse charge system could effectively solve the problem of unlawful deductions from fictitious invoices issued by missing traders which render the recovery of the charged VAT declared on the issued invoices impossible.

In the procedure of adopting the ZDDV-1 in 2006, TARS tabled no official proposal to the MF to introduce the reverse charge system for the construction industry.

The MF is a member of the expert group on combating tax fraud within the framework of the European Commission. One of the measures that must be examined by the European Commission in accordance with the conclusions of the Economic and Financial Affairs Council (hereinafter: the ECOFIN Council) is also the introduction of the general reverse charge procedure as proposed by Germany and Austria. According to this procedure, the tax liability should be transferred from the supplier to the recipient of domestic transactions whose value exceeds certain threshold. The objective of these two countries is to introduce an option to the European legislation that would allow for such a system. The European Commission analysed the effects of the aforementioned option, regarding which most of the EU Member States expressed their reservations, and on 22 February 2008 submitted to the Council of the European Union the Communication from the Commission to the Council and the European Parliament on

measures for changing the VAT system to improve the fight against VAT fraud¹¹⁹ (hereinafter: the Communication). In the Communication the European Commission stated the strengths and weaknesses of the reverse charge system and envisaged the possibility of conducting a pilot project in the interested Member State (Austria). The proposed introduction of the reverse charge system and of the pilot project was discussed by financial ministers at the ECOFIN Councils in March and May but no conclusions were adopted.

Conclusion

The MF actively participates in the European Commission by presenting its opinions with regard to the positions of other EU Member States. The analysis that would show potential effects related to the introduction of the reverse charge system in the Republic of Slovenia has not yet been carried out. Measures taken by the MF will depend on the results of the analysis of the European Commission following a public discussion.

Recommendation

To help the MF justify drafting the amendments to the legislation pertaining to the introduction of the reverse charge system, we suggest TARS to substantiate and reinforce the envisaged measure with the results of concrete analyses. Therefore we recommend TARS to:

- start analysing financial impacts of the amended regulations due to the introduction of the aforementioned mechanism;
- examine for which service industries the aforementioned mechanism would be efficient and acceptable and
- examine strengths and weaknesses of or hindrances for the establishment of the aforementioned system.

We recommend the MF to decide about introducing (or not) the reverse charge system on the basis of concrete analyses carried out by TARS and of the recital 42 of the Council Directive 2006/112/EC¹²⁰ stating that Member States should be able, in specific cases, to designate the recipient of supplies of goods or services as the person liable for payment of VAT (this should assist Member States in simplifying the rules and combating tax evasion and avoidance in identified sectors and certain types of transactions).

Measure by TARS

TARS explained that it has already submitted to the MF the proposal for amending the ZDDV-1¹²¹ by introducing Article 76.a which designates individual cases in which the recipients of supplies of goods or services are persons liable to pay VAT.

5.2 Establishment of the joint and several liability system

In the case of a VAT evasion of the MTIC type the debt must be recovered from the remaining participants in the carousel fraud (considering the fact that it cannot be recovered from the missing trader where it was generated) who might be treated by the tax authority in the same way as the missing trader,

¹¹⁹ No. 6859/08 FISC 24 as of 22 February 2008.

¹²⁰ Official Journal of the European Community, no. L 347 as of 11 December 2006.

¹²¹ Proposed amendments to the ZDDV-1 with the wording of articles sent on 20 March 2008.

i.e. as tax evaders or debtors. This means that pursuant to the ZDavP-2 the tax authority is not bound by the formal legal relations between taxable persons if it can prove that these relations are fictitious. In such cases the tax authority shall impose taxes on transactions according to their economic contents.

Theoretically, countries predominantly use the following two options:

- a delivery of a taxable person supplying goods within the European Community (the missing trader) is not exempted and thus the supplier is charged the unpaid VAT and
- a supplier buying goods from a missing trader on the basis of received invoices that include the charged VAT is not recognised the right to VAT deduction.

According to TARS, the joint and several liability system of VAT payment between taxable persons participating or being a link in a tax evasion chain is an efficient model for VAT recovery. The proposal for introducing the joint and several liability system was submitted by TARS to the MF already in 2004 and 2005, however, TARS failed to do so in the procedure of adopting the ZDavP-2.

