

Fiscal Cyber-tools in the Fight against Tax Evasion on the Example of the VAT Tax Gap

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Abstract: The following article deals with an important issue of the fight against the VAT gap resulting from criminal activity. There are no laws against tax optimization as defined in the present text. In addition, the differences between tax optimization and tax evasion have been outlined. The term of 'VAT gap' has been defined and its extent presented. Moreover, the application of the Laffer Curve theory in increasing the VAT has been referred to. Chapter Three characterizes selected techniques and methods of limiting the VAT gap, e.g. reverse charge, split payment, increased penalties, joint responsibility for tax arrears, the electronic mechanism of Standard Audit File for Tax, the creation of National Revenue Administration, the IT System of the Clearing House. This article aims to demonstrate that the actions taken with the view to limit the VAT gap have had tangible effect. While the budget revenue on VAT and taxes in general has been increasing, it is difficult to point out a single most efficient tool, as a number of various actions have been introduced simultaneously.

Keywords: grey economy, tax gap, tax crime, VAT

Introduction

Tax revenues constitute a great majority of the state budget, and the VAT tax is a crucial element of the revenues. Indirect taxes amount to 72% of state revenues, 47% of which is VAT tax (Strecula, 2018, p. 581). Tax payers often resort to a variety of actions, at times bordering on illegal, in order to reduce their tax obligations. Some of these actions are often defined as tax optimization. Any tax optimizing activity must be within the limits of the

functioning tax law. Crossing those limits is characterized as criminal activity. Tax optimizing activities are essentially only permissible as far as income and wealth taxes are applicable. Due to its legal arrangement, the VAT tax and the compensation scheme for input VAT have created scope for abuse of the system instead of legal tax optimization. At the early stages, these tax liability reduction activities usually amounted to withholding the tax base, by undeclared sales or conducting taxable activities without registering as a taxpayer. Thus, they did not result in tax liabilities.

One of the conditions for Polish access to the European Union was harmonisation – adjusting Polish regulations on certain taxes to EU requirements. One of the EU founding assumptions is the free movement of goods and services. Customs frontiers and control made selling goods to foreign parties particularly difficult and a number of procedural requirements were to be met. This often led to customs seizing goods at the border. Indeed, opening the borders and the lack of formalities have brought about much greater trading opportunities. However, the lack of tax and customs control as well as a 0% VAT tax rate on exported goods with the possibility of compensation for input VAT have enabled tax criminal activities. Not only do these activities lead to taxes not being paid, but also, through fake transactions allowing for VAT compensation and reimbursement, they create room for tax evasion amounting to billions of Polish zloty.

Tax optimization and tax fraud

The notion of tax optimization is not derived from any legal norms. It is used to define a way of tax planning which is essentially based on minimizing the amount of tax paid, as opposed to calculating a tax liability whose height would be optimal for both the taxpayer and the tax authorities (Sokółek, 2015, pp. 183–184). Tax optimization includes searching for and identifying the legal instruments and organisational frameworks that provide the lowest possible level of taxation for a company, consequently maximizing a company's net profit. In result, tax savings are created. Such activities are in line with the functioning legal regulations and should not be used to bypass tax laws (Werner, 2013, pp. 58–59). In other words, using 'legal ways to modify and lower the amount of tax owed [tax avoidance], as opposed to tax fraud and tax evasion. Thus, any entity, regardless of its size, will take a set of actions leading to tax optimization, which in its essence is minimizing the amount of tax to be

paid. These actions are normally associated with business planning and usually involve tax advisors' (Stolarski, 2016, pp. 151-159).

