TAX CONTROL AS A MECHANISM FOR PREVENTION OF FISCAL EVASION IN KOSOVO

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Abstract
Kosovo tax system is a tax system built upon basis of objectives to be a modern one and in line with the tax system and fiscal policies of the European Union countries. One of the main mechanisms that the Tax Administration of Kosovo (TAK) applies to prevent tax evasion, is "tax control". Tax Control includes a set of actions undertaken by the TAK management in verifying whether or not the legal procedures are being applied and violations are timely detected.
This paper handles the entire tax control process as a very important area and the main mechanism which aims at detecting and preventing tax evasion. The main purpose of the paper is to bring up to the surface all the difficulties faced by tax officers in the course of tax control at taxpayers, and draw conclusions or findings supported by a list of recommendations in order to change the current situation so that these difficulties are mitigated and eliminated during the tax control process at the taxpayer, which will also reflect in reducing the rate of tax evasion as a very disturbing phenomenon in our country.
Key terms: Tax control, Tax Administration of Kosovo, tax evasion, the taxpayers.

1. Introduction

Building up tax policies and their implementation by filling the state budget of Kosovo have a significant economic role for retaining and development of a series of sectors within Kosovo society. Policies and tax system of any country except providing revenues play a very important role in economic development, education, culture, employment, etc.
Kosovo tax system is a tax system built upon basis of objectives to be a modern and in line with the tax system and fiscal policies of the European Union countries. This tax system is built upon the basis of self-assessment and self-declaration and payment of taxpayers' liabilities.
Due to a long history of isolation and economic difficulties, the people of Kosovo, in terms of the taxpayer, is not aware and shows no willingness to be accurate and honest when performing this assessment, in which case many tax violations are made having the effect of avoiding correct payment of taxes. The main mechanism that TAK applies to prevent tax evasion is "tax control". Tax Control includes a set of actions undertaken by the TAK management to verify whether or not the procedures are being applied and legal violations are timely detected.A large part of the taxpayers during the self-assessment do not show willingness to be accurate and honest when performing this assessment, where many tax violations are made having the effect of avoiding the correct payment of taxes.
Therefore, the Tax Administration of Kosovo established corrective mechanism which comes into play every time the latter notices that certain taxpayers violate and make false statements/estimates on tax liabilities. This mechanism through which Tax Administration performs reassessment of taxpayers statements (previously assessed on voluntary basis), in the field of taxation is known as the **"Tax Reassessment through control process", "tax reassessment"** or **"tax control".**
Therefore, selecting a best appropriate method presents a difficulty of its own, and the right selection of this method would provide accurate results on the taxpayer's tax liability subject to tax control.

2. The tax system in post-war Kosovo

During the last war in Kosovo in 1999 our country suffered in all dimensions, starting from destructions having human and material consequences up to the overall destruction of the infrastructure which would enable rapid re-functioning of systems and the state's administrative, social, educational, political, economic mechanisms, etc.
In these post war circumstances, UNMIK which as a mission had an authority for interim administration in Kosovo, was originally focused on meeting the urgent needs for financing and activating public administration, rehabilitation of infrastructure and public services[1].
Meeting these needs were conditioned with provision of financial sources, for collection of which, appropriate mechanisms had to be set up, therefore pursuant to Regulation 1999/16 interim administration of United Nations mission in Kosovo (UNMIK) under its mandate, issued a decision to establish the Central Fiscal Authority (CFA) on 06 November 1999.
Central Fiscal Authority (CFA) was in charge for the overall financial management of the Kosovo budget and the budgets falling under the responsibility of the municipalities, which together formed the Kosovo Consolidated Budget[2]. Functions and duties of the Fiscal Authority were established in line with Article 2 of this Regulation aimed at establishing and development of fiscal policy in Kosovo.
Defining and formulating a consistent long-term fiscal policy in Kosovo was characterised with many obstacles, and the most interesting are the following[3]:

- specific political status of Kosovo at that stage;
- Difficult post-war economic situation;
- Lack of statistical system, statistical institutions and macroeconomic indicators related to formulation of fiscal policy;
- Failure to consolidate local tax administration.

[1] Sabahudin KOMONI-Prishtina 2008- page 131
[2] UNMIK Regulation no. 1999/16 on CFA Establishment on 06 November 1999- Article 1
[3] www.scribd.com – fiscal policies

However, in late 2001 after the parliamentary election process in Kosovo was finalised, the Ministry of Economy and Finance was established and the latter got some of the functions previously carried out by CFA, mainly those related to budget execution.