The issue of joint and several liabilities is one of the measures for fighting against tax fraud which is subject to discussions of the expert group on combating tax fraud within the framework of the European Commission. The legal basis for introducing the institute of joint and several liability is provided in Article 205 of the Council Directive 2006/112/EC as of 28 November 2006 on the common system of value added tax¹²² (hereinafter: the VAT Directive) according to which joint and several liability may also be introduced for domestic transactions as well as in the case of intra-Community acquisitions of goods. Despite the fact that the legal basis already exists, the institute of joint and several liability has so far been introduced into the legislations of the following EU Member States: Austria, Belgium, Bulgaria, Denmark, Germany, Great Britain, Italy, Netherlands, Portugal and the Slovak Republic. The EU Member States that have introduced the institute of joint and several liabilities emphasize that irrespective of the sufficient legal basis it is difficult to prove that a taxable person participating in a chain knew or should have known about the tax evasion and omission of VAT payment.

Conclusion

Legal transactions that are only fictitious and do not affect taxation (if a fictitious legal transaction conceals another legal transaction, the concealed legal transaction shall be used as a basis for taxation) are regulated by Article 74(3) of the ZDavP-2. We have found out that in the ZDavP-2 fictitious transactions are only regulated at the principle level and that the procedure and method of assessing the VAT liability in the case of a tax evasion of the MTIC type are not regulated at all.

TARS believes that the institute of joint and several liability is an efficient model for recovering VAT in the case of a tax evasion of the MTIC type where VAT is recovered from other participants in the chain that should have known about the tax evasion or have even participated in it. Notwithstanding the existence of the legal basis necessary to introduce the institute of joint and several liability and despite the fact that ten EU Member States have already introduced the aforementioned system, the MF explained that it would only take measures after solutions have been drafted by the European Commission within the framework of the Strategy for Combating Tax Fraud.

¹²² Official Journal of the European Union, no. L347/1 as of 11 December 2006.

Recommendation

We recommend TARS to start analysing financial impacts as well as strengths and weaknesses of introducing the joint and several liability systems; based on the results obtained from the conducted analyses it shall forward to the MF the proposals for amending the legislation, particularly the proposal for amending the ZDDV-1 that regulates the VAT collection system. The MF shall use the submitted justifications and analyses to draft proposed amendments to regulations.

Measure by TARS

During the audit, TARS submitted to the MF a proposal¹²³ to amend the ZDDV-1 by introducing Article 76.b stipulating that every taxable person identified for VAT purposes in the Republic of Slovenia that was delivered goods or provided services shall be jointly and severally liable to pay VAT if it is obvious from objective circumstances that this person knew or should have known that the respective purchase was a part of the scheme intended to evade VAT payment. Simultaneously, TARS also submitted a proposal to amend the Rules on VAT with an explanatory provision of Article 76.b of the ZDDV-1.

5.3 Security for identification number allocations

The institute of security when issuing the identification number for VAT purposes is intended for the cases when the allocation of a VAT identification number is requested by taxable persons who have already been involved in tax evasions or have already committed offences related to VAT as well as by persons who intend to carry out an activity involving risky goods or an activity considered risky in the sense of VAT evasions.

Recommendation

We recommend TARS and the MF to use the analysis of the envisaged output of the proposed measure to examine whether it is reasonable and possible to amend Article 111 of the ZDavP-2 which regulates the security for discharging and paying tax liabilities as well as whether it is reasonable and possible to amend the ZDDV-1.

Measure by TARS

On 20 March 2008 TARS forwarded to the MF a proposal for amending the ZDDV-1¹²⁴ by introducing Article 77.a which defines special cases when the instrument of security must be produced to secure the discharge of VAT liability before the VAT identification number is allocated and the consequences of a failure to produce the instrument of security.