Planning to make use of the available tax allowances and deductions on income tax requires one to become familiar with the rules of taxation throughout the fiscal year. In Poland it is tax advisors, a highly specialized group of professionals, who normally deal with tax optimization. Tax planning as well as tax optimization in small companies typically take place at the outset of their economic activity. What follows is strictly the implementation of the plan. Large enterprises update, correct and adjust their activities to new techniques and changes in the general court rulings on and administrative interpretations of tax regulations. New fiscal schemes are also introduced, allowing for the lowering the company's tax obligations in a legal way. The body of professional literature on the issue also defines tax-related savings as 'activities leading to lowering one's fiscal obligations, neutral to the tax law, in principle consisting in refrainment from certain activities that could lead to tax obligations' (Gaudemet, Molinier, 2010, p. 585). In this way, the taxpayer makes conscious decisions to take specific actions, potentially imposing a fiscal obligation on them. For example, buying an imported car results in excise duty to be paid. The amount is based on engine capacity (Żabska, 2013, p. 262). Buying a car with a lower engine capacity does not entail a higher tax amount. Choosing a quarterly tax statement does not impose the duty to make tax payments on a monthly basis, the tax is paid quarterly. Later, VAT cash statements transfer the tax obligation to the period when the payment by the counterparty has been made. The essential prerequisite of economic activity is profit maximization, not tax liability maximization. There are no grounds to impose the requirements of decreasing their profits on companies, be it private or corporate, so that the state tax revenues increase (Radzikowski, 2010, p. 10).

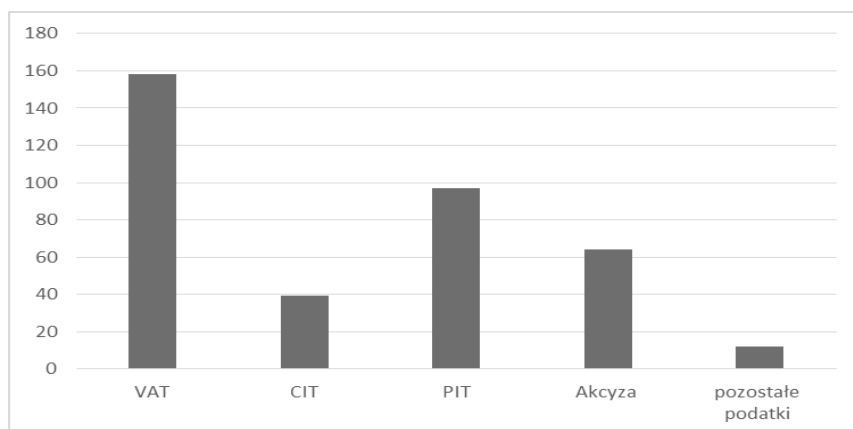
Nonetheless, it is worth bearing in mind that 'it is against the law to act contrary to the statute, and it is fraudulent to act within the statute to bypass its intended purpose' (Stanik, 2008, p. 50). In consequence, the difference between tax optimization and tax fraud is drawn by a thin line. The concept and scope of tax fraud as a crime or a fiscal offence has been defined in penal fiscal code. As a rule, it is a criminal offence. According to this legal standard, a taxpayer who either refrains from reporting the subject of taxation or the tax base or does not submit their tax statement to a competent tax authority causes tax depletion (art. 54 of Penal Fiscal Code). What is more, a taxpayer who uses another person's name, another company's name or trademark to

conceal their own economic activity, or the size of it, thus causing tax depletion (art. 55 of Penal Fiscal Code), subsequently making false claims or withholding the truth; or does not fulfil the obligation to report relevant changes to the authorities, thus causing tax depletion (art. 56 of Penal Fiscal Code), is punishable by a fine, or imprisonment or both. Financial penalties are mainly applied with reference to tax crimes and tax offences in line with Penal Fiscal Code. Fines and tickets have proven to be an exceptionally useful instrument of fiscal criminal policy (Melezini, ed., 2010, pp. 275–276), an adequate reaction to the violation of tax regulations, as the offender is punished by a fine of the same nature as the actual depletion or its likelihood they have caused. In addition to that, a fine fits well into the fiscal character of the Penal Fiscal Code, as it provides an additional source of state revenue and is relatively low-cost in execution in comparison to imprisonment, not generating extra costs for the state (Nalikowski, 2016, p. 217).

The VAT gap

Based on the analysis of budget revenue it is safe to say that the VAT tax is the most important source of income for the state. Consequently, the volume and the stability of the proceeds are extremely significant. The structure of budget revenue from taxation is presented in Fig. 1 below.

