

## Economic Damage to the State due to unpaid Taxes and Levies

Anna Harumová<sup>1</sup>

<sup>1</sup> University of Economics in Bratislava, Faculty of Business Management, Department of Business Finance, Dolnozemska cesta 1, 852 35 Bratislava Slovak Republic

anna.harumova@euba.sk

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**Abstract.** In my contribution, I focused on issues that are directly related to tax fraud, tax evasion and tax avoidance. The area can be described as an abuse of the tax system, which in its opinion is a real reflection of the behaviours of tax subjects in a specific tax practice. As a result of this procedure, the tax revenues of public budgets are reduced, as the collection of taxes decreases from year to year compared to the estimates of the tax administration in most EU Member States. Tax evasion due to fraudulent practices causes economic damage to individual states.

**Keywords:** economic damage, taxes, levies, multinational companies

**JEL classification:** H21, H24, H26

### 1 Introduction

Tax planning represents the optimization of tax and contribution obligations in accordance with the relevant tax regulations. Taxes in Slovakia are divided into direct and indirect. Income and property taxes in particular are direct. Indirect are those that are already included in the price of goods, such as excise duties or value added tax. In addition to taxes, the tax burden on entrepreneurs is also affected by the levy burden.

When we talk about tax optimization, we mean mainly income tax optimization. An important role in income tax taxation is played by the tax rate, which is currently 15%, 19% and 25% for natural persons according to the amount of the tax base, and 15% and 21% for legal entities (with exceptions in law). However, the final tax paid by the state is also affected by the creation of the tax base, the eligibility of tax expenditures, the possibility of claiming a tax loss, exemptions and tax relief, etc. The much higher tax burden than the direct tax rate is due to wage and income levies. The number of contributions affects not only the net salary of the employee, but also the price of the employer's work. The levies are paid from the salaries of employees in enterprises or are paid by natural persons engaged in business from their income. Employee

contributions in 2021 represent 13.40% of his gross salary and employer contributions represent 35.20%, so the total payment from wages is 48.60%.

Not only large multinational companies, which mainly use the differences in tax regulations of different countries, but also small Slovak companies can optimize taxes. Legislation provides entrepreneurs with a number of options for optimizing the amount of their tax liability within the limits of the law. A necessary condition for tax optimization is to know the possibilities that the law allows. We divide tax optimization into three basic types: legitimate tax optimization, aggressive tax optimization and tax fraud.

Legitimate tax optimization can also be understood as a set of tax tricks, how to pay the smallest possible amount of taxes from the entire tax basket, which the company is obliged to pay to the state according to tax laws. Although in recent years Slovak tax entities have made significant progress in using legitimate tax optimization, there is still potential for the use of reserves in this area. The positive effects of tax optimization are particularly effective in the long term. In addition to the direct impact on increasing the profit of tax subjects, tax planning also contributes to reducing the risks of the corporate economy in a market environment.

International tax planning through multinational holding structures is a long-term and detailed work consisting in the consideration, preparation and subsequent implementation of individual transactions of companies in the group. International tax optimization is widespread mainly through the structures of holding groups, which often represent the best conditions for this activity. Holding groups also take advantage of tax havens to some extent to reduce their tax liability. The basic starting point of tax planning is to set the holding company's tax goals. Subsequently, the economic holding, general tax assessment, subsequent optimal tax setting and elimination of individual risks are defined in individual holding structures and their transactions.

International tax optimization is usually carried out through the use of double taxation treaties. The savings are achieved by more favorable taxation under the Treaty in one country and non-taxation in another. Typical tools and methods of optimization include: foreign trade, holding structures, licenses, intellectual property, loans, financing, consulting services, trusts, foundations, partnerships, etc. (Petrovič, P. et al., 2002).

Aggressive tax optimization is most often the procedure of a taxpayer who did not technically violate any provision of the law, but by his actions reached a state that is contrary to a principle of justice, abused the law, and thus the tax advantage achieved by this action is illegitimate. Aggressive tax optimization lies between legitimate tax optimization and tax fraud. Perhaps the simplest example of aggressive tax optimization is selling something at a non-market price to gain a tax advantage.

Tax evasion due to fraudulent practices causes economic damage to individual states. In essence, damage represents the value expressed in the money of the damaged property, health or rights of specific entities, which may be natural or legal persons having a certain relationship to the object of damage. Very often there is damage in business to natural and legal persons, ordinary citizens, but also the state. Damage to the state can occur in various ways, and these certainly include damage to the state on unpaid taxes and levies. Small businesses, small, medium and large companies, as well

as multinational companies, can take part in this damage. Multinational companies can use different systems to avoid paying taxes in countries with huge incomes. As a result, public services are either underfunded or must be funded by other low-income taxpayers. At the same time, it contributes to increasing inequality around the world.

