TAX ASPECTS OF INTERNATIONAL TRANSACTIONS AND INTERNATIONAL TAX EVASION

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Daňové aspekty medzinárodných transakcií a medzinárodných daňových únikov

Abstract: *In the current period, most EU countries are trying to significantly consolidate public finances. Increasing attention is focused on public revenue dedicated to efficient tax collection and tax evasion. In these times of high capital mobility, states have to face the possibility of outflows of capital abroad and act as competitors to each other in terms of attracting investment from abroad. Some countries try to attract foreign investors by offering them little or no tax burden. These situations are the subject of tax evasion investigations and the possibilities of reducing such tax evasion in direct and indirect taxes are also being investigated to a large extent. If they are reduced, higher tax revenues can be achieved without the need to raise tax rates. Tax administration includes the institutions directly responsible for collecting taxes in the state, and it is clear that the proper functioning of these authorities can have a significant impact on the extent of tax evasion. It is this issue that is addressed in this paper.*

Keywords: *international transactions, tax, tax evasion, VAT gap, Slovakia*

JEL Classification: H21, H25, H26

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1 Introduction

There are several initiatives in the world that have a significant impact on international tax optimization. One of the most important initiatives is BEPS (Base Erosion and Profit Shifting), which directly fights multinationals that reduce their income tax base by using loopholes in local tax legislation. This initiative is aimed especially against multinational giants such as Google, Starbucks, Amazon and so on. The impact of BEPS affects all international transactions. The BEPS initiative places a high emphasis on the so-called substance, that is, the company is actually managed from the place where it has its registered office (Randa, 2019).

2 International Trade and Transaction Taxes

In international trade and transactions, the taxpayer may encounter a corresponding adjustment to the tax base. This adjustment occurs in transfer pricing and represents a reduction in the tax base. The corresponding adjustment of the tax base may also be made by the taxpayer in foreign transactions. The corresponding adjustment of the tax base in relation to foreign audited transactions (with taxpayers with limited tax liability) is more complicated. (Kudlová, 2019). These are therefore controlled transactions of Slovak taxpayers with taxpayers domiciled or resident abroad. A controlled transaction is the purchase and sale of goods, the purchase and sale of services, the receipt and provision of credit, and the like. For a transaction to be considered a controlled transaction, it must be a legal or similar relationship between dependent persons and at least one of them must be a taxable person with income under § 6 of the Income Tax Act that achieves taxable income or income from the activity or property. The opposite of a checked transaction is an uncontrolled transaction, that is, any transaction that is not a controlled transaction. Basically, an uncontrolled transaction is a legal relationship or a similar relationship between two or more independent persons (Štrba, 2018).

The corresponding adjustment of the tax base in relation to foreign controlled transactions has to be requested by the Slovak taxpayer to froma specialized tax office. The application is submitted to the “Tax Office for Selected Tax Subjects” based in Bratislava and does not have a specimen. According to § 18 par. 13 of the Law on Income Tax, *"this application shall be accompanied* *by the transfer pricing documentation, which must be drafted in such a case to the extent of a complete transfer pricing documentation."*

Most importantly, the tax authority will allow a taxpayer to make a corresponding adjustment to the tax base in relation to foreign controlled transactions only if the tax administration of the State with which the Slovak Republic has concluded a double taxation treaty has made a primary adjustment to the taxable person's tax base abroad in accordance with the principle of an independent relationship. Therefore, all the above conditions must be fulfilled for the Slovak taxpayer to make the corresponding adjustment of the tax base in relation to foreign controlled transactions. The tax office shall notify the taxpayer in writing of the authorization of such a corresponding adjustment (Štrba, 2018).

Table 1: Representation of individual proceedings in courts

Year	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
mil. EUR	35,4	38,9	30,8	27,6	31,5	28,9	28,9	24,5	25,5	21,5
Annual change %	30.20	10.00	-20.90	-10.40	14.40	-8.30	0.00	-15.20	4.30	-15.70

Source: own processing according to INESS (2020)

The table shows that the highest volume of collected tax on international trade and transactions was in 2011. In this year, the volume of collected tax on international trade and transactions was EUR 38.9 mil. So far, the lowest volume of taxes on international trade and transactions was in 2019 last year at EUR 21.5 mil. This represents a year-on-year decrease in tax collection of 15.7% compared to 2018. The most significant positive year-on-year change occurred in 2010, when international trade and transaction taxes increased by 30.2% compared to 2009.

