

Information System as Tax Evasion Prevention Means – Application of Personal Identification Number

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Abstract. *Tax payment is a burden to taxpayers, what is reason for tax evasion presence in almost all the forms of social development. Trying to evade tax liability payment, taxpayers commit legal and illegal acts or omissions, and the State applies various measures to prevent tax evasion. The purpose of the work is to establish importance of information system with tax evasion discovery and prevention. Personal identification number is applied pointing to the ways and forms of the tax procedure department and the records of Tax Administration, in terms of the timely recognition of taxpayers' efforts to avoid tax payment.*

Keywords: taxes, tax evasion, tax fraud, information system, personal identification number.

1 Introduction

In terms of meeting ever larger public needs and other expenses from its competence, the State reaps revenues in the form of contributions, fees, duties and taxes that are the most numerous income of every contemporary state. Large amounts of financial means are collected by compulsory pecuniary fees through many kinds of tax forms.

Due to increased needs of the State, a tax role as a basic financial instrument of public income collection is daily increased, due to what: a) a circle of persons – natural and legal – is increased, which take out from their income (exceptionally from the assets too) to meet the needs of the State, b) the number of tax forms collecting the income is increased and c) tax burden is increased [1].

Nowadays, in the systems of many modern states, to which our country is also included, the collected taxes serve to settle not only fiscal expenses of the state administration, justice, army but also the taxes are used by the State to achieve also other non-fiscal objectives. Tax is characterised by derivative property (*derivare Lat. divert, deflect, and deduce from something*), compulsion, non-returnability and the absence of a direct counter-compensation (consideration), what results necessarily in negative relation of taxpayers to fulfilling their liability of tax payment [1].

Every tax payment is a burden for taxpayers who are obliged to pay it, due to what in almost all the forms of social development larger or smaller resistance is present to its payment. Resistance to tax payment grows with a higher taxation rate, the increase of the number of tax types, irrational spending of public income of the

State as well as inadequate Tax Administration organization and insufficient qualification of tax administration. Contrariwise, resistance to pay taxes is smaller when tax burden is smaller, if there is larger responsibility of the State to the means collected by taxation and when the purpose of public income allocation is closer to meet the needs of taxpayer.

In financial theory on taxation, a rule of declining tax yield is met, known as "Swift's 1 x 1", as per which the increase of a tax liability does not simultaneously means equal increase of the amount of collected tax [2]. Namely, if a tax is increased by 50%, the amount of collected tax will not be increased by 50%, but the increase is always smaller, whereby the difference in the magnitude of resistance is when tax evasion is met.

With respect to many-year work in Tax Administration and everyday use of information system with implementing tax procedure, the purpose of this work is to point to the role of efficient information system and information data exchange between the State Administration Authorities using personal identification number, as the means for prevention of tax evasion, as well as to point out the significance of preventive control of the operations of supervision service, what in conclusion contributes to faster collecting budget revenues.

2 Types of tax evasion or a tax liability avoiding

Tax evasion is an indicator of non accepting tax liability, due to what a larger or smaller resistance is present almost always in taxpayers with the payment of the tax. As per Barbara Jelčić, the concept of tax evasion understands payments and omissions undertaken by a taxpayer in order to avoid tax payment.³

The concept of tax evasion denotes illegal actions or omissions by means of which tax liability is hidden or removed. A taxpayer pays smaller tax than should be obliged according to the law. Illegal evasion of tax payment can be effected by omitting to declare the taxable income or the transactions from the tax return, by stating higher deductible expenses than the real ones, omitting to submit a tax return, by means of pretended transactions or reduced actually due amounts, false statements or presented facts [3].

Two types of tax evasion can be distinguished in tax legislation:

- 1) legal or permitted tax avoidance enabling legal avoidance of the liability to pay tax, and
- 2) illegal or illicit tax evasion, when taxpayer confronts with the law, avoiding tax payment.