Fig. 1. Budget revenue from taxation in 2017 r. (in billion PLN)

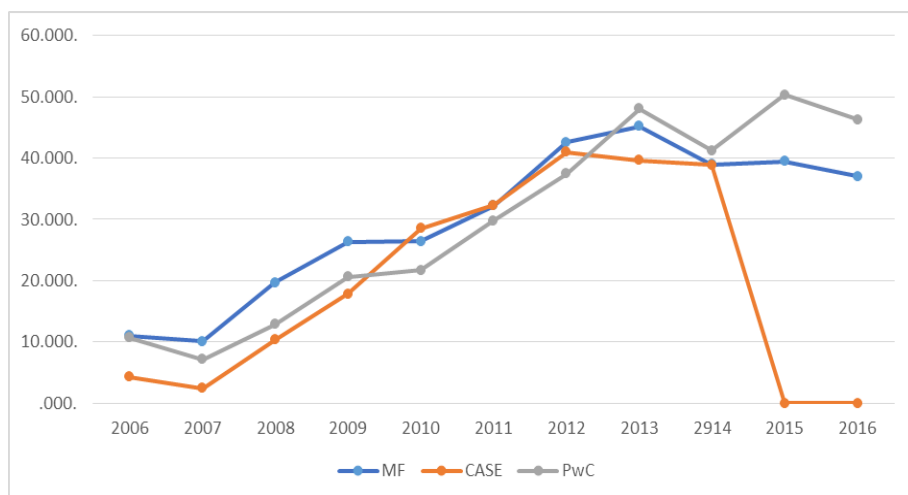


Source: Author's own elaboration on Ministry of Finance data.

As presented above, the VAT tax is the most important source of budget tax revenues and as such has become the most popular area for tax criminal activity.

The concept of the VAT gap has not been regulated in the Polish legal system. The term has appeared in response to the phenomenon of tax depletion, and subsequently the need to keep a record of the VAT tax paid. It is defined as the difference between the amount of tax owed and the amount of tax actually paid to the state budget (Małecka-Ziębińska, 2017, p. 46). Since 2008 a dramatic rise in the VAT gap has been recorded. Hence, the budget revenues from the VAT tax up to 2012 showed a steady decline. Estimated value of the VAT gap is regularly analysed and researched by the Ministry of Finance, CASE and PwC.

Fig. 2. Estimated value of the VAT gap for 2006–2016 (in million PLN) according to Ministry of Finance, CASE and PwC data



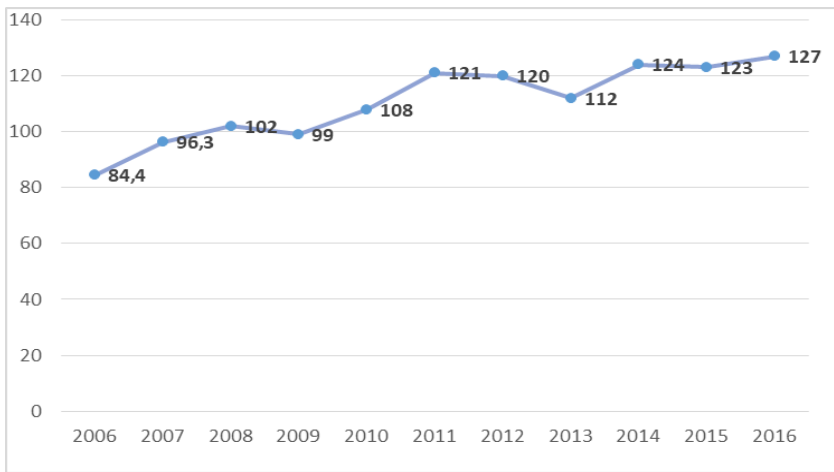
Source: Strąk, T. Analiza i ocena skuteczności realizacji dochodów podatkowych z VAT w Polsce w okresie od stycznia 2005 r. do kwietnia 2017 r., *Problemy Zarządzania* No 15/2 (1)2018, p. 111

The budget revenues in 2011 started to decline, following a dramatic rise in the VAT gap.