## **2 Methodology**

This paper examines the economic damage incurred by the state in unpaid taxes and levies in Slovakia and in the countries of the European Union. To obtain the necessary information and data, a survey method was used through statistical data obtained from Crime Statistics in the Slovak Republic, Ministry of the Interior of the Slovak Republic. The resulting data show, based on a comparison of the development of aggregate numbers of economic crime in Slovakia, that the number of crimes gradually decreased in the years 2008-2019. A positive trend is also the development of clarification in the crime of money laundering.

## **3. Current state, essence and development in the field of payment of taxes and levies in Slovakia and in the world**

Tax fraud distorts the business environment and is also a threat to public finances. Tax fraud is part of economic crime. Tax fraud is most often committed on value added tax, income tax and excise duties. Due to the negative consequences of tax fraud, countries are trying to combat it. It is also the case in the Slovak Republic, where tax fraud arises in the business of Slovak entities, but also international companies.

The fight against tax fraud, whether it takes the form of tax fraud, tax evasion or tax avoidance, has become

a real global challenge not only for the EU and its Member States, but in a way for the whole world. In essence, these are various forms and ways of abusing tax systems both within the EU and abroad.

From the point of view of EU law, the area of combating the abuse of the tax system is undoubtedly a very topical issue and at the same time a very complex and sensitive topic. This applies not only to indirect taxes, in particular VAT, but also to direct taxation. In the implementation of tax fraud on VAT, there is ultimately a tax evasion on this tax and thus a loss of state budget revenues. However, this leakage does not necessarily have to be the result of the implementation of tax fraud by the taxable person within the applicable system of VAT application, ie which is the object of interest of criminal legislation.

In today's globalized economy, the biggest problem of states is multinational companies and their sophisticated structures of international tax planning, which intervene in several tax jurisdictions. The purpose of these structures is to circumvent the legislation of the State concerned and to obtain a tax advantage in the form of non-payment of tax or reduction of the tax base. Although this circumvention of the legislation will not violate the legislation, it will achieve a tax advantage that is contrary

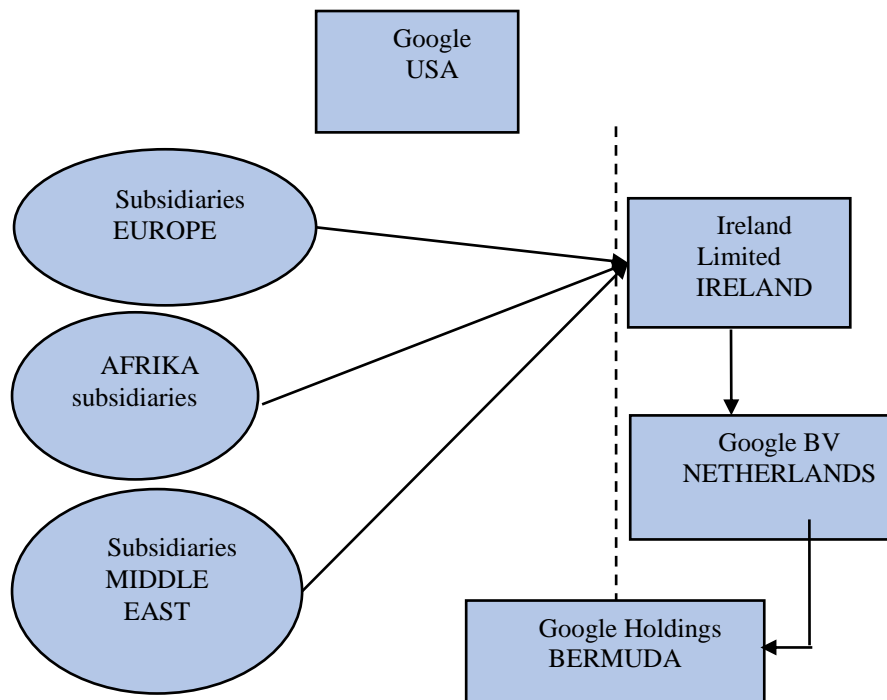
to the principles of taxation and at the same time contrary to the intentions and objectives of the tax legislation.