2.1 Legal avoiding of a tax liability

Legal or permitted tax evasion does not bring a taxpayer into conflict with law regulations. The taxpayers can achieve legal avoidance of tax payment in different ways, as follows:

- a) By means of a change of the residence place for natural persons and a seat of business activity of the company for legal persons – to other parts of a country or even States, the tax flight where lower tax rates are applied to the same amount of the tax base. For purpose of the use of tax benefits, the taxpayers have smaller tax burden. The possibility of legal tax reduction can be realised also in Croatian tax system through tax exemptions for certain activities of the companies if they have operations at the area of the Town of Vukovar, at the Areas of Special State Concern, the Hilly and Mountains Area, for investments in free zones, with education and training and research-developmental projects [4];
- b) finding loopholes in the law when the avoidance of tax payment is the consequence of the inadequacy, confusion and vagueness of the tax system.
- c) through reduction or abandoning the consumption and reorientation to the use of other products – law organised evasion, what can be one of the objectives of economic or social tax policy of a State, by means of which it wishes to influence domestic trade and balance of payments;
- d) by means of the changes of technical or production character with performing the activities of taxpayers, which changes become necessary with the operations to influence the tax regulations, as per which the taxpayers should react in an expected and in advance foreseen way;
- e) through law provisions as per which the funds singled out for meeting precisely defined needs as e.g. education, health, science, etc., are exempted from tax payment.

2.2 Illicit avoidance of a tax liability

If taxpayers perform some impermissible economic activity, in which way they consciously avoid to pay tax, then we speak about illicit or impermissible tax evasion, that can be:

- a) total tax evasion or tax fraud, and
- b) partial tax evasion or fraud.

2.2.1 Total tax evasion

Total tax evasion or tax fraud is made when a taxpayer does not declare at all the revenues to financial authorities declare to possess the assets to be the subject of taxation and on which property the tax is to be paid. Such taxpayers do not pay any tax; according to tax discipline, they are defaulting taxpayers, who do not response to the invitations of financial authorities and which are hardly reachable. Illegal evasion of a tax liability is reflected also in the ability of the State to correctly distribute the tax burden, as the taxpayers which incorrectly declare their income, can realise unjustified benefits which have been intended by the State only to those who earn less than defined amount [5].

Separate analysis of tax evasion that was implemented with particular direct and indirect taxes in our country for the period from 1994 – 2000 shows that the lower border of tax evasion evaluation, which follows the trend of a share of unofficial economy in GDP ranges at about 5.5% [6]. Due to the mentioned, the tax regulations and criminal legislation prescribe certain sanctions – the high pecuniary penalties, confiscation of evaded amount, prohibition of performing further activity or imprisonment for the procedures of illegal tax evasion.

2.2.2 Partial tax evasion

Partial tax evasion exists when taxpayers present incomplete, respectively partial or false tax return and other financial indicators concerning the rate of realised income, profit or the value of the assets, when a taxpayer pays smaller tax than he should be obliged to pay according to the law regulations.

Tax fraud is related with the avoidance of indirect and direct taxes as e.g. income tax or the profit tax, while in cases of the avoidance of the payment of indirect taxes – sales tax and customs duties, the names of smuggling, contraband or black market are applied. However, from the point of view of taxation, individual smuggling,

contraband or black market is not only the avoidance to pay prescribed customs duties and other customs fees with the import, export or transit, but also the avoidance to pay the indirect taxes within the State borders (e.g. sales of tobacco or alcohol drinks directly from the manufacturers to end users, without paying sales tax) [1].

One of the most frequent forms of tax fraud within the income tax in our country is recording the employees to minimal wages. In such case income tax and compulsory contributions for social insurances are computed based on smaller base, while the other part of the wages is paid to employees directly in cash or through false expenses for daily allowances for business trips, whereby that second part of earnings is not a subject to any taxation.

On the other hand, due to self-controlling mechanism, the least possibility of tax fraud is present with VAT. Namely, all the participants in production cycle are interested to receive an invoice for carried out turnover with especially presented VAT, whereby the declared VAT can be deducted as an input tax.