3. Establishment of Tax Administration of Kosovo

Starting from the first legislative forms, since 01.02.2000 in Kosovo under United Nations Resolution 1244 for monitoring of Kosovo's territory, a small number of employees started the first local institution in cooperation and overall monitoring of the international personnel[4].

Date of establishment public tax administration for national and international staff was 24 January 2000. When the interim government was established, following free and democratic elections, especially after the independence of the Republic of Kosovo, local legal infrastructure on the functioning of the Kosovo Tax Administration was in place, or known earlier as the Central Fiscal Authority (CFA).

The responsibility of the Tax Administration, the Executive Agency with full autonomy, is to administer the applicability of each type of tax applied by tax legislation in the Republic of Kosovo.

Therefore, TAK mission is to develop the highest level of voluntary compliance in accordance with the laws and regulations in force as well as the provision of professional services, transparent and effective for the taxpayer.

Tax administration has an obligation and duty foreseen by law to secure uniform application of legal provisions for all taxpayers in the same way and situation and in order to carry out its job is efficiently spread around in regions throughout territory of our country.

4. Taxes imposed in Kosovo

Taxes imposed in Kosovo since 01.01.2005 administered by the Tax Administration, are[5]:

- **Corporate Income Tax,**
- **Personal income tax,**
- **Value added tax (consumption tax)**

Corporate income tax - since 01.01.2005, Kosovo started to apply corporate income tax, according to the Regulation no. 2004/51. Corporate income tax replaces the income tax, according to the regulation no. 2002/3, which (income tax) had been applied in Kosovo since 01.04.2002.

Legal entities as well as individual businesses were registered for income tax. When the corporate income tax entered into force, a condition for registration was to establish the legal status and applied on:

- the corporation business organizations (non-individual legal entities)
- non-permanent residents units,
- socially owned enterprises,
- non-governmental organizations (NGOs)

After the amendments were made in tax legislation 2009-2010, in this case we have a reduction concerning the corporate income tax from 20% to 10%, which amendment entered into force on 1st of January 2009.

Table 1. Corporate Income Tax

	Before 2009	Before 2009
Tax level	20%	10%

Source: Central Office of Tax Administration of Kosovo

Personal income tax – is applied to all individuals, including partnerships, non-corporative partnerships, which will be taxed on their share of revenues from the partnership[6].

According to the regulation on the PIT no. 2004/52, taxpayers' are natural persons, resident and non-resident in Kosovo, who receive or generate gross revenues.

The subject to taxation for a resident taxpayer is when revenues are generated in Kosovo and the source of revenues is from abroad. The subject to taxation for non-resident taxpayer is taxable revenue having its source in Kosovo.

The Assembly of Kosovo adopted the Law on Personal Income Tax, which entered into force on 01 January 2009.

Table 2. Personal Income Tax

Tax rate	before 2009	Before 2009
0 – 80	0%	0%
80 – 250	5%	4%
250 – 450	10%	8%
Over 450	20%	10%

Personal Income Tax

Annual tax rate	Before 2009	Before 2009
0 – 960	0%	0%
960 – 3000	5%	4%
3000 – 5400	10%	8%
Over 5400	20%	10%

Source: Central Office of Tax Administration of Kosovo

Value added tax – VAT

The Assembly of Kosovo adopted the Law on Value Added Tax.

Under the law on VAT, the rate was increased from 15% to 16%. The new rate entered into force from 1 January 2009 and this change affected every VAT registered business which makes sales and purchases of goods and services or imports goods other than those exempted. VAT when importing goods and VAT on purchases of goods and services will be higher as a result of this, including deductive VAT[7].

Increase of VAT rate has multiple effects which could harm the people of Kosovo both on customer and manufacturer level.