The best-known tax structure currently used by many multinational companies in various variants is called "Double Irish Dutch Sandwich".

The basic scheme of this tax structure consists of two subsidiaries incorporated under Irish law. The first is a tax resident in a tax haven (since, under Irish tax law, only a legal entity which has its place of effective management in Ireland is a tax resident), and the second is a Dutch subsidiary. The tax haven company owns the intellectual property rights from the parent company, which licenses the other Irish company, which is tax resident in Ireland. This company generates revenue from the sale of internet advertising or technology products from the region, but its tax base is low as it pays royalties, payments for services, etc., which are tax deductible expenses under Irish law, to companies from a tax haven. The Dutch subsidiary is used to avoid paying Irish withholding tax on these payments. As a withholding tax is not applied to most payments under the double taxation agreement between the Netherlands and Ireland, the Irish company pays selected payments for the Dutch company's royalties. It in turn pays the license fees of an Irish company established in a tax haven, but since the tax can no longer be taxed, this income goes directly to accounts in a tax haven, where no income tax is levied. As a result of this tax structure, for example, Apple paid about \$ 130 million in tax on its foreign income in 2010, which was \$ 13 billion that year (Böll - Dettmer - Dohmen - Pauly - Reiermann, 2021).

Google also accounted for only 3.2 percent of tax profits in countries outside the United States in 2011. At the same time, revenues in European countries, in which the corporate income tax ranges from 26 to 34 percent, contributed the most to this profit. For example, the UK market accounted for 11 percent of Google's total revenue from outside the United States. In the UK, Google had revenue of \$ 4.2 billion, but paid only \$ 9.6 million in income tax, although corporate income tax is set at 26 percent in the UK. At the same time, Google has an operating margin of 28 percent globally and it can be assumed that it has a similarly high margin in the United Kingdom.

Illegal tax evasion, in general, consists of illegal agreements where the actual amount of tax liability is hidden or ignored by the taxpayer, that is, the taxpayer pays a lower tax than is liable, by hiding income or information from tax administrations. In addition to these concepts, it is possible to look at tax evasion as "tax fraud", which is an intentional illegal tax evasion, which can be sanctioned by criminal law (Huba - Sábo - Štrkolec, 2016).

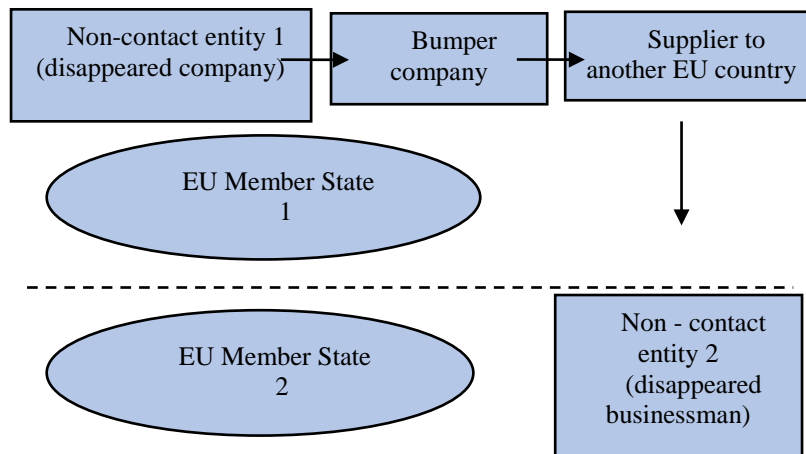


**Figure 1** Double Irish Dutch Sandwich. Google Tax Monitoring  
Source: Own processing

The double Irish sandwich, which makes Google avoid taxing work that way, will establish the Irish company Google Holdings in Bermuda, which provides services and marketing. The management is based in Bermuda, so for the purposes of Irish tax law it is a Bermuda company. It will also create an Irish subsidiary, Ireland Limited, which has the rights to license know-how for all Google subsidiaries in Europe, Africa and the Middle East. Payments go to her to use the intellectual property license. However, Ireland Limited does not send royalties to Bermuda as it would have to pay withholding tax in Ireland but will move them to an EU country that will treat the Bermuda payment differently. Therefore, the payments go to the Dutch company Google BV. These payments are tax-free because both countries are part of the European Union. The Dutch Google BV then moves them to Google Holdings in Bermuda, again without withholding tax (for Dutch taxpayers, it is an Irish company and not a Bermuda company). Income tax in Bermuda is zero. While U.S. tax law requires taxation on the payment of remittances abroad within a group, for U.S. law purposes, Irish and Dutch companies will not be corporations but only Google divisions, so no withholding tax is required. As a result, for tax purposes in the USA Ireland Limited and Google BV do not exist, but for Europe they do. For Ireland, Google Holdings is a Bermuda company,

but for the United States, it is Irish. Ultimately, Google (USA) effectively 2 to 8% tax on foreign profits. Other tax obligations did not seem to exist.