It is also worth noting that in 2011 in Poland the VAT tax rate was raised. As the graph presents, the introduction of a higher tax rate did not result in an increase in the budget revenues. Since 2011 initially the revenues continued to decrease. It was not until 2014 that the proceeds from the VAT tax began to rise. It was observed at the time that the VAT gap has a significant

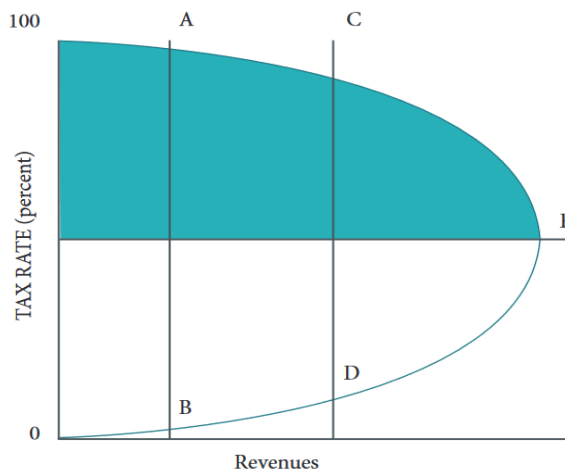
influence on the country's economy, making it both a social and a political issue. A development of a variety of tools began to reduce tax evasion and tax criminal activity in this respect. Drawing from Fig. 1 and 2, raising the tax rate does not necessarily result in a higher budget revenue volume. The opposite was recorded. The Laffer Curve Theory became applicable.

Fig. 3. VAT budget revenues for 2006–2016 (in billion PLN)



Source: Author's own elaboration on Ministry of Finance data

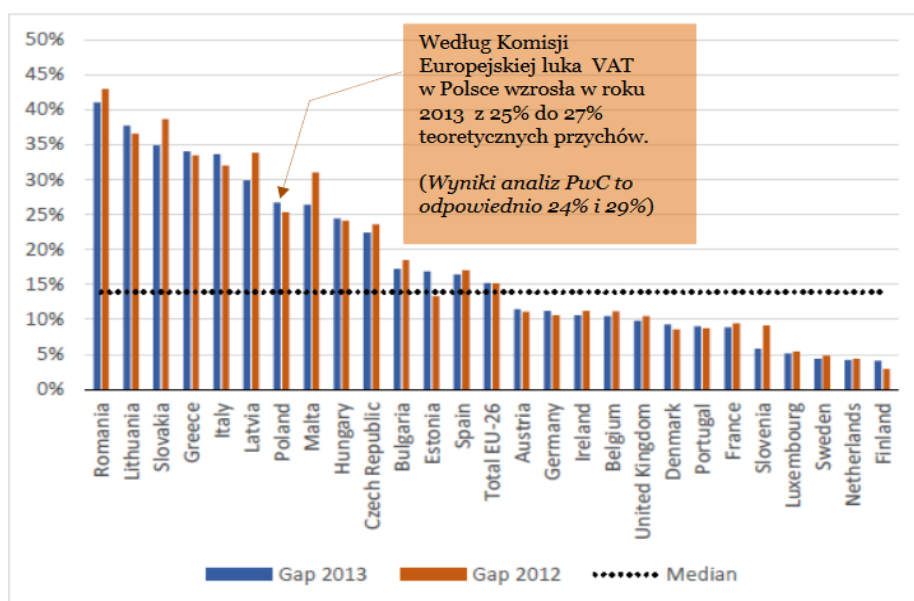
Fig. 4. The Laffer Curve



Source: Gwiazdowski, R. Krzywa Laffera. Rzecz o tym, jak obniżki stawek podatkowych mogą skutkować zwiększeniem wpływów podatkowych i vice versa. Downloaded from: https://zpp.net.pl/wp-content/uploads/2017/11/omt8r4_02.04.2014BroszuraKrzywaLaffera....pdf (access date: 7.06.2019)

Budget revenues will rise as the tax rates rise, but up to a certain point only. At the turning point, however, raising tax rates will eventually result in a drop in revenues. This may be the consequence of an excessive fiscal approach and a reluctance on the part of some to pay taxes, or even the illegal act of tax evasion. Roman Rybarski claims that ‘the source of social fiscal potential lies in a society’s wealth, its production [...], a screw cannot be turned endlessly or else it will break’ (Rybarski, 1938, p. 10). In relation to the VAT gap, it seems probable that the higher VAT tax rate might have encouraged tax frauds from other EU states in their criminal practices. It should be stressed that the VAT gap and VAT tax evasion are both issues present in all EU states, including Poland.