3 Tax Evasion in an International Context

International tax evasion and its origins date back to the period between the two world wars when the system of international tax relations based on bilateral tax treaties began to form. Since then, the state is advised to proceed in the taxation of income based on the principles of the source state and the state of tax residence. These two universal tax principles are still applied by states in their tax systems to this day. They are the basis of bilateral tax relations, but national tax legislation also determines which one applies in specific situations and how they will be applied. It is the clash of these two principles of taxation that is one of the main reasons leading to international tax planning and ultimately to tax avoidance (Huba et al., 2016).

Businesses try to minimize the payment of the tax burden. If we assume that the amount of tax can be expressed by business entities themselves according to the conditions laid down in tax legislation, different responses of tax subjects to tax obligations may be considered (Sopková, 2018):

- The business will seek to avoid paying the tax by reducing the activities that are subject to tax, thus reducing the tax burden, but also reducing its own available funds;
- attempt to shift the tax burden to the second by changing the conditions of the business activity that is subject to taxation (tax impact – incidence);
- changes the place of business (tax domicile);
- legal or illegal evasion (tax evasion).

Tax avoidance is carried out by taxpayers if the benefit of a successful tax evasion is greater than the cost of potential tax audit, detection and subsequent punishment. The difference between the taxes actually paid and the taxes that should be paid if individuals and businesses report all their activities and transactions correctly and is legally called the tax gap. In the case of value added tax, we are talking about the VAT gap. According to Orviská (2017), the VAT gap is usually much smaller in countries where they have better value added tax administration. It is the tax gap that is one of the most common indicators for assessing the success of tax collection in a given country.

The definition of tax evasion should be based on traditions, national nature and national legislation. In tax evasion, Slovakia ranks together with Greece in the EU rankings. Estimates of foreign and domestic experts oscillate up to EUR 3 billion per year, predominantly in VAT. In principle, we distinguish two basic forms of tax evasion (Burák, 2019):

- Legal evasion – the taxpayer uses the advantageous wording of the tax legislation or uncertainty in order to reduce the amount of tax liability or not to pay the tax at all. For example, a trader in income tax by paying a lump sum instead of the actual one he had lower, pays a lower tax.

- Avoid tax avoidance – it is a direct violation of tax law standards, ie tax fraud. In principle, the mechanism of illegal tax evasion has two basic forms: on the basis of total concealment (tax defraudation) or failure to declare part of the income for taxation (tax malverisation).

The global trend of establishing companies in countries with favourable tax regime is also evident in the business environment of the Slovak Republic. This is evidenced by the increase in the number of Slovak companies, which have their registered office in tax haven states. Their number in 2019 amounted to 4,979 Slovak companies residing in tax havens. This is the highest number in the last eight years. Cyprus has been a popular tax haven for Slovak businesses until recently. Bisnode's research has shown that interest in this country is declining. At the end of 2017, there were 1,106 Slovak companies, in 2019 it was 1,056. On the contrary, the inflow was recorded in the United States, where in 2019 there were 1,201 Slovak companies. The most popular tax haven for Slovaks is the Netherlands, from where 1,159 Slovak companies are managed. Owners from destinations considered a tax haven control 1.8 % of Slovak companies and have invested almost EUR 10.4 billion in share capital. Most Slovak companies based in tax havens are engaged in wholesale and retail trade, professional and scientific activities and real estate (TASR, 2020).

There is no need to confuse tax optimization with tax fraud, but tax optimization needs to be considered during the year. In the course of the year, it is necessary to reflect on revenues, revenues and expenses, respectively costs of the company and their inclusion in the tax base. More effective tax optimization can also be achieved by making the taxpayer aware of the next effective version of the specific tax law well in advance, thereby preparing for changes and taking advantage of the fact that some things are preferable to do in the old year or, conversely, to leave them except for the New Year (Seneši, 2020).

