

PERFORMANCE OF PUBLIC SECTOR INSTITUTIONS AND ECONOMIC GROWTH: SLOVAK TAX ADMINISTRATION

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Abstract

Functional public sector is one of main pre-conditions for sustainable development and economic growth. This paper evaluated the performance of the Slovak tax administration and the Slovak tax system as the whole, with focus on three possible performance lines - calculation of administrative costs of taxation (input – output measurement), calculation of compliance costs of taxation (measuring “administrative” burden caused by taxation) and the general opinion of experts about the system. Its findings are rather negative and highlight major deficiencies that should be addressed by future public policies and reforms.

Keywords: performance, tax administration, Slovakia, administrative costs, compliance costs

JEL Classification: H21, O43

Introduction

Many sources stress the importance of the functional public sector for sustainable development. For example the European Semester documents (<http://ec.europa.eu/>), as the main external public administration reform driving force for new EU member countries and all accession countries, clearly state: “Overregulation, inefficiencies and lack of stability of the public administration do not create a supportive environment for long-term growth”.

The goal of this paper is to evaluate the institutional performance of the Slovak tax administration. Three lines are included – calculation of administrative costs of taxation (input – output measurement), calculation of compliance costs of taxation (measuring “administrative” burden caused by taxation) and the general opinion of experts about the system.

1. METHODOLOGY

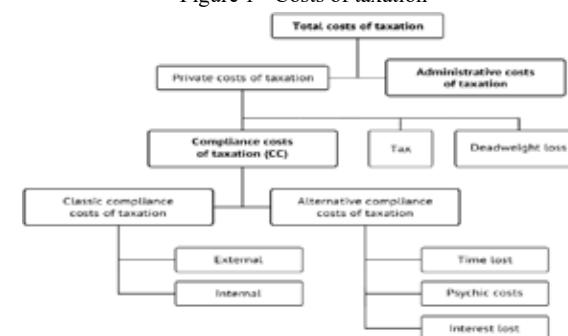
The terms “tax system performance” and “tax administration performance” do not have a fully unified meaning. The first integrated concept of how to construct tax systems was presented by Smith (2005), whose principles of taxation (justice, certainty, convenience, and efficiency), involved in the canons of taxation, formed the starting point for the study of the theory and practice of tax administration. However, this kind of approach needs operationalisation in order to be able to create benchmarks. One interesting framework, provided by Barbone et al. (1999), suggests that the performance of a tax system can be measured via a matrix, where the core areas to be investigated are policy formulation, accountability, and service delivery indicators. Many other authors (e.g. Tanzi, 1991, 1996; Gallagher, 2005; Das Gupta, 2002) do not include accountability as specific sub-area, focusing on two core levels of tax system performance: tax policy (‘macro-level’) and tax administration (‘micro-level’).

On the micro-level, academic studies focus particularly on costs of taxation (Figure 1). The costs of taxation may be analysed in one of two ways. One group of authors uses the term ‘administrative costs of taxation’ to cover only the expenses of the public sector (Sandford et

al., 1989). A second group of authors, most notably Stiglitz (1989), divides the costs into the administrative costs of taxation and the indirect expenses of the private sector (the incurred compliance expenses of taxation). In our paper we deal with both dimensions.

The issue of costs of taxation is subject of many books and articles. We can mention for example There have been many important international studies about this topic (Alm, 1996; Evans, 2003; Hasseldine and Hansford, 2002; Chittenden et al., 2005; Lignier and Evans, 2012; Malmer, 1995; Mirrlees, 1971; Sandford, 1989 and 1995; Slemrod and Sorum, 1984; Susila and Pope, 2012; Tran Nam et al., 2000; Vaillancourt, 1987). There have also been some studies in the Central European region (Bayer, 2013; Klun 2004; Klun and Blazic, 2005; Pavel and Vitek, 2012; Pavel and Vitek, 2015; Solilova and Nerudova, 2013; Teperová and Kubantová, 2013; Vitek, 2008; Vítková and Vitek, 2012).

Figure 1 - Costs of taxation



Source: Cizmarik, 2013

To calculate administrative costs of taxation we chose to quantify the relation between tax revenue and operational expenses, to facilitate comparison with other studies, especially with results from the Czech Republic (Vítková, Vitek, 2012). Thus our contribution is not a novel methodology, but is producing comparable Slovak results using existing methods. The data for calculation of the administrative costs of taxation were collected from existing sources.

To obtain the necessary data needed for estimating the compliance costs of taxation we used a questionnaire distributed by electronic post and accessible also on line. The total sample achieved was 88 responses, from which we had to exclude eight respondents for formal reasons. The statistical significance of the sample was tested by a Pearson test with a 5 % significance level and the achieved p-value was 0.844 for physical persons and 0.094 for legal persons as a group – this should mean that the sample has statistical relevance.