5.4 Supervising VAT circumvention

TARS monitors possibilities and potential forms of VAT circumvention by providing tax advice as well as by publishing professional articles, publications and books of consulting firms explaining the VAT legislation. It also attends specific seminars organized by tax consulting companies. When solving the issues of taxable persons and their tax consultants, TARS also follows the trends related to outwitting taxation law. When tax consulting companies publish their opinions that contravene the positions of

¹²³ Letter by TARS no. 4230-115/2008-2 01032 01 as of 11 April 2008 (sent on 14 April 2008).

¹²⁴ Proposed amendments to the ZDDV-1 with the wording of articles, sent on 20 March 2008.

TARS, the latter notifies the general public or persons to whom such opinions were communicated about it. When proposing amendments to the legislation TARS particularly considers the findings obtained during TIs and controls.

Recommendation

We recommend TARS to, in cooperation with the MF, examine the possibility of introducing a system of mandatory reporting of lawful cases of VAT payment evasion or VAT circumvention schemes (hereinafter: the VAT schemes). It shall establish connections with tax authorities from other EU Member States that already have introduced such systems and use the findings to study advantages and disadvantages as well as outputs of the system of mandatory reporting of VAT schemes in the Republic of Slovenia. TARS shall use these findings when introducing activities on the basis of which the cases of lawful VAT circumvention would be defined and subsequently VAT schemes and taxable persons obligated to report in such schemes proposed.

5.5 Introduction of fiscal cash registers

In February 2007, the MF received from TARS the initiative to systemically regulate the supervision of VAT taxable persons that operate with cash. The MF forwarded this initiative for further examination to the Ministry of Public Administration which has not yet provided an answer to it and to the Ministry of the Economy (hereinafter: the ME) which supported the activities aimed at solving the problem of an efficient supervision of cash operations by adding a remark that taxable persons included in the system of fiscal cash registers must be precisely defined and the replacement of existing cash registers at traders evaluated. The initiative was also examined by the Directorate for Electronic Communications but it was not able to express its opinion because this does not fall within its competences.

On 14 September 2007 the MF received an answer from the Ministry of Higher Education, Science and Technology, i.e. the Metrology Institute of the Republic of Slovenia, in which the Ministry assessed that it has enough know-how and experience to verify software of fiscal cash registers but lacks human and financial resources necessary to ensure appropriate quality of expert work. The Metrology Institute of the Republic of Slovenia would need an appropriate laboratory for such verification. It would be necessary to establish a system of regular and extraordinary checks and verifications for the entire set of fiscal cash registers in the territory of the Republic of Slovenia. The Institute was willing to organize a meeting with TARS to discuss this topic.

On its premises, TARS held a presentation of the Italian and Serbian models of fiscal cash registers that was also attended by the representatives of the MF, i.e. the Department for Tax and Customs Policy and Legislation.

The decision on introducing fiscal cash registers is still pending (which is bound to increased costs and administrative burdens of taxable persons and tax authorities due to mandatory use of such registers), it has not yet been decided on the requirements with regard to software and hardware and the list of taxable persons who would mandatory have to use fiscal cash registers has not yet been composed – therefore the MF cannot fix the envisaged deadline for introducing fiscal cash registers. The MF emphasizes that the question must be examined or answered whether it is reasonable to introduce such registers also from the aspect of ensuring free competition with regard to their supply.

Recommendation

We recommend TARS to estimate, in cooperation with all competent bodies, the envisaged costs of the introduction of fiscal cash registers for the Republic of Slovenia and taxable persons as well as to compare it with the estimate of VAT losses at those taxable persons that would mandatorily have to introduce such fiscal cash registers. For such an analysis TARS shall use the existing databases to provide the data on the total sum of the assessed VAT as well as on the VAT additionally assessed during TIs carried out at taxable persons operating with cash, structured by types and sizes of taxable persons, types of activities and other indicators necessary to decide which taxable persons would have to mandatorily use fiscal cash registers.

On the basis of positive results of the TARS analysis regarding the introduction of fiscal cash registers, the MF shall coordinate all necessary activities with other line ministries (provision of human and financial resources as well as technical capacities necessary to verify software, fiscal cash registers, etc.). Before that it shall, in cooperation with other line ministries, examine and consider any possible limitations for the introduction of fiscal cash registers (the aspect of ensuring free competition and other aspects).