Fig. 5. The VAT gap in EU states in 2012 r.



Source: PwC (2015). Wyludzenia VAT – luka podatkowa w 2014 roku i prognoza na 2015.
Pobrano z: <https://www.pwc.pl/pl/pdf/luka-vat-pwc-wrzesien-2015.pdf> (published: 25.09.2015, access date: 7.06.2019)

According to the European Commission, the VAT gap in Poland in 2013 increased from 25% to 27% of theoretical revenue (PwC results quote 24% and 29% respectively). The numbers for the VAT gap in Poland are well above the EU median, but they are considerably higher for Romania, Lithuania, Slovenia, Greece or Italy. The high volume of the decrease in the VAT proceeds led to a number of actions aimed at limiting the size of the gap.

Selected Ministry of Finance tools for limiting VAT tax criminal activity

Originally, the Ministry of Finance focused its activity on reducing the tax gap to strictly legislative measures. As one of the first tools, reverse charge was introduced in 2011, by which economic entities only deal in net amounts, transferring any tax-related operations to the tax authorities. Selected groups of goods, most commonly the source of tax evasion (steel trade, and later electronics, construction material, construction services), were included in the reverse VAT charge mechanism. A buyer of goods within those categories cannot file for a VAT tax deduction. In an interview dated to March 19, 2018, Wojciech Śliż, the Director at the Ministry of Finance, claims that reverse charge fulfils its role, but is not without its shortfalls. First of all, as Śliż points out, ‘tax criminal activity is highly migrant by nature, whereas the legislative process is time-consuming. Before more areas of economic activity are included in the reverse charge mechanism, criminals manage to transfer their activity to various other ones. Secondly, reverse charge in domestic trade is a breach in the construction of the VAT tax legislation. It was introduced for the want of a better, more effective measure. Currently, there are better ideas at hand. Compulsory split payment in business areas currently under reverse charge obligation together with a voluntary split payment in other areas will leave potential VAT tax offender uncertain whether their criminal plan to extort VAT will prove successful. With other instruments already functioning, such as the Standard Audit File for Tax (SAF-T), the IT System of the Clearing House (ITSCH) and penal regulations, they should be an effective enough deterrent for those planning to commit these types of crimes’ (Śliż, 2018).

Higher penalties, fines and tickets resulting from Penal Fiscal Code regulations (prison sentence for a period of 25 years or a fine of up to PLN 6 million for the most serious tax offenders) have created an opportunity for more efficient preventive actions. On the legislative level, joint and several responsibility has been introduced, according to which a VAT-registered buyer is jointly responsible with the supplier of goods for their tax liabilities up to the value of the tax proportionate to the value of goods delivered to them. On the other hand, Witold Modzelewski claims that the time period for the introduction of legislative measures to curb the VAT gap ‘was no better than any other time, so, frankly speaking, either nothing has actually been done to make reparations or the steps taken have been ineffective or seemingly superficial’ (Modzelewski, 2017).

Nonetheless, the data for budget revenues since 2012 has shown a slight increase in the tax take. It is, of course, understandable that tax extortion should not take place as a rule, but eliminating the phenomenon completely does not seem practicable either. However unsatisfactory the final effect might seem, certain steps have been taken. Their outcome, though, was deterrence only. In result, recent years have seen a shift in the approach to one that is more determined to reduce the VAT tax gap by a significant degree.

The creation of a National Revenue Administration (NRA) seems to be yet another reasonable step towards limiting the scope of VAT criminal activities. On March 1, 2018 revenue and customs offices were merged. The underlying premise behind the decision to consolidate tax and customs authorities was acceleration of the exchange of information through a unified IT system. Since then, a joint analysis of tax and customs data has been possible owing to the fast flow of information. Thanks to the NRA among other administrative bodies, a number of ‘carousel’ fraud have been exposed, in which over 170 polish and 55 foreign companies have been involved, 13 members of an organized crime group have been detained, after extorting PLN 124 million on Vat and PLN 160 million of an unfounded VAT refund has been prevented.