The last part of this paper is based on primary and secondary data; it combines qualitative and quantitative research methods. The primary data were collected in two rounds – by long-term research about the needs perceived by tax officials and by the ‘Delphi method’ (questioning a panel of experts). The long-term research was conducted between February 2013 and February 2016. During this period, we interviewed 282 executive tax officials participating in training at the tax school of the Slovak Financial Office. Our request was rather simple: ‘Try to define the most significant elements of the possible optimisation of the Slovak tax system.’

Based on the results from the first phase, we created a ‘matrix’ of the main determinants of the performance of the Slovak tax system. Thirteen questions included in the questionnaire

mirrored the structure of the main responses collected from tax officials during our long-term research. Experts in political, administrative, and academic positions were asked to rank the proposed tax system performance determinants and also to provide proposals for other determinants and their own comments. This phase took place in April 2016. We received responses from 18 experts, a fully sufficient and significant number of responses.

2. ADMINISTRATIVE COSTS OF TAXATION IN SLOVAKIA

Using the recalculated employee estimates (Pompura, 2012), following the Czech methodology, the total administrative costs of the Slovak tax system were calculated according to the main tax types (see Table 1).

Table 1 - Total administrative costs of taxation in Slovakia according to main types of taxes (2004-2008 in thousands SKK, 2009-2011 in thousands €)

Years	2004	2005	2006	2007	2008	2009	2010	2011
Income tax of individuals – Employees	353 874	596 514	701 980	683 474	733 550	23 826	25 979	27 161
Income tax of individuals – Entrepreneurs	516 308	391 828	429 482	415 387	428 940	14 930	15 137	15 801
Corporate income tax	887 585	693 009	731 600	727 664	795 716	25 462	27 160	28 273
Income tax – lump sum form	75 416	93 571	97 744	67 758	90 140	2 513	3 114	3 228
Property tax	14 503	17 545	5 924	11 784	6 217	102	107	111
VAT	992 007	1067 292	938 936	992 805	1007 788	33 950	34 137	35 064
Road Tax	52 211	55 558	50 353	41 244	40 407	1 227	1 503	1 447
Total	2900 606	2924 089	2961 942	2946 008	3108 264	102 215	107 350	111 085

Source: own calculations from annual reports of the Tax Directorate of the Slovak Republic

To allow for comparative analysis the absolute data from Table 1 is presented in relative form in Table 2. The results suggest that the main problem is connected to the income tax paid by self-employed entrepreneurs – but also because the revenues from this tax step by step decrease resulting into the rise in the relative costs of collecting this tax.

Table 2 - Administrative costs as a percentage of tax revenues, by specified tax, 2004-2011

	%							
	2004	2005	2006	2007	2008	2009	2010	2011
Income tax of individuals – Employees	x	1,77	1,96	1,64	1,48	1,62	1,81	1,65
Income tax of individuals – Entrepreneurs	1,98	5,86	7,64	7,92	7,04	7,92	30,76	25,51
Corporate income tax	2,99	1,62	1,52	1,37	1,23	1,18	2,11	1,65
Income tax – lump sum form	1,33	2,43	2,01	1,19	1,45	1,61	2,04	2,25
Property tax	0,53	1,82	1,81	19,32	14,80	14,61	13,42	31,80
VAT	3,63	1,32	1,28	1,41	1,47	1,52	1,52	1,59
Road Tax	4,10	1,97	1,72	1,16	1,52	1,00	1,26	1,12

Source: own evaluation of data

To assess our results, it is needed to compare them – the Table 3 provides benchmark, which is not very positive for Slovakia.

Table 3 - Taxation level and administrative costs of taxation: selected countries

Countries according to the their administrative costs of taxation (%)	Countries according to their tax revenues to GDP			
	< 20%	20-30%	30-40%	Over 40%
- 0,60		USA		Sweden
0,61 - 0,80		Korea	Ireland, Spain, New Zealand	Austria, Denmark, Finland, Germany, Norway
0,81 - 1,00	Mexico	Turkey		France
1,01 - 1,20			Hungary, Netherlands, UK	Luxembourg
1,21 - 1,40			Canada	Belgium, Czech Republic
1,40 +		Japan	Poland, Portugal, Slovakia	

Source: OECD, 2011

3. COMPLIANCE COSTS OF TAXATION

The estimated compliance costs of the income taxation in Slovakia are presented in the Table 4 and discussed by the following text.