5.6 Detecting shadow economy

According to auditees, in the period covered by the audit there were no studies into the scope of shadow economy in the Republic of Slovenia.

We believe that it would be reasonable to assess the scope of VAT losses due to shadow economy or the scope of unlawful VAT avoidance and to detect the areas with the highest risk for the occurrence of shadow economy; the obtained results shall be used for designing activities to reduce the scope of shadow economy.

Recommendation

We recommend the MF, TARS, CARS and SORS to examine whether it would be reasonable to carry out a study into the scope of shadow economy in the Republic of Slovenia and, if it turns out that such a study is justified from the financial aspect and from the aspect of the envisaged output, we suggest them to, in cooperation with other line ministries, provide initiative to define holders of activities, activities, responsibilities and tasks of individual bodies during such a study.

5.7 Approach to drafting the Strategy for Combating Tax Fraud

Notwithstanding the conclusions of the ECOFIN Council from November 2006, the European Commission has not yet prepared the proposal for the Strategy for Combating Tax Fraud. Pursuant to the conclusions of the ECOFIN Council as of 5 June 2007¹²⁵ contained in the press release¹²⁶, the European Commission was supposed to draft a proposal for the Strategy and short-term (customary) measures pertaining to the Strategy by the end of 2007. The ECOFIN Council invited the European Commission to prepare all necessary legislative proposals no later than by the end of 2007 so that the Council would be

¹²⁵ Document no. 9803/07 as of 22 May 2007 FISC 81.

¹²⁶ [URL: http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/94513.pdf].

able to adopt them by the end of 2008. The Commission was also invited to immediately examine all measures for combating tax fraud that were proposed by Member States and to produce a report about them in the second half of 2007 so that the ECOFIN Council could decide about further activities until the end of 2007.

At the ECOFIN Council in June 2007 the ministers agreed that within the framework of the Strategy for Combating Tax Fraud the following customary measures must be given priority:

- to amend provisions with regard to reporting on the supplies of goods within the European Union to reduce time-frames;
- to ensure faster exchange of such information between tax authorities;
- to examine joint and several liability in the case the information on supplies within the European Union was not communicated or was not communicated correctly and in a sufficient scope to lead to VAT in the next phase and
- to upgrade the certification of notifications and information on companies identified for VAT purposes to companies taking active part in trading activities within the European Union without risk analyses used in the EU Member States.

The Republic of Slovenia supported the conclusions of the ECOFIN Council in June 2007. It particularly endeavours to introduce measures for efficiently combating tax fraud and to actively cooperate with the European Commission in preparing the Strategy for Combating Tax Fraud, particularly in the fields of a more efficient administrative cooperation as well as faster and more detailed exchange of information between the EU Member States.

Currently, the Council's working group on tax issues – indirect taxation (VAT) is not working on the strategy or measures for combating tax fraud because the European Commission has not yet submitted the proposal for the Strategy for Combating Tax Fraud.

Conclusion

We have found out that the Republic of Slovenia actively participates in producing the Strategy for Combating Tax Fraud that is being drafted by the European Commission, however, it has not yet introduced the activities necessary to draft and implement possible measures to reduce VAT losses within and beyond the borders of the Republic of Slovenia.

Recommendation

We recommend the MF to define and coordinate the activities of the working group for VAT so that it would start designing and continuously searching for and upgrading common solutions to reduce VAT losses due to tax evasions. The MF as a coordinator of the working group for VAT shall ensure a continuous and timely exchange of good quality opinions, initiatives and positions reinforced by analyses of current situation and the envisaged output in the field of reducing VAT losses.

6. OPINION

We have audited the collection of value added tax in the Republic of Slovenia. The audit was carried out to answer the question *whether VAT collection in the Republic of Slovenia is efficient or not*. To provide the opinion on the efficiency of VAT collection we have set ourselves two sub-objectives: to check whether the volume of VAT losses in the Republic of Slovenia is known at all and to assess the activities and measures carried out by TARS, CARS and the MF to reduce VAT losses.