4 Research

The subject of the analytical part of the thesis will be the analysis of specific data regarding tax evasion in Slovakia and the world. Tax havens are closely linked to tax evasion. Taxpayers expect the state to have an effective tax system, wise tax policy, and motivationally low tax rates. However, if this does not happen in practice, many taxpayers migrate to one of the tax-privileged territories of the world where no taxes are paid or very low. In addition, there is a discreet possibility of secrecy for real business owners, which is highly motivating for taxpayers. The following table shows the numbers of Slovak companies in tax havens.

Table 2: Slovak companies in tax havens

Country	2016	2017	2018	2019
Bahamas	10	10	10	9
Belize	91	91	86	83
Bermuda Islands	1	2	2	3
British Virgin Islands	127	122	107	101
Gibraltar	15	14	14	16
Guernsey (Great Britain)	10	9	10	10
Hongkong	41	39	50	50
Jersey (Great Britain)	14	15	12	14
Cayman Islands	7	8	7	6
Cyprus	1 066	1 106	1 099	1 056
Lichtenstein	82	84	84	83
Latvia	92	112	126	139
Luxemburg	402	414	412	428
Malta	92	102	109	117
Marshall Islands	21	24	39	41
Monaco	40	37	22	22
Netherlands Antilles	4	3	3	3
Netherlands	1 142	1 139	1 154	1 159
Man (Great Britain)	5	5	6	5
Panama	153	145	146	146
Republic of Seychelles	207	169	141	117
UAE	127	157	174	170
USA	1028	989	1 068	1 201
Total	4 777	4 796	4 881	4 979

Source: own processing

The tax gap is the difference between the potential VAT revenue and the tax actually paid. Potential VAT should be adjusted for the impact of the economic activity of entities not registered as VAT payers before calculating the tax gap. These entities contribute to the theoretical VAT base, but no VAT is levied on their value added. There is currently no way to estimate their impact. The potential VAT is therefore slightly overestimated. We assume that the rate of overvaluation is not negligible, as Slovakia has one of the highest turnover thresholds for mandatory VAT registration. In 2017, we registered 428,000 companies (legal and natural persons), which created added value in the amount of EUR 1,969 mil. However, this value does not represent an overestimation of potential VAT. Only unregistered entities selling goods and services to final consumers have an impact on potential VAT and VAT is not levied on their value added.

Table 3: The amount of the VAT gap

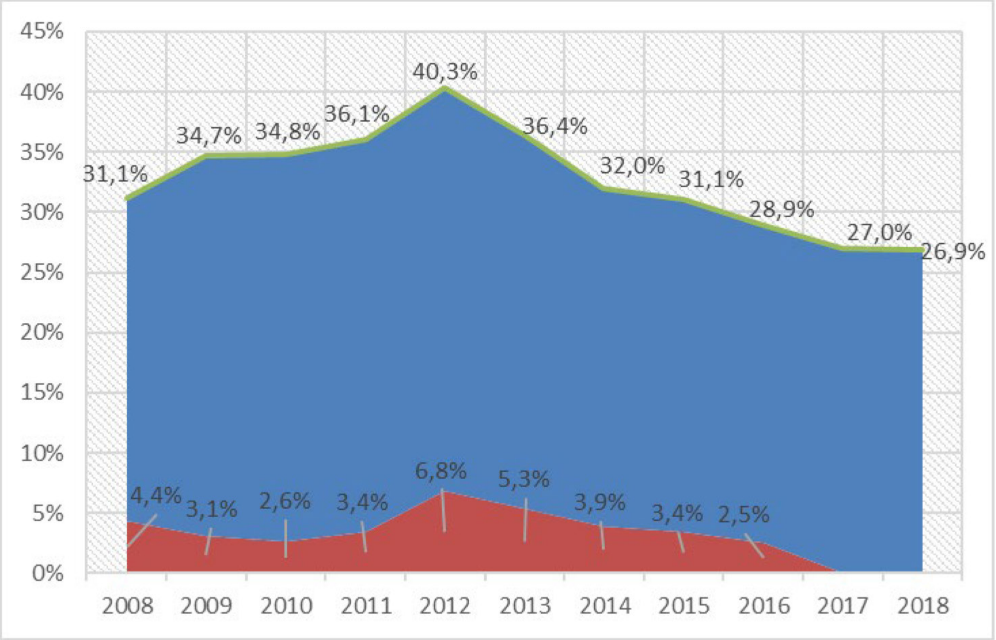
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018
VAT gap	34.8%	36.1%	40.3%	36.4%	32.0%	31.1%	28.9%	27.0%	26.9%