One of the key IT solutions introduced has been the obligation to submit a Standard Audit File for Tax (SAF-T). Since January 1 2018 every VAT-registered taxpayer is obliged to submit a monthly report on VAT sales and purchases in a specified format. SAF-T reports enable various analytical methods, SAF-T_Analyzer and SAF-T_Scope included. The main assumptions behind SAF-T were quick verification and identification of the so called dummy invoices, issued by non-existent taxpayers or not included in statements. Thanks to SAF-T tax offices are able to conduct up-to-date cross-checks. Before that, these procedures followed on from a formal tax inspection or verification activities. The inspection aimed to establish whether VAT deductions were correctly done and reported between the parties involved. At present, such checks are done *ex officio* and in real time, with irregularities being detected and examined through verification activities. Nevertheless, it is worth bearing in mind that submitting a standard file in a pre-set format aims to reduce the tax gap, i.e. tax evasion, VAT tax evasion and ‘carousel’ fraud (Fijałkowska, 2017, pp. 24-25). Thus, ‘in order to seal the Polish tax system, the Ministry of Finance is transferring tax settlements into the virtual dominion. Gradually, it is imposing obligations to record VAT reports ‘in the cloud’ on new

groups of taxpayers in order to be able to perform mathematical data processing and identify irregularities' (Fijałkowska, 2017, p. 17).

Another IT tool implemented is the IT system of the Clearing House (ITSCH). Designed by civil servants and IT professionals together with the banking system, it is an electronic mechanism of network reporting. A series of algorithms for the analysis of banking data on economic entities, this new reporting and analysis tool is designed for a more efficient fight against tax crime through its counteracting the use of the financial sector for tax fraud. It imposes new duties on financial institutions, requiring them to regularly send reports on companies with the aim of detecting any activity potentially resulting in VAT evasion, dummy invoices, 'carousel' fraud and many others. 'The Head of the NRA will receive data on accounts classified under the ITSCH statute (excluding private ones, used for personal purposes), as well as any transactions by these entities through banking accounts listed in the system or savings-and-loan banking services (SKOK). Based on the data thus acquired, the Head of the NRA will assess the risk of tax evasion. All the data will be submitted in an electronic automated way through the clearing house' (Ministry of Finance, 2018a).

Split payment is a mechanism designed to tighten up the VAT tax system by eliminating the risk of the VAT due vanishing after being paid by one party to another, but not to tax authorities. The procedure applies to electronic payments for B2B transactions and is allowed between VAT taxable persons that have an account with a Polish bank. Under this new procedure the buyer transfers to the seller's account only the net amount shown on the invoice. At the same time the equivalent of VAT is automatically transferred to the seller's dedicated, limited access VAT account. According to the Ministry of Finance, the ITSCH has already proven effective. In April 2018 over 5.6 million qualified banking accounts have been covered with it. One of the first achievements is a speedy identification of newly established, suspicious bank accounts. The joint operational activities together with the Chief Inspector of Financial Information (GIIF) have allowed for the retaining of a total of around EUR 350 000, i.e. almost PLN 1,5 million. 'The desired effect of the preventive measures for analyzing the risks of abusive tax practices as well as NRA's prompt reaction should be a significant reduction in tax evasion, but also an improvement in the general conditions of conducting economic activity for every taxpayer through re-establishing fair competition in the market' (Ministry of Finance, 2018b). In theory, this model might eliminate the