The answer to the set question was sought at TARS and CARS that are responsible for assessing and collecting VAT, the MF that is competent for drafting tax and customs legislation and SORS that was in the period covered by the audit the only authority systematically engaged in estimating the scope of VAT evasions as a predominant share of the total VAT losses.

In 2006, in the Republic of Slovenia the assessed VAT amounted to 650,911 million SIT and the actually collected VAT to 650,858 million SIT (2,716 million EUR). Revenues from collected VAT represent a 36.7 % share in the total revenues of the central government budget of the Republic of Slovenia in 2006.

In the period covered by the audit, the competent authorities endeavoured to solve the problem of VAT losses and upgrade the system of VAT collection, however, we assess that the efficiency of VAT collection could be improved by introducing some further activities and particularly a better cooperation of auditees. Namely, we found out during the audit that the volume of VAT losses in the Republic of Slovenia is not known or has not been established and that the activities for their reduction were not appropriately planned, analysed and implemented. Hereinafter we present individual findings that were used as a basis for our assessments.

6.1 Estimating VAT losses

To be able to successfully set objectives and effectively plan the activities for reducing VAT losses, it is important to know the scope of the total VAT losses and the VAT losses within the framework of individual elements (activity, type of cause for the occurrence of VAT losses, type and size of taxable persons, type of goods, etc.).

In the Republic of Slovenia it was only SORS that regularly produced calculations of the theoretical VAT and the scope of VAT evasions – see point 3.5. During the audit CARS produced the first trial estimate for 2006 for the segment of VAT collection falling within its competence based on the extrapolation of results of controls within the framework of the bottom-up method – see point 3.3.

In the period covered by the audit, TARS and the MF *did not estimate* or participate in any way in estimating VAT losses in the Republic of Slovenia – see points 3.2 and 3.4.

Neither TARS nor CARS *carried out individual analyses or estimated the volume of VAT losses* within the framework of the bottom-up method for individual elements, therefore the main risks for the occurrence of VAT losses by causes, types of activities, size of taxable persons and types of imported goods were not established.

During the audit, based on the data about the results of inspections submitted by TARS, the Court of Audit produced an estimate of VAT losses in the segment covered by TARS by using the bottom-up method.

Considering both calculations of VAT losses, one carried out by CARS within the framework of the segment it covers and the other by the Court of Audit for the segment of VAT collection that falls within the competence of TARS, we estimate that VAT losses in 2006 amounted to 44,174 million SIT (184 million EUR) which is 6.4 % of the total VAT income in 2006, if the total income is also considered to include the estimated VAT losses – see points 3.2, 3.3 and 3.6.

6.2 Measures and activities to reduce VAT losses

The VAT collection system includes the MF, TARS and CARS.

The MF as a line authority in charge of drafting the legislation in the field of VAT collection is obligated to produce proposals for acts and implementing regulations. It is also responsible for monitoring the developments pertaining to VAT collection as well as for systematically examining and analysing the situation in this field. The key tasks of TARS and CARS with regard to VAT collection predominantly include VAT assessment, control and inspection of taxable persons, investigation activities, recovery of VAT, imposition of sanctions on taxable persons, education and information of tax and customs officers as well as international cooperation.

It was not possible to assess the performance of the MF operation – whether it reached the set objectives or not – because the MF failed to set objectives in the field of VAT collection or reduction of VAT losses in the period covered by the audit. Within the framework of the European Commission, the MF participates in the expert group on combating tax fraud but it has not yet addressed the coordination of competent bodies for regular and continuous analyses of the outputs of the implementation of possible measures that are already being implemented in some Member States of the European Union (reverse charge system for some activities, joint and several liability system, security for identification number allocations, system of mandatory reporting of lawful VAT circumvention schemes, introduction of fiscal cash registers and studies into the scope of shadow economy) – see point 4.3.

TARS and CARS stimulate voluntary VAT payment by different preventive and curative approaches, the most important among them being information and education of taxable persons, implementation of inspections as well as sanctioning taxable persons for committed minor offences and filing criminal complaints in the case of a suspected criminal act. We have found out that sufficient information, education and advice are available to taxable persons as well as employees in tax and customs administrations which can be deemed an *effective* measure ensuring a timely assessment and payment of the correct VAT amount by taxable persons.