According to the OECD, the most common way is to reduce the tax base ("tax base erosion") and transfer profits ("profit shifting") of taxpayers. These are complex legal structures and acts aimed at transferring profits from the state where they were generated to a state with a low or zero tax rate. In particular, taxpayers take advantage of situations not covered by law which arise as a result of the interaction of tax legislation of two or more states.



**Figure 2** VAT fraud with a missing trader  
Source: Own processing

The biggest tax evasions in the field of value added tax (VAT) are carousel fraud (carousel fraud, circular fraud, Missing Trader Frauds). Organized groups usually use cross-border trade in the European Union, where The term "missing trader" refers to the fact that the trader disappears and with it the VAT he was supposed to pay to the state disappears, which is why missing traders are also referred to as white horses. a complex type of fraud where goods are traded in a chain, where no tax is declared or paid at one point in the VAT chain and the relevant economic operator ceases to exist or the company cannot be traced.

### 3 Results and Discussion

- International tax evasion is a series of steps by taxpayers to achieve their goal of exploiting differences in the effective tax burden across countries, as well as other benefits from cross-border income tax regimes, to reduce their tax burden and the overall tax burden on all connected persons. (Huba- Sábo - Štrkolec, 2016). In the professional literature of American origin, the term tax shelter is

used to describe these steps. Taxpayers who take such steps are building a "shelter" under which they can "hide" from tax liability. According to Graetz, a tax shelter is "an agreement made by very wise people that would be very stupid without tax implications" (McMahon, 2003). An analogy of illegal tax evasion in the case of shelter before tax is the so-called abusive tax shelter. This concept is a well-established concept in the Anglo-American environment, being "primarily based on the common law doctrine of the economic substance of the transaction" (Department of the Treasury, 1997). In terms of the substantive proximity of these terms, the term tax shelter and illegal tax evasion will be used promiscuously for the purposes of this monograph. The defining features of illegal tax evasion in the US legal environment were characterized by Bankman (2004) and the fact that it is a tax-motivated transaction, unrelated to the taxpayer's normal business activities, in a formalistic interpretation of the law creating a tax loss in excess purpose of the law. At present, business entities have many options for optimizing their tax obligations. The following methods are most commonly used (Korb, 2005):

- income shifting, which is the arrangement of transactions so as to distribute taxable income, tax expenditure and tax credit among taxpayers so that they have the lowest possible tax liability,
- exemption, which is a reduction in the tax liability through an exemption for certain categories of taxable income,
- deferral, which is the deferral of tax liability by shifting income to future tax periods, for example in the form of an investment against tax expenditure that will not be repaid in the future,
- conversion, which is the conversion of taxable income into income which is in some way tax-advantaged,
- Leverage, which is the financing of business activities through borrowed funds, which allows for an increase in tax expenditure.

At the same time, it should be further noted that debt in combination with exemption, conversion or deferral is referred to as tax arbitrage, which results in a tax loss (or tax expense) more than the actual economic loss.

According to the OECD, the most common way is to reduce the tax base ("tax base erosion") and transfer profits ("profit shifting") of taxpayers. These are complex legal structures and acts aimed at transferring profits from the state where they were generated to a state with a low or zero tax rate. Taxpayers take advantage of situations not covered by law which arise as a result of the interaction of tax legislation of two or more states.

**Table 1 Groups of economic crimes in the Slovak Republic 2008-2019**

Crimes	Number of detected	Count clarified	Damage in thous. EUR	Average damage in thous.EUR	Degree of clarity
					in %
Crimes	1266	203	131346	104	16
money laundering	53155	33151	1635796	31	62
Tax offenses	57260	30393	1590934	28	53
Frauds	3015	552	274408	91	18
Bankruptcy crimes	2184	604	1434991	657	28
Selected economic crimes	<b>116880</b>	<b>64903</b>	<b>5067476</b>	<b>43</b>	<b>56</b>

Source: Own processing

According to individual groups of economic crimes, in the years 2008 to 2019 there were the most tax crimes that caused damage to the state, up to 1,635,796 thousand. EUR. The number of detected tax crimes was 53,155, of which only 33,151 were solved. The rate of clarification of these crimes was 62%. The second group of crimes that caused the most damage was tax fraud. These caused damage to the state in the amount of 1,590,934 thousand EUR. . The clarity of these crimes was 53%. This was followed by selected economic crimes (damage of EUR 1,434,991 thousand), bankruptcy crimes (damage of EUR 274,408 thousand) and criminal offenses of money laundering (damage of EUR 131,346 thousand), depending on the amount of damage caused.