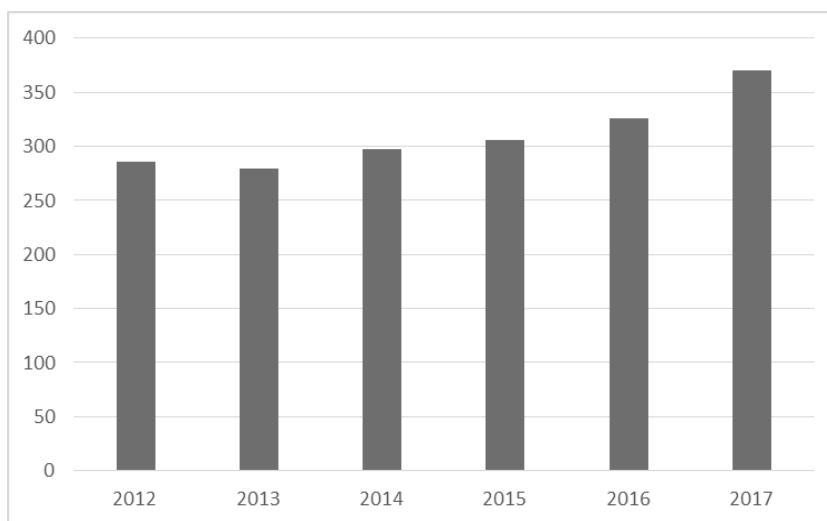
VAT gap. Taxpayers would have no access to the VAT paid by the buyers, thus being unable to withhold it. In reality, however, split payment is applied only to electronic transactions and the VAT gap is partly the result of business liquidation, grey economy activities or declaration errors (Śliż, 2018).

In the future, the Ministry of Finance intends to introduce the obligation for online cash registers, which will enable up-to-date reports on sales to be transferred to the fiscal administration data servers.

Conclusions

In recent years, one of the most essential activities undertaken by the Ministry of Finance has been the fight against VAT tax evasion. Many of the actions taken by taxpayers are falling short of legal tax optimization. Economic activity leading to VAT evasion is marked by organized crime groups often referred to as 'white-collar crime.' At present criminal activity is far from clandestine, hidden; nor is it reminiscent of spectacular armed robberies with police cars chasing criminals, with sirens wailing. Illegal decisions leading to tax evasion are made in the drawing rooms, with tax law professionals attending to make sure every pretence of lawfulness is upheld. They exploit ambiguities and loopholes in legal documents, with complete disregard for the fiscal law. They utilize mechanisms which tax administration finds hard to detect. Investigative specialists do their best to detect anomalies and show a prompt reaction to the illegal activities of tax criminals. Their decisions, nonetheless, are always made after the fact. Owing to a variety of legislative actions, and more recently, cyber actions, the scope of the VAT tax gap has consistently been reducing. It is estimated that by 2020 the tools already at the disposal of the Ministry of Finance, together with a further dynamic development of automated verification tools and advanced analytical IT methods, will have diminished the tax gap by PLN 6.840 billion. The European Commission recommends that continual investment in IT tools shall lead to further reductions of the VAT tax gap.

It is observable that the actions taken have already resulted in the growth of fiscal proceeds. It is worth stressing that budget revenues are not solely dependent on the tightness of the fiscal system. Poland has enjoyed a favourable economic situation and a high GDP in the last several years, which to a certain degree has also been of importance in the volume of budget revenues from taxation.

Fig. 6. Budget tax revenues for 2012–2017 (in billion PLN)

Source: Author's own elaboration based on <https://finanse-arch.mf.gov.pl/strona-glowna>
(access date: 7.06.2019)

Pointing to the single most efficient tool in the fight against tax fraud is a challenging task, even more so as a number of them are often introduced simultaneously by the Ministry of Finance and their fiscal effectiveness can only be assessed at a later time. Some measures introduced much earlier have already delivered good results. The prospective mechanisms for the calculation and measurement of the tax gap; its potential effects, as well as the results expected of the newly introduced tool are exceedingly complex. It is equally important that the scope of the VAT tax gap be monitored on an ongoing basis, and that the effectiveness of the reduction measures taken be reflected upon for further improvement.

What must essentially be considered is that these tools should only be targeted at the criminal activities of dishonest taxpayers. It is equally of importance that honest taxpayers should be able to enjoy freedom of economic activity and not feel the oppressive weight of the taxing system and related authorities. Financial and accountancy departments point to excessive tax bureaucracy resulting from the numerous reports required of them. Adjusting the existing accounting systems to modern data transfer is as costly as it is crucial.