Table 4: Estimated costs of taxation in Slovakia in 2011: income taxation

Subject: Legal form	Average CC (EUR)	Total number of tax subjects	Total CC (EUR)	Total tax revenues (EUR)	Relative CC (%)	CC to GDP (%)
Self-employed	861	481 996	414 871 309	X	x	x
Other physical persons	770	75 754	58 354 569	X	x	x
Physical persons total			473 225 878	56 402 000	839,02%	0,69%
Limited companies	4 067	181 192	736 921 800	X	x	x
Other companies	3 186	12 191	38 841 609	X	x	x
Legal persons total			775 763 409	1 645 905 000	47,13%	1,12%
Total			1 248 989 287	1 702 307 000	73,37%	1,81%

Source: own calculations

Especially the estimates of compliance costs for income taxation of physical persons are very negative and this fact provides the impetus for a comprehensive discussion. To respond to this challenge we recalculated the results for the following possible biases – the total tax revenues from income tax, the real total number of legal persons, replacing average with median data, different values of the calculated proportion of total accounting costs (coefficient “A”) and different monetary values of time.

The recalculated results for the total income tax revenues are shown as alternative A in Table 5. Reducing the total numbers of tax payers to more realistic estimate generates alternative B in Table 5. Replacing average with median data generates alternative C in Table 5. Recalculated

accounting costs with different percentages (90, 50 and 20 instead of 100, 60 and 30) lead to alternative D in Table 5. The recalculation of our results using the average wage to estimate value of time generates alternative E in Table 5. The most cautious calculation is generated by simultaneously applying the corrections A, B, and C to the compliance cost calculations – last row in Table 5.

Table 5 - Alternative recalculations

Alternative	CC to tax revenues total	CC to tax revenues physical persons	CC to tax revenues legal persons
Original results	73,37 %	839,02 %	47,13 %
Alternative „A“	53,11 %	242,29 %	35,98 %
Alternative „B“	62,36 %	713,17 %	40,06 %
Alternative „C“	40,12 %	637,04 %	19,67 %
Alternative „D“	61,36 %	734,61 %	38,29 %
Alternative „E“	62,99 %	599,71 %	44,59 %
Alternative „A+B+C“	24,69 %	156,37 %	12,76 %

Source: own calculations

4. TAX SYSTEM PERFORMANCE

Table 6 highlights the main responses (responses with the highest frequency or specific important responses) of the tax officials that were included in the first phase of our research.

Table 6 - Selected responses of tax officials

Most frequent responses – suggestions	Frequency
Simplify tax collection, decrease tax bureaucracy	158
Decrease the tax burden	145
Provide better information about the tax system to businesses and citizens	110
Increase the level of risk connected with tax evasion	86
It is difficult to optimise the tax policy and the tax system, because there is no optimum model available	80
Prevent the transfer of Slovak firms to tax havens by lowering the direct and indirect tax burden	43
Utilise existing international good practices	33
Educate taxpayers – taxes are not the worst issue in the world	31
Be administratively simple, using low and stable tax rates and providing effective tax administration services	27
Improve tax administration services	26
Important but infrequent response	Frequency
Create a whistle-blowing system for reporting tax evasion	4

Source: own research

The set of responses indicates that tax officials clearly perceive most of the main problems of the Slovak tax administration – as defined by the academic literature and by the opinion of international organisations. However, it also indicates that the tax officials interviewed are somehow biased and that they may be influenced by political rhetoric.

The fact that tax officials perceive the Slovak tax system as complicated, bureaucratic, expensive, and not customer friendly, generating significant tax administration and tax

compliance costs reflects the situation (see data on administrative and compliance costs above). However, the issues of tax avoidance and tax evasion (still major issues in Slovakia, despite some moderate improvements) are not so well reflected. Orviska and Hudson (2003) clearly indicate that tax evasion is a common approach in Slovak business, in part perhaps because the risk of punishment is low.

Compared to the tax officials from the first phase, the experts from the second phase prioritize the issue of tax evasion, which is a very topical issue for Slovakia. Somewhat surprisingly, they also ranked the issue of decreasing the tax burden relatively high. This fact can be explained by one statement of the owner of tax and audit advisory firm:

This issue shall be evaluated from the position of a taxpayer and his dilemmas, as: ‘What do I get from the state as compensation for paid taxes? What level and quality of public services is provided? Is the scope of public services delivered by the Slovak state adequate to the tax burden?’ The corruption and very low efficiency of the Slovak public administration has a really negative impact on what taxpayers understand by the term ‘tax fairness’.

Conclusions

This paper evaluated the performance of the Slovak tax administration and the Slovak tax system as the whole. Its findings are rather negative and highlight major deficiencies. The fact that the Slovak tax system should improve was already reflected by the Slovak government. Reform UNITAS, which started in 2012, is expected to achieve this goal and we will be able to assess its results within a few years. Changes should be based on existing knowledge derived from studies focusing on the sphere in question, on issues like the size of tax offices, time-consuming agendas, the functional positions of employees, the structure of expenditures, the quality of tax control and the qualifications and motivation of all staff. One of the specific steps forward would be creating a “customer friendly” tax administration system which will provide tax payers with better information and increase their trust in the tax system.

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