The main weaknesses detected in the VAT collection system at TARS as well as CARS predominantly relate to the system of planning individual activities and *deficient VAT records*¹²⁷ – see points 4.1.4 and 4.2.4.

The goals set by TARS and CARS are not related to individual types of taxes or duties. We believe that VAT is such an important source for covering budget expenditure that when planning individual measures and activities it would be reasonable to set objectives that are exclusively focused on the field of VAT collection. Besides, we have found out that TARS failed to achieve two goals that are also directly related to VAT collection, i.e. to reach the planned scope of applied software solutions helping inspectors to detect tax evasions and the planned amount of resources earmarked for training and education of employees. At TARS we also detected significant deviations of the realised number of TIs from the planned ones – see points 4.1 and 4.2.

Monitoring the situation of the assessed and actually collected VAT pursuant to various criteria is *not yet satisfactory*. The TARS and CARS records provide individual information on the additionally assessed VAT in controls and inspections but fail to ensure accurate and complete data by individual elements of the VAT assessment (e.g. the additionally identified VAT liabilities by types of activities and by causes for VAT losses within the framework of individual activities), therefore the risk exists that the data available cannot be used to the most efficient extent possible for the analyses on the basis of which individual risks could be defined and more precisely focused activities reducing VAT losses carried out – see points 4.1.4 and 4.2.4.

Regarding TARS and CARS we have found out that *investigation activities are efficient* which is reflected in the volume of the additionally assessed VAT on the request of investigation departments – see points 4.1.4.d and 4.2.4.c.

At TARS and CARS inspections are carried out by inspectors who cover all kinds of duties and are not particularly specialised in VAT. We believe that it would be possible to achieve *better efficiency* in detecting irregularities and reducing VAT losses by specializing a certain number of inspectors only in the field of VAT and within it in particular causes for the occurrence of VAT losses – see point 4.1.2.

In general, the system of VAT collection in the Republic of Slovenia is satisfactory, however, we believe that the possibilities for different kinds of avoidance and non-payment of tax liabilities could be further limited by eliminating the weaknesses and deficiencies stated in the audit report.

¹²⁷ Regarding CARS, particularly from the aspect of assessing VAT losses.

7. RECOMMENDATIONS

Based on the obtained findings about the VAT collection system in the Republic of Slovenia we assess that it would be possible to even further improve the VAT collection system by:

- determining clear and measurable objectives in the field of VAT collection;
- continuously estimating the total VAT gap;
- estimating VAT losses and carrying out analyses by typical individual causes for their occurrence which shall be used as a starting point for detecting concrete risks and taking adequate action;
- continuously analysing the envisaged output of potential measures to increase the efficiency of VAT collection or limit the possibilities for VAT evasion;
- more adequately planning and implementing individual measures and activities;
- improving VAT records used as a basis for planning, analysing and implementing individual measures;
- coordinating all necessary activities of TARS, CARS and the MF as well as
- promptly and continuously exchanging information, data, views and know-how between TARS, CARS, the MF and SORS.

Already during the audit, desiring to make the estimation of VAT losses a standard procedure and to highlight the necessity of designing common solutions for reducing VAT losses, the Court of Audit organized a joint meeting and encouraged TARS, CARS, the MF and SORS to cooperate. In accordance with the agreement reached at the meeting, the working group for VAT was established composed of the representatives from the MF, TARS, CARS and SORS. The working group for VAT is expected to implement concrete tasks in accordance with the time schedule. We recommend the MF, as a coordinator of the working group for VAT, to consistently and continuously coordinate the cooperation of representatives of the MF, TARS, CARS and SORS in the field of regular and upgraded estimation of VAT losses, particularly regarding the implementation of activities that are necessary for their reduction.

Hereinafter we present recommendations to individual auditees for eliminating some weaknesses and deficiencies detected during the audit procedure to be able to improve the efficiency and effectiveness of the system used to estimate VAT losses and of the entire VAT collection system.