Source: own processing according to the Ministry of Finance of the Slovak Republic (2019)

The table shows that the highest tax gap in 2012 was 40.3%. The latest figure from 2018 suggests that this value gradually decreased to 26.9% of the potential tax in 2018. The estimated tax gap is then divided into unidentified VAT and a collection gap. The most significant part of the collection gap is the additionally assessed tax after tax audits. However, tax controls tend to be completed some time apart from the tax period, so it is not possible to correctly estimate the gap over the entire gap estimate. Therefore, the sampling gap value will not always be reported for the last two years of the current estimate, but this does not mean zero in these years. The previous Table No. 3 is followed by a graph showing the VAT collection gap in red and unidentified VAT in the middle of Graph.

In Graph no 2, we can see a sectoral tax gap, which is blue represented a potential tax, VAT returns in the top of the Graph and black listed VAT return. From the point of view of the tax gap, the most risky sectors were identified from the sector analysis: industry (C), wholesale and retail trade and repair of motor vehicles (G), construction (F), accommodation and food services (I), agriculture (A), professional services (M) and other services (S). The following graph shows the sectoral VAT gap in Slovakia in 2015. Sectoral VAT is an alternative approach to estimating the tax gap, which identifies the most risky sectors in terms of tax evasion. The graph shows the development of potential (middle part of the Graph) and declared (the top of the Graph) tax and VAT revenue (bottom of the Graph).

Graph 1: Dividing the tax gap into unidentified VAT and the tax collection gap



Source: own processing according to the Ministry of Finance of the Slovak Republic (2019)

Methodologically, the declared VAT is taken from the tax returns of entities. Tax entities were divided into sectors on the basis of the database of the Statistical Office of the Slovak Republic and the database of the FSSR. The VAT paid is based on transactions between the FSSR and taxpayers, as well as an estimate of the overall gap. Potential VAT is calculated separately for each sector as the difference between output tax and input tax, which can be recorded as follows: (Institute of financial Policy, 2019)

$$Potential\,VAT = \sum (M_{s,k} * t_k) * r_s + \left[\sum (Y_{s,k} - X_{s,k}) * t_k\right] * r_s - \left[\sum (N_{s,k} - I_{s,k}) * t_k\right] * r_s * (1 - e_s) * \mu_{k,s}$$

where:

$M_{s,k}$ imports by sector and commodity

t_k VAT rate on the selected commodity

r_s the share of output for the sector that is produced by VAT payers

$Y_{s,k}$ output by sector and commodity

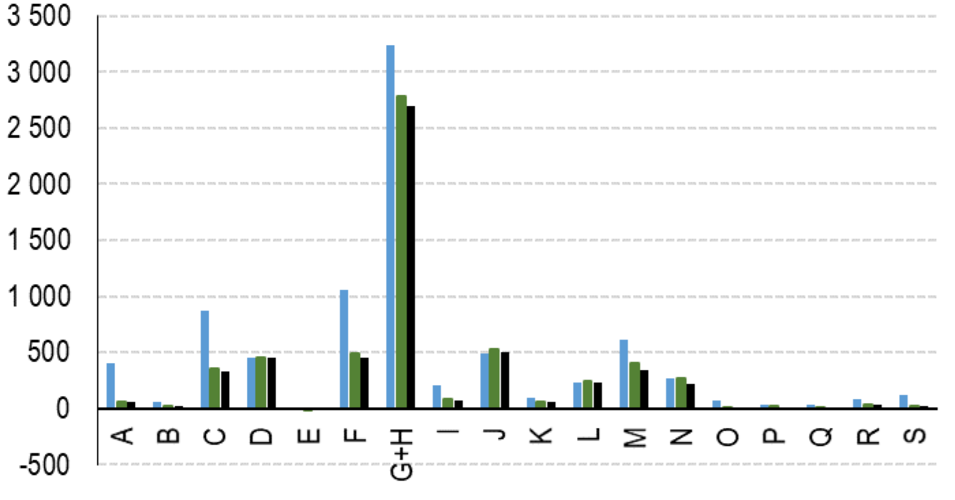
$N_{s,k}$ intermediate consumption by sector and commodity