3 Measures foreseen to try to prevent tax evasion

To prevent tax evasion, the State uses various measures, which as per Šimović, can be divided into three groups: a) institutional measures, b) legal measures and c) socioeconomic measures, whereby actual effect and impact can be achieved only through their combined application [7].

3.1 Institutional measures

Institutional measures are directed to: a) efficiency of tax administration, b) mutual confidence to administration and taxpayers, and c) obligation to proceed *bona fide*.

Civil servants who perform tax assessment, collection and control must adhere to the principles of legality and be impartial. The civil servants are requested to be objective with performing their jobs, to know tax regulations and to be professionally trained, to have good organization of work to use their work hours rationally, in order to achieve the purpose of taxation having, with it the procedure of tax collection as cheap as possible.

Tax authorities that implement tax procedure and the taxpayers that realise their rights or fulfil the legal liability are obliged to proceed in a good faith or *bona fide*. *Bona fide* principle should be reflected in mutual trust, in the relations among taxpayers and official persons of the tax authorities such as are deficient sometimes among them [8.] Namely, tax authorities are not in charge of the tax collection procedure only (although it is their basic liability and duty), but is obliged all the circumstances essential for legal decision making in the tax procedure being implemented, and that means to establish the facts that are favourable and unfavourable for a taxpayer. Further on, in the procedure of establishing a tax liability, the official persons must not start from the assumption that the data based on which the taxation is performed are false and incomplete, and that the taxpayer kept some facts secret and reduced so the amount of tax burden as such an attitude provokes a negative reaction with those taxpayer who execute all their liabilities correctly and in time. Tax-debtor relationship must be based on mutual trust, and as stated by Jelčić – individual cases of tax fraud evidence must not be generalised and lead to the aprioristic attitude of the tax authorities that the tax returns and statements of the taxpayer are to be approached with expressed mistrust.² Establishing mutual trust between tax authorities and a taxpayer influences positively the increase of the tax ethics.

For an efficient tax administration a good information equipment is required that is in line with a fast development of information technology, And which enables safe coverage of the data and timely processing of all the facts for establishing the liability of tax payment.

3.2 Legal measures

Legal measures are directed to: a) stability of tax system, b) efficiency of the tax supervision system c) seriousness of the sentences for tax offences.

The stability of a tax system is characterised by the continuity with the application of the tax regulations, without often law amendments. Namely, if the tax laws are subject to frequent changes, due to the instabilities in economy the taxpayers are also insecure with the risk evaluation with planning and making business decisions. The readiness of business subjects to execute tax liabilities is larger when the tax

system has fewer amendments of tax laws, but also when the penalties for evidenced acts of tax fraud are severe. The Department of Inspection Control, covering frequent systematic control of the work and operations of taxpayers plays a significant role with the preventing and discovering of illicit avoidance of tax payment. Due to weaker actions of Inspection Control Department and the facts that the operations of a taxpayer are not followed continuously, the taxpayers are consciously exposed to the risk of avoiding to pay tax liabilities. It is therefore necessary, an effective action of the control services, the frequency of the control of the facts essential for taxation, as well as a permanent education of employees with their simultaneous remuneration, that finally has the objective of the increase of motivation for a qualitative performing complex operations of the control of taxpayers.

3.3 Socioeconomic measures

Socioeconomic measures are directed to: a) building and increase of the ethic of taxpayers, and b) responsibility with spending the funds collected by means of taxation.

Tax ethics include the standards of behaviour related to taxation, habits, positive personal attitude of the taxpayers to pay law prescribed amount of tax. With the increase of the tax ethics the trust of the taxpayers to tax institutions is of great importance, as well as their positive attitude to the allocation of collected funds. With the taxpayers, the resistance appears to tax payment if the taxes finance unnecessary and inadequately justified expenses, while, in the opposite case, the tax resistance is smaller if the purpose of spending public income is closer to real needs of the individuals.