**Table 2 Overview of economic crimes in the Slovak Republic 2008-2019 (in thousands of EUR)**

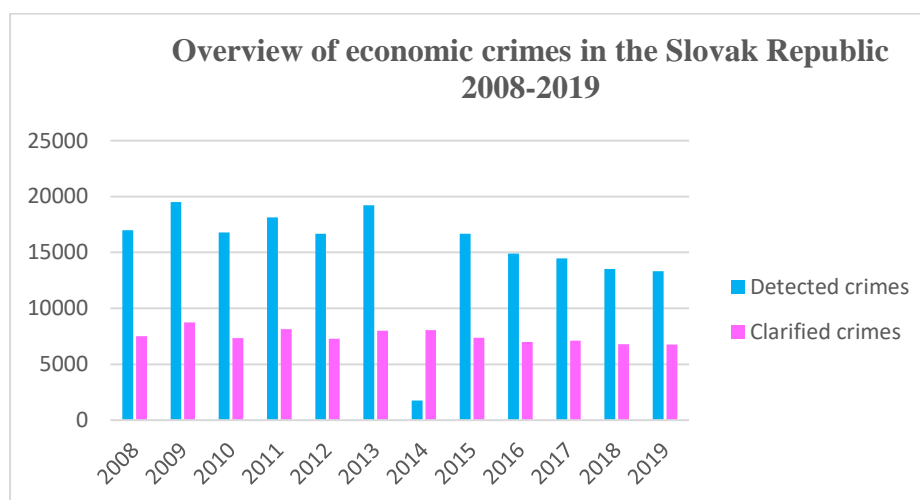
Year	Detected crimes	Clarified crimes	Clarity in%
<b>2008</b>	16974	7513	<b>44</b>
<b>2009</b>	19518	8739	<b>45</b>
<b>2010</b>	16781	7338	<b>44</b>
<b>2011</b>	18145	8137	<b>45</b>
<b>2012</b>	16681	7272	<b>44</b>
<b>2013</b>	19218	7995	<b>42</b>
<b>2014</b>	1745	8060	<b>46</b>
<b>2015</b>	16661	7375	<b>47</b>
<b>2016</b>	14895	6994	<b>47</b>
<b>2017</b>	14460	7108	<b>49</b>
<b>2018</b>	13515	6784	<b>50</b>



<b>2019</b>	13326	6757	<b>51</b>
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Source: Own processing

In the years 2008 to 2019, according to Table 2, the clarity of economic crimes ranged from approximately 40 to 50%. This means that the damages enumerated in Table 1 are at least 2 times as high as indicated. This fact is also illustrated by Graph 1, which provides an overview of detected and clarified economic crimes in the Slovak Republic in the years 2008 to 2019.



**Figure 1 Overview of economic crimes in the Slovak Republic 2008-2019**

Source: Own processing

Table 3 lists the most common types of economic crimes and the damage caused by individual tax subjects of the state.

**Table 3 Overview of the most significant economic crimes by average damage (in thousands of EUR).**

	Crime	Total damage in thous. EUR	Total number of detected	Average damage
1	Distortion. hosp. and business records	1 150 347,00	1 242	926,00
2	Machinations at ver. competitions, auctions	11 745,00	222	503,00
3	Breach of duty in the administration of foreign property	273 751,00	893	307,00
4	Fraudulent and guilty bankruptcy	22 756,00	93	245,00

5	Misuse of information in business. contact	10 863,00	45	241,00
6	Smuggling (§ 254)	9 807,00	69	142,00
7	Abuse of power by a public official	37 065,00	279	133,00
8	Damage to the EC 's financial interests	61 101,00	557	110,00
9	Legalization of proceeds of crime	131 346,00	1 266	104,00
10	Damage to the creditor	251 653,00	2 922	86,00
11	Theft of road shipments	1 284,00	15	86,00
12	Threat to hosp. secrets	4 080,00	52	78,00
13	Fraud (§ 221)	1 425 552,00	36 381	39,00
14	Violation of plant and animal protection	79 830,00	2 305	35,00
15	reduction of taxes, fees (§§ 276-279)	1 635 796,00	53 155	31,00