7.1 Estimating VAT losses

We recommend TARS to:

- precisely define tasks related to estimating VAT losses and persons responsible for this exercise;
- also examine, beside the presented method of the extrapolation of results of TIs, other bottom-up methods used in practice by the EU Member States, select the most appropriate one and start estimating VAT losses as soon as possible (here it shall establish connections with tax administrations of other EU Member States that already use this or any other method for estimating VAT losses);
- continuously analyse and upgrade the adopted method for estimating VAT losses and document its results;
- start estimating VAT losses by individual characteristics of causes for the occurrence of VAT losses and particularly to detect risks related to tax evasions of the MTIC type;
- examine which data would be needed to analyse VAT losses by individual characteristics of causes for their occurrence; by doing so, it shall upgrade the existing records in such a way as to enable an automated access to important useful data (the additionally assessed and actually paid VAT by types of activities, causes for the occurrence of VAT losses, types and sizes of taxable persons, etc.);
- examine how to set up a system of capturing data about the assessed VAT within the framework of the activity actually pursued by a taxable person and not only within the activity that was registered as the main activity of a taxable person and
- consider the needs of SORS when reforming the information system and establish a system that will enable the form and contents of extracted data useful to SORS when estimating VAT losses by using the top-down method.

We recommend CARS to:

- continue upgrading and improving the existing method of estimating VAT losses and document the results or also examine other bottom-up methods used in practice by other EU Member States, and decide on the most appropriate one;
- start estimating VAT losses by individual characteristics of causes for the occurrence of VAT losses, particularly to detect risks related to tax evasions of the MTIC type, and
- examine which data would be needed to estimate VAT losses by individual characteristics of causes for their occurrence; by doing so, it shall upgrade the existing records in such a way as to enable an automated access to important useful data (the additionally assessed and actually paid VAT by types and sizes of taxable persons, types of causes for the occurrence of VAT losses, types of goods or departure points of shipments and types of supervision).

We recommend the MF to actively cooperate with TARS and CARS when examining different approaches and defining the most appropriate method or a combination of methods for estimating VAT losses and individual analyses of VAT losses within the bottom-up method as well as when producing regular estimates of VAT losses.

7.2 Measures and activities to reduce VAT losses

We recommend TARS and CARS to:

- examine whether it would be reasonable to define more concrete objectives pertaining only to VAT collection and, if yes, which;
- set objectives that would be based on the analyses of the current situation and envisaged effects of planned activities;
- examine whether it would be reasonable to plan separate inspections for VAT;
- consider whether it would be appropriate to specialize individual inspectors exclusively in VAT or in individual types or causes for the occurrence of VAT losses and in the implementation of international inspections in the field of VAT and
- introduce relevant planning of inspections by taking into account the detected risks or data about already carried out inspections by individual indicators (volume of the additionally assessed VAT by types of inspection, by types of activities or goods and within it by types of causes for the occurrence of VAT losses, by types and sizes of taxable persons, etc.).

We also recommend TARS to:

- establish a system ensuring that the data is only entered into the analytical records on VAT by persons who are appointed users of the application for keeping records on VAT in accordance with the job classification;
- examine the causes for the occurrence of the high number of errors when entering transactions into the records on VAT and the possibilities for preventing from such errors;
- define the objective of data collection and draft instructions for users accessing the data repository;
- continue encouraging inspectors to consistently enter the TI findings into the Profil DZ application;
- ensure better direct support of the IT Department necessary to estimate VAT losses as well as to analyse the effects of envisaged measures for the reduction of such losses until the reform of information systems is carried out;
- precisely define during the reform of information systems which data is needed for the procedures of analysing the measures that are already underway and the envisaged measures as well as for the relevant planning of TIs; such data shall be automatically provided by individual applications;
- carry out an analysis of estimated costs necessary to ensure access to all data bases and the intranet to all inspectors when working in the field as well as an analysis of envisaged effects of the respective measure; appropriate measures shall be taken on the basis of the results of such analyses;
- produce a time schedule of activities necessary to establish and operate the CAT application while considering the user requirements of inspectors, controllers and the IT Service;
- start analysing the downward trend of the volume of the VAT additionally assessed during control and TI procedures as well as take appropriate measures on the basis of the results of such an analysis;
- clearly define the tasks of controllers that will have to be carried out by them because of the introduced scanning of VAT returns that shall replace the manual entry of VAT returns;
- also raise the awareness of taxable persons within the framework of the first TIs about the positive effects of collecting VAT for the Republic of Slovenia and its citizens as well as about the forms and means of access to assistance when discharging tax liabilities;
- introduce activities that will provide conditions necessary for a regular implementation of simultaneous international TIs;