Analyses of financial experts show that the tax payment is not seen by the taxpayers only as a part of the own liability to the State but as a liability of their fellow-citizens. If a taxpayer is therefore persuaded that the others do not pay to the State their part of the tax, he/she does not wish therefore to be the only one to pay it [9].

As per Charles W. Adams, ethical aspect of taxation shall refer equally also to the State and to the taxpayer. The duty of every state authorities to develop a rightful and adjusted system of public income, *justified* in the way of tax assessment and collecting, and *justified* with respect to management of public income and to their spending [10]. If the taxpayers believe in

the righteousness of the tax system, then they are more prone to settle their tax liabilities, and through that, their inclination to tax fraud is reduced.

Beside a personal attitude of a taxpayer to tax payment, the elements influencing the readiness of the tax payments to pay the tax depends also on: a) the amount of the tax liability, b) assessment of the tax burden, c) social and political life of the surroundings which is a subject to taxation what includes the view of life, national mentality, the level of education etc., d) purpose of the spending of tax collected means, e) additional costs of the taxpayer concerning the settlement of his tax liability [1].

Although all the enumerated measures have the same goal; to prevent the tax fraud and increase collected resources, only by means of their joint action the avoidance of the tax payment can be made a less frequent phenomenon.

4 Basic characteristics of the Tax Administration information system in the Republic of Croatia

With a professional tax administration and for implementing a tax procedure and timely book entries, keeping and storage of registered data on the operations of a large number of taxpayers requires having an efficient information system.

The Tax Administration as an administrative organization within the Ministry of Finance performs in our country the jobs of gathering, assessing, control, collecting and forced establishing of taxes, contributions and other public income, by means of its information system. The information system of the Tax Administration (Croatian: ISPU) has been made of a large number of application programs and various databases subsystems (as contained in Table 1) and which enable the support to all the operations performed by the employees of the Tax Administration. ISPU is continuously developed and annexed in its software infrastructure due to the adjustment and changes in law regulations, and in its computer-communication infrastructure, due to the influence of contemporary information technologies, and according to locations, it has been spread to the whole territory of the Republic of Croatia; so it supports all the business technologies in the Tax Administration.

In its hierarchically organised network of IS which follows the organisational structure of the Tax Administration 122 branches of the Tax from 20 branch offices are included, with the existence of the central location at the Headquarters in Zagreb. Software support to business processes of the tax system is performed at the Agency for Support to Information Systems (APIS-IT), using a *host-central model* of terminal access and centralised data processing which cooperates closely with the tax procedure department and tax records within the Tax Administration.

Dependent on the tax procedure being performed, the tax administration keeps different records on the taxpayers using IS which consists of the following subsystems:

Table 1 ISPU¹ subsystems

| | | | |
|-----------------------------|------------------------|-------------------|--------------------------|
| Basic and auxiliary records | Tax assessment | Tax book-keeping | Compulsory contributions |
| Office operations | Inspection control | Forced collection | Violations |
| Business informatics | Bankruptcy proceedings | Issuing receipts | Other subsystems |

Source: data taken from internal records on the Information System of Tax Administration

In each of the presented subsystems numerous operations are performed from the domain of assessment, collection and control of compulsory public fees, whereby jointly collected data on the taxpayers are useful in several different subsystems. However, in this work the role and significance of the register of taxpayers as a main register and one of the most important components of subsystems of the master and auxiliary records will be emphasized.

4.1 Register of taxpayers

The main duty of the subsystem of master and auxiliary subsystems within ISPU is to collect and include the recorded data on the taxpayers, their processing, storage and the possibility of searching. The mentioned data can be provided in the register of taxpayers that includes domestic and foreign subjects, foreign agencies and international organizations, domestic natural persons and foreign subjects who are taxpayers in RH.