It is believed that the first effect of VAT is to increase prices as a result of increased costs for business. Businesses

[4] MEF-TAK – Handbook on Taxes in Kosovo – first edition, Prishtina 2007

[5] www.telegrafi.com Taxes applied in Kosovo, 2010

[6] http://www.telegrafi.com/

[7] www.atk-ks.org

facing the need to pay taxes increase their prices reassigning the tax to consumers.
Certainly, the immediate effect of VAT is to reduce revenues for businesses. Lower revenues mean leaving marginal producers out of the market by reducing the amount of product in the market. Low revenues discourage the development of new businesses. As a result, the supply for products is reduced and this explains increasing of prices on long-term basis. This law entered into force since 01.01.2009

Table 3. VAT

	Before 2009	Before 2009
Tax rate	15%	16%

Source: Central Office of Tax Administration of Kosovo
VAT in the world today is considered a very significant tax, and it plays an important role in tax structure and occupies a very important position in collection of tax revenues. Besides this, VAT exerts its influence on fiscal policy and reduction of tax evasion.
This type of tax has major effects in the overall economic policy given that by applying rates it stimulates businesses and local producers, and export abroad, as you know, the tax legislation in force for exports of goods abroad foreseen that VAT rate on exports to be zero.

5. Tax evasion

Tax evasion or avoiding payments of tax burdens is a phenomenon that occurs when taxpayers try to find methods, tools and different forms while exercising their businesses to completely or partially avoid payment of certain tax liabilities. The phenomenon of avoiding tax evasion is evident in almost all countries of the world including countries with high economic standard and highly developed tax system.
Avoidance from paying taxes and the level of deviation from this payment depends on various factors such as[8]:

1. Level and educational structure of the population,
2. Tax Discipline of the taxpayer,
3. Professional skills of the tax authorities and staff,
4. Efficiency when it comes to tax collection,
5. Sanctions and prosecution against undisciplined taxpayers, etc.

Tax Administration of Kosovo while beefing-up and developing is trying to reduce the level of tax evasion by applying forms, strategies and different mechanisms. Finally, Tax Administration drafted a strategic plan which above all, foresees ways how to affect the reduction of tax evasion rate starting with the first step which relates to the increased volume of information available to the Tax Administration, following the extension and expanding the tax base covering all taxpayers, creating channels for education, counselling and information for taxpayers, organising systematic training for staff etc. A particular step taken in this direction is the establishment of Tax Investigation Unit which functions under the umbrella of the Directorate General for fulfilment, responsible for investigating tax fraud and works with Prosecutors in order to bring tax fraud cases before the court[9].
In theory, tax evasion can be classified in two ways:

1. Legal fiscal evasion
2. Illegal fiscal evasion.

Legal fiscal evasion presents a phenomenon when the taxpayer is not in contradiction with the applicable legal rules and at the same time makes tax evasion[10].
Illegal fiscal evasion presents a phenomenon when a taxpayer is in contradiction with legal rules when performing the act of avoidance. This evasion is not allowed and brings up certain legal sanctions.
Illegal fiscal evasion appears in two forms[11]:
A. Complete hiding of taxes; and
B. Partial hiding of taxes.
Complete hiding of taxes appears when the taxpayers' hides all revenues from certain business activities subject to taxation, following trace cover up, failure to present certain assets and in this case damaging the state budget. One of the current format of complete hiding of tax faced by the Tax Authorities including the Customs is smuggling which has and continues to evolve since the act of Declaration of Independence on 17 February 2008 onwards, when the Customs and Tax Authorities were completely cut off or have very limited access to this part of the territory of our country, where goods circulate and enter into the country through illegal channels creating non-equilibrated market circumstances and unfair competition is caused with consequences also in other parts of the country, besides this, including complete hiding of taxes.
Partial hiding of the tax is an illegal form of tax evasion that occurs when taxpayer partially presents (declares) tax revenues before the Tax Authorities, or presents incomplete facts and records, incorrect or misleading concerning the amount of revenues for the specified period.

6. Understanding Tax Control

Tax Control is a group of actions or activities undertaken by the TAK management to verify whether or not the applicable legal procedures are being applied and deviations from recognised standards are timely detected including violations of legality principles[12].
Upon taking this action, the Tax Authorities are obliged to comply with tax rules in accordance with TAK applicable procedures, which rules define the validity time, the opportunity to access to official records, the obligation to official secrecy and act only upon facts.
Competent tax authorities, in all kinds of tax controls, should have in mind the following principles:

- Integrity (honesty, justice, purity and reliability in workflow)
- independence and objectivity, for the entity subject to control,
- Competence and due care, the opinion should be based solely on the facts.

[8] Dr. Sebahudin KOMONI, Public Finances – Prishtina, page 108
[9] MEF-TAK – Strategic Plan 2010-2015, Prishtina 2010, page 10
[10] The same part, page 41
[11] The same part, page 108
[12] www.atk-ks.org. Kosovo Tax Handbook, page 107

- Professional Conduct, fully in compliance with the legal framework; and
- Confidentiality.