- examine whether it would be reasonable and possible to extend the powers of the tax service to be more effective in detecting and investigating tax evasions;
- substantiate and reinforce the idea of introducing the reverse charge system with the results of concrete analyses of financial impacts of envisaged changes of regulations due to the introduction of such a system; examine for which service industries this system would be efficient and acceptable as well as define advantages and disadvantages or obstacles for the establishment of this system;
- start analysing financial effects as well as advantages and disadvantages of introducing the joint and several liability system and forward concrete proposals to the MF for amending the legislation;
- examine together with the MF the adequacy of establishing a system of mandatory reporting of lawful VAT circumvention schemes and
- carry out, together with competent bodies, the analysis of envisaged costs of the introduction of fiscal cash registers for the Republic of Slovenia and taxable persons as well as compare it with the estimate of VAT losses at those taxable persons that would mandatory have to introduce such fiscal cash registers.

We recommend the MF to:

- set measurable and scheduled objectives to improve the VAT collection system as soon as possible;
- examine, together with TARS, the possibilities for the soonest possible provision of a legal basis that would regulate the procedure of refusing the allocation of a VAT identification number;
- produce, together with TARS, a legal basis for shortening the procedure for terminating a VAT identification number to those taxable persons regarding which it was established that they took part in tax evasions, particularly in MTIC;
- examine, together with TARS, whether it would be reasonable and possible to amend Article 111 of the ZDavP-2, which currently regulates the security for discharging and paying tax liabilities, by introducing a provision on securing the allocation of a VAT identification number as well as whether it would be reasonable and possible to amend the ZDDV-1;
- as soon as possible successfully finalize the activities intended to ensure stating of receivables from taxable persons originating from VAT in the books of the central government budget of the Republic of Slovenia and
- coordinate, on the basis of positive results of TARS regarding the introduction of fiscal cash registers, all necessary activities with other line ministries (provision of human and financial resources as well as technical capacities necessary to verify software, fiscal cash registers, etc.).

We recommend the MF, TARS, CARS and SORS to examine whether it would be reasonable to carry out a study into the scope of shadow economy in the Republic of Slovenia and, if it turns out that such a study is justified from the financial aspect and from the aspect of envisaged effects, we suggest them to, in cooperation with other line ministries, start proceedings to define holders of activities, activities, responsibilities and tasks of individual bodies during such a study.

We particularly recommend the representatives who are appointed members of the working group for VAT to examine all aforementioned recommendations and to start implementing the activities within the framework of this working group on the basis of which these recommendations will be realized. We particularly stress the importance of a regular exchange of all data, information and know-how that members of the working group for VAT and individual bodies might find useful for analysing risks and that might contribute to a more efficient prevention of VAT losses.

Legal caution

Based on Article 1(3) of the ZRacS-1, this report cannot be challenged in courts or any other state bodies.

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Ljubljana, 15 July 2008

Dr Igor Šoltes
State Auditor General

Sent to:

1. Ministry of Finance, by registered letter;
2. Tax Administration of the Republic of Slovenia, by registered letter;
3. Customs Administration of the Republic of Slovenia, by registered letter;
4. Statistical Office of the Republic of Slovenia, by registered letter;
5. Dr Dušan Mramor, by registered letter;
6. Stojan Grilj, by registered letter;
7. Zvezdana Gržina, by registered letter;
8. Franc Košir, by registered letter;
9. MSc Stanislav Mikuž, by registered letter;
10. Tomaž Banovec, by registered letter;
11. National Assembly of the Republic of Slovenia, by registered letter;
12. archives, here.

Bedimo nad potmi javnega denarja

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