¹ Information System of Tax Administration

At the register of taxpayers the basic identification data are entered based on the registered number of ID of 7 digits and the name of a legal person, and personal identification number of citizens – PIN consisted of 13 digits and the surname with the name for natural persons who perform the registered activity and for the citizens. The taxpayer register contains also other data that are important for implementing a tax procedure, as e.g.: address of the headquarters for legal and residence or temporary residence for physical persons, the data on giro account number, data of start and termination of dealing with entrepreneurial activity, date of entry and exit from the VAT system, marked types of basic tax liabilities of each particular taxpayer, competence of the branch of Tax Administration in charge for monitoring entrepreneurial activity of the taxpayer, etc. Updating of the data is performed based on the declarations of the very taxpayers and using the data from other auxiliary registers within the subsystem of the basic and auxiliary registers within the subsystem of basic and auxiliary records as e.g.: register of citizens, register of companies, register of business banks, and register of spatial units. For updated state of the main register of the taxpayers the employees of the Tax Administration are responsible; they are obliged regularly enter the changes of the data for the taxpayers that have already been entered into the register and enter the data on the new taxpayers. Only updated and correct data in the register of taxpayers enable correct assessment of tax liabilities for each particular taxpayer.

4.2 Introduction of a personal identification number into the tax system

Besides data updating on the existing and new taxpayers in the register of taxpayers through registry numbers and PIN-s, because of the future accession of RH to the membership of European Union, all the taxpayers – the legal and natural persons and citizens will be entered and kept in the master register of taxpayers through personal identification numbers (PINs) from 1 January 2010.

Namely, European Union is characterised meaning a big integration of national markets that enables free movement of capital, goods and services as well as people. With emergence of

the common market the borders among the member states have been abolished whereby the system of border controls till that time was replaced by a new system of the control for the common market. Connecting national economies has, however, a great influence also on the tax system and the measures of tax policy among the member states and on the candidate members states that are still at the access to EU. Creating the common market imposed a need of cooperation among European Tax Administrations at the fight against tax evasions using developed information system that should enable a quick exchange of information and simple control and checking of the data on taxpayers among the members states. Therefore, each tax administration had to establish electronic data abase containing identification numbers of national entrepreneurs [11], which are especially significant in the taxation of the deliveries of goods and services with the value added tax.

One of the conditions for future access of our country to EU membership was so to issue the Act on Personal Identification Number (Croatian: OIB) [12], which will entirely replace present use of registry number and PIN in the register of taxpayers from 1 January 2010.

As per legal provisions, OIB is a permanent identification code of each person, used by the public authorities in everyday work and consists of eleven digits, and for international data exchange the letters of “HR” will precede the digits as a mark of the country from which an entrepreneur, dealing with operations in the common market, comes.

Tax Administration grants *ex officio* the OIB to all the tax obliged persons who are entered into the register of taxpayers at the Tax Administration, but also to other business subjects kept by other registry bodies as e.g.: Commercial Courts, Government Statistical Office, Ministry of the Interior, and Central State Office for Administration. Established information connection between the Tax Administration and other registry bodies enables that OIB is granted immediately at the moment of the first entry of a person into the register or immediately with the change of the data connected with the income scale of the citizens. The use of OIB as a unique identification is not therefore limited only to the domain of the tax system, but OIB is used also at the domain of social payments and the system of pension insurance, and with the access of our country to

EU, OIB will be used also for international exchange of the data.

5 Application and use of the personal identification number with preventing tax evasion

As by means of law regulation OIB has been prescribed as a permanent mark for the entry of taxpayers into all the official records kept by State bodies with public authorities, so that, based on informatics data exchange between all the official registry bodies, the systematic following of all the changes of the income scale of the citizens in our country will be enabled with its introduction and application from the start of the next year.