Source: Own processing

A comparison of the development of aggregate numbers of economic crime in Slovakia shows that the number of crimes gradually decreased. In 2014, 17,450 cases of economic crime were detected in the Slovak Republic, in 2019 it was only 13,326 cases (by 24% less, is by 4,124 cases). However, the current trends in the rate of clarification of economic crime are the opposite. The rate of clarification increased by 4.5 percentage points (from 46.2% to 50.7%). This positive development for Slovakia, however, is significantly influenced by the high level of clarification and frequency of tax crime (tax crimes accounted for up to 43% of the total number of detected economic crimes in 2019. It follows from the above that statistics contain a high number of tax crimes. Statistics on other monitored economic crimes show a low level of crime detection in Slovakia, with the level of detection falling to 40% for fraud crimes and up to 16% for bankruptcy crimes in recent years. obligations in the management of foreign assets) to 23%.

One of the few positive trends is the development of clarification in the crime of money laundering. Although it is one of the least numerous among those surveyed, its level of clarity has risen sharply in the last three years in the Slovak Republic (from 14% in 2017 to 33% in 2019). The average amount of damage in 2019 in Slovakia is also unusual, reaching up to 701 thousand. EUR.

Tax fraud distorts the business environment and is also a threat to public finances. Tax fraud is part of economic crime. Tax fraud is most often committed on value added tax, income tax and excise duties. Due to the negative consequences of tax fraud, countries are trying to combat it.

## 4 Conclusion

The international tax optimization of multinational companies has recently become the subject of intense international debate. There are currently several initiatives in the world that have a significant impact on international tax optimization. The most important initiative is BEPS (Base Erosion and Profit Shifting), which directly fights against multinational companies reducing their income tax base by exploiting loopholes in local tax legislation. This initiative is aimed primarily at multinational giants such as Google, Starbucks, Amazon and others, but ultimately the impact of BEPS will affect all international transactions. The BEPS initiative is mainly about changing the role of the tax administration. Its task will be to obtain a significantly larger volume of data from companies, which it will then compare and look for ambiguities. By analysing this data, the tax administration eliminates the need to actively look for suspicious companies that it should control. An example of such data acquisition is transfer pricing documentation and related reporting of business transactions between related parties. Multinational corporations as well as ordinary companies (even natural persons in Slovakia) must prove the correctness of transfer prices in more detailed assessments and declare transactions with related parties in tax returns. BEPS also places more emphasis on the so-called substance, is that the company is actually managed from the place where it is based. Significant tightening will also affect the procedures for assessing tax deductibility and the justified amount of costs associated with the use of licenses and trademarks. The assessed values of licenses will be tightened, which will have to be substantiated by expert opinions. Other steps that will change tax planning are the effort to tax income in the countries of their origin and the long-term revision of double taxation treaties. All BEPS-related activities mean that tax optimization will need to have significantly stronger foundations and greater emphasis will be placed on ensuring that tax planning is not the main goal of multinational corporate structures. However, well-established holding structures that meet the owners' primary non-tax objectives will be affected by higher administrative costs for BEPS.

Currently, the most frequently discussed economic topic is the reduction of budget deficits, which are the result of a pandemic recession. Central banks are being called upon to support the economy with cheap credit, as well as national governments, so as not to stop stimulating the domestic economy, which, of course, is already increasing their huge indebtedness. However, coalition governments then have no choice but to increase budget revenues only by increasing taxes and levies, which always causes social tensions in the country. In general, those who have income from anything should pay tax where they have "earned" income, which has not been the case, especially with digital companies. Until now, digital companies have shifted profits outside the countries where they were generated, where taxes were lowest, if at all. However, the problem is not only the payment of taxes, but also on what basis, as their business is an online way, without the possibility of a legal way of calculating it. The solution could be a lower tax rate on revenues, which would be paid to the state budget in the state where the digital company generated revenues. The European Commission has not yet been able to agree with the US administration on the conditions for the introduction of the digital tax, also because it is said to have "threatened" the introduction of renewed

customs protection measures for the export of European products to the American continent. However, the pandemic has accelerated the European Commission's efforts to seek financial resources to cover the aforementioned deficits in the Member States of the Union, including the introduction of a Europe-wide digital tax, which has not yet been the case.

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