$I_{s,k}$ investments by sector and commodity

e_s the share of the tax-exempt sector's output

$\mu_{k,s}$ the share of applicable input VAT for the commodity and sector

Graph 2: VAT sector gap in 2015 (EUR million)

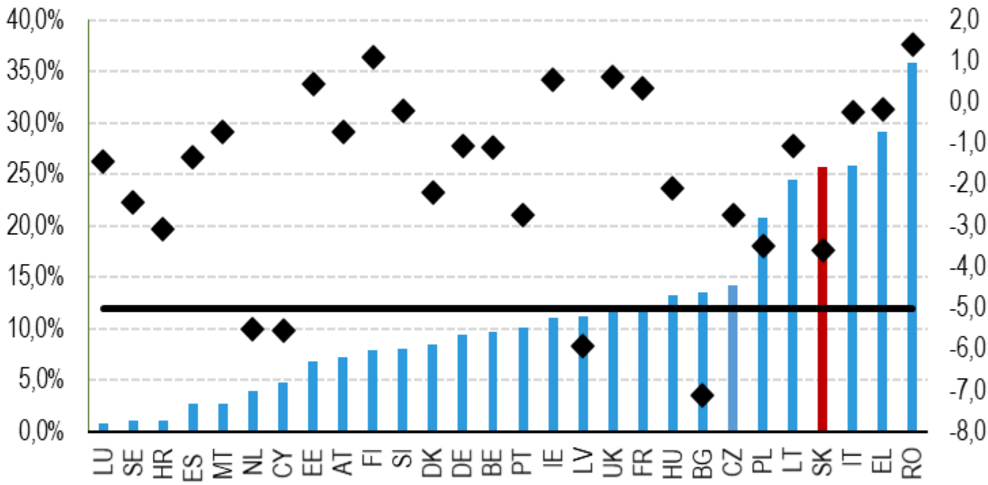


Source: own processing according to the Ministry of Finance of the Slovak Republic (2019)

Next graph No. 3 shows the VAT gap in EU countries in 2016. The blue gap is the VAT gap, the black line indicates the EU average. The graphical representation of the squares presents a year-on-year change in VAT gaps in individual countries.

The comparison with the EU average continues to show a crucial scope for continuing the successful fight against tax evasion to date. By way of illustration, we state that reducing the VAT gap to the average level in the EU in 2016 would mean additional revenues to the state treasury in the amount of 1.1 billion. EUR (1.3 % of GDP). The largest increase among EU member states is registered in Romania. Slovakia reduced the tax gap by 3.6% year-on-year.

Graph 3: VAT gap in EU countries in 2016



Source: own processing according to the Ministry of Finance of the Slovak Republic (2019)

5 Conclusion

Today's life on the planet has been hit by the phenomenon of globalization, accompanied by the boom of multinationals and the associated international business, leading to national and regional markets being implemented in the international and global markets. The development of cross-border trade between countries has also meant an increase in fraudulent behaviour by a number of large corporations, as well as politically and entrepreneurially strong individuals. In relation to the EU, a challenge has been created to counter this trend, which negatively affects the EU's single internal market and trade relations between EU Member States and third countries (Babčák et al. 2018).

Nowadays, it is common practice for taxpayers to try to pay the lowest possible taxes, so they try to reduce their tax base in a legal or illegal form. It is also common practice for taxpayers to transfer their tax base to countries with little or no taxation. In the EU internal market, where there is free movement of goods, services, people, capital, the move is all the easier. Not only in the conditions of the Slovak Republic, but also from transnational and international points of view, the tax evasion represents a serious economic and society-wide problem, which adversely affects the tax revenues of the state budget, and thus fulfilling the basic functions of the state (Mihoková et al., 2016).

It would be interesting to deal with the issue of taxes from the perspective of the Real Property Taxation in the Slovak Republic, which is related to the analyzed issues. (Vartašová and Červená, 2019).

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