7. Tax Control Process

Upon control, the Tax Authorities (TAK), in all kinds of controls, should have in mind:

- Information on compliance with tax rules,
- Preparation of the inspector managing the tax control,
- Economy and nationality of action,
- Professional Ethics.

A tool for deciding which procedures should be performed in formulating control programme is Risk analysis. In carrying out Risk analysis, Tax Authorities assess control risk. Risk analysis includes: identification, estimation and risk assessment that a tax declaration contains errors of material importance.

TAK is using the most advanced information technology to speed up processes, eliminate errors, make it easier for taxpayers to declare and these technology resources reduce the role of the human factor, exercising controls and actions based on risk, which automatically selects cases for control[13].

This initiative is improving communications and relations between business representatives and TAK institution, allowing businesses to express their concerns when it comes to paying tax liabilities through proper communication, TAK created a tax system that protects them.

Tax control process goes through the following phases:

- Planning of the tax control,
- Execution of the tax control,
- Forming a judgement,
- Reporting; and
- Creating the file.

8. Results of control and fulfilling activities

Additional tax as a result of the 900 tax controls and assessments made from the office is €27 million, which according to tax type greater participator is: VAT with €12.2 million (46.4%); Corporate Tax and Profit Tax (CT-PT) €8.4 million (31.7%); tax for Large Individual Businesses €3.3 million (12.8%); Pension Contributions €1.0 million (4.0%); Rent Tax €0.57 million (2.2%); Small Individual Business Tax €0.35 mil (1.3%); €0.27 mil wage tax (1%); Interest Tax, lottery games, €0.12 mil (0.5%) and Presumptive Tax €0.04 million (0.2%)[14].

[13] www.ekonomia-ks.com

[14] www.atk-ks.org- Annual work Report

Table 4 Comparison of additional tax as a result of control in 2010/2011

TYPES OF TAXES	ADDITIONAL TAX 2010	STRUCTURES 2010 %	ADDITIONAL TAX 2011	STRUCTURE 2011 %	INDEX 2011/2010
0	1	2=1/∑	3	4=3/∑	5=3/1
VAT	17,648,564	32.3%	12,294,397	46.4%	69.7%
PT-TAK	21,693,183	39.7%	8,402,932	31.7%	38.7%
LIB	8,928,285	16.3%	3,385,531	12.8%	37.9%
Pension Contr	2,026,892	3.7%	1,069,918	4.0%	52.8%
Rent	773,144	1.4%	579,627	2.2%	75.0%
SIB	821,314	1.5%	354,042	1.3%	43.1%
Wage Tax	772,607	1.4%	270,717	1.0%	35%
Int. lottery games	1,882,692	3.4%	122,639	0.5%	6.5%
PT	107,115	0.2%	40,101	0.2%	37.4%
Total	54,653,795	100.0%	26,519,904	100.0%	48.5

Source: Tax Administration

Table 4 presents a comparison of additional tax as a result of the control for 2010/2011. In 2010, the total additional tax was €54,653,795; while in 2011, the total additional tax amounted to €26,519,904. Index 2011/2010 was 48.5%. From this comparison results that in 2011 it was collected 48.5% less additional tax, all this as a result of fewer controls made during this year, compared with the previous year.

Table 5: Comparison of the number of control and additional tax for 2010/2011

REGION	EXECUTION 2010	PLAN 2010	EXECUTION 2011	COMPARISON	INDEX 2011/2010	ADITIONAL TAX 2010	ADITIONAL TAX 2011	INDEX 2011/2010
0	1	2	3	4=3/2	5=3/1	6	7	8=7/6
FERIZAJ	195	217	95	44%	49%	2,156,262	1,962,808	91%
GJAKOVA	75	84	28	33%	37%	1,592,628	335,066	21%
GJILAN	221	253	112	44%	51%	1,670,171	1,093,411	65%
MITROVICA	153	185	66	36%	43%	1,524,339	546,398	36%
LTU	84	168	73	43%	87%	26,338,913	12,267,232	47%
PEJA	333	278	108	39%	32%	5,654,433	1,635,569	29%
PRISHTINA 1	255	366	171	47%	67%	8,156,723	4,940,877	61%
PRISHTINA 2	171	269	80	30%	47%	4,408,870	2,768,240 6	63%
PRIZREN	347	348	167	48%	48%	3,056,338	970,304	32%
NJKS	1		0	0%	0%	95,118	-	0%
Total	1,835	2,168	900	41.5%	49.0%	54,653,795	26,519,904	49%

Source: Tax Administration of Kosovo

In Table 2 we presented a comparison of the number of controls and additional tax for 2010 and 2011. In 2010, there were 1835 controls carried out and additional tax for this year was €54,653,904 while in 2011, there were 900 controls carried out and additional tax amounted to €26,519,904 or 49% lower than in the previous year.