Namely, IS network connecting and the use of OIB as a unique identification mark enable the collected data to which the Tax Administration came to be exchanged and compared with the data about the taxpayers available by other registry bodies, as e.g. the records on the owners of motor vehicles by Ministry of the Interior, on the owners of real estates from the land books, on the owners of companies at the Commercial Courts, on the owners of securities by the Central Depository Agency and other records. A quick flow of information among the State Administration Authorities enable OIB to become the main instrument by means of which the realised income from performing various activities will be compared with the data on acquired fixed, movable and other assets. If during the procedure of data collecting and comparison it is established that there exists a imbalance between the receipts and expenditure and that the amounts for the property of taxpayers are not proved, that means that a tax evasion was made, due to what the taxpayer's income must be established as a difference between the value of acquired assets and the proved amount of the resources required for their acquiring.

Monitoring of the changes of the income scale of taxpayers has been prescribed in art.63 of the Income Tax Act as per which the Tax Administration is obliged to collect the data continuously during a year on the taxable receipts, to follow the sales of the goods and perform other required actions, with the data on purchased property of natural persons and their liabilities during a tax period. For the purpose, there must be established records on personal

property of taxpayers with the Tax Administration, using the own data available with the Tax Administration, the data advised by the taxpayer with the implementing of a tax procedure as well as based on collected data from other State Administration authorities [13].

It can be concluded from the mentioned through the insight into the applicative programs of our IS and using OIB, to provide for the exchange of the data with other systems, that the data on movable and fixed assets of taxpayers will be reached quickly, as well as a taxpayer's tax burden dependent on the amount of realised income from performing the activity. When an imbalance is found between the realised income and the value of acquired property for which no proved resources for its purchase can be proved, that is one of the first indicators of tax evasion.

To prevent tax evasion, the activity of the existing department for tax procedures and the tax records with the Tax Administration is of a great importance. Namely, besides the fact that the existing task of the mentioned department refers to performing the jobs of normative regulation and tax procedures, its operations must be extended also the a risk analysis in a timely recognition of the taxpayers trying to avoid tax payment; based on collected data from the ISPU subsystems and the data from other official registry bodies, connected through OIB with the Tax Administration.

Further on, for discovering possible taxpayers with possible abuse, the HR and organisational changes are necessary that required to establish a standing program of education of the existing professionals from the Tax Administration to ECDL and other programs of professional training, as well as engaged professionals employed with other firms with the expertness and required skills to perform the jobs from the domain of IT.

And conclusively, tax evasion is influenced also the efficiency of the control performed by the inspection service, as well as the amount of pronounced penalties for offences made, if some irregularities with operations were found. Supervision service must perform control of operations preventively, meaning in time and early enough to discover illegalities in operations if they exist. It is necessary to apply with it the information from data mining by means of specialised software, from which the tax employees will be able to separated useful information necessary for analysis and evaluation of the risk degree of taxpayers. The

choice of taxpayers with which it is necessary to implement control of operations for purpose of the existence of larger probability for tax fraud that can be established as per the following criteria: size of taxpayer, dependent on the value of taxable and non-taxable deliveries of goods and services, share of tax liabilities in the total income, tax discipline with submitting law-prescribed monthly and annual reports and the tax return as well as the combination of the mentioned criteria. Performed preventive control with taxpayers which have been chosen, application of data base information, will not entirely prevent tax evasion, but can certainly contribute to the reduction of the possibility of leading to it.

6 Conclusion

Successful functioning of the State and financing its numerous objectives as well as realising various needs interested in life and work of its inhabitants, would not be possible without financial resources, due to what the taxes as their most abundant income become *sine qua non* of the survival of every state. Tax evasion is an indicator of avoidance to accept tax burden, and with the efforts to reduce tax evasion, a contemporary state uses institutional, legal and socioeconomic measures, whereby a good information system has a large role.

Fast development of IT in the world, puts requests to the development of our ISPU: a) for efficient and safe coverage of the data on taxpayers and timely recognition of risky taxpayers trying to avoid tax payment, b) to adjust tax system of RH to normative organisational organisation of European Union that is to be accessed by our country. Therefore the jobs of existing department of tax procedures and the records with the Tax Administration should also be extended to the risk analysis in the timely recognition of the taxpayers attempts to evade tax. This will be facilitated by introduction of OIB and use of information from data mining by means of specialised software.

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