TAK tax control is a very important activity in collecting as much tax as possible and a mechanism to prevent fiscal evasion in Kosovo.

9. Applying methods during tax control

Performing tax control at certain taxpayer is done based on documentation, books and other records of the taxpayer as foreseen by the applicable legal provisions.

Performing control based on inspection and examination of the books and records of the taxpayer is referred to as form or **direct method** of tax control.

When carrying out a tax control, at large part of the taxpayers, information and examinations in their books and records do not provide sufficient sources of information, and do not allow to ascertain the accuracy of the declaration and payment of tax liabilities, given that these records may not be complete and accurate, therefore the control should be based on other control methods otherwise known as "**indirect method**" of tax control.

The application of these methods is also determined by the applicable legal provisions in Article 19.3 of the Law no. 03/L-222.

Steady tax administrations in different countries have developed and continue to develop various indirect methods through which they attempt to determine understatement when books, records and statements cannot serve as a base on which would the control rely upon.

Today in many countries in which tax administrations operate, various types of indirect methods of control have been developed and applied, which may vary in terms of names, but in essence they involve the following types of indirect methods:

1. Method of Source and Application of Funds (also known as T-calculation method)
2. Bank Deposit Method and Cash Cost
3. Margin method (hereafter MM)
4. Unit and Volume Method
5. Net Value Method (NAM)

10. The application of indirect methods and difficulties in defining tax liabilities exactly

The application of these methods is not based on the taxpayer's books and records, but on the analysis of financial issues and in a variety of indirect methods of measuring revenues which apply in those cases when the taxpayer's books and records are considered highly unrealistic and with major shortcomings.

The selection of the right and appropriate indirect method to be applied in control is considered one of the difficulties that may be encountered in course of tax examinations when applying these methods.

This means that tax officers should make the selection of an indirect method which will be applied in the course of the tax control and control results are provided on basis of the method they have already selected since the beginning of control.

Which of the indirect methods for control will be selected depends on various factors and circumstances. However, in general, the selection of the method depends on:

- the nature of the business or the type of activity performed,
- legal status or tax scheme that the taxpayer applies, and
- the type and volume of information that control officer may secure during the initial interview of control.

Besides this, control officers should make an effort to identify high-risk areas of non-declaration, and depending on that determine the type of method to be applied in order to have an effective control.

8. Conclusion and Recommendations

A respected Tax Administration will create a certain level of voluntary compliance, simply acknowledging that the public is the one meeting its obligations in a professional way and possesses values such as: integrity, professionalism, transparency, respect and flexibility.

While drafting this paper, we have tried to bring into surface, the role and importance of the concept of tax control, which is considered as the main mechanism that TAK implements in order to combat and reduce the level of tax evasion. In this case, we have presented and analysed both the concept of tax evasion and the tax control as two interrelated elements, where some of the factors affecting tax evasion were presented, as well as instruments and mechanisms available to TAK in combating this phenomenon where tax control is considered an underlying mechanism.

Further on, the whole process of tax control is described and we presented a number of direct and indirect methods which are applied when carrying out tax control.

When drafting this paper, we have analysed the tax control process and methods applied during this process, and we noticed that this process faces difficulties and various problems, which make it difficult to correctly determine tax liabilities.

The main focus of the paper was to bring into surface the difficulties faced by Tax officers when carrying out control at taxpayers. In this case, we have identified many factors and circumstances affecting and making it difficult to correctly determine the tax liabilities.

In an effort to make changes and reform in the Tax administration in order to increase the efficiency at work, besides the amendments in legislation in these last three years within the Tax Administration, new developments were made that have not been applied before. At this point, we can mention the decision of the Department for Fulfilment within TAK to report for every purchase over €500 to TAK, through on-line system of Tax Administration. This report is prepared and submitted on an annual basis, i.e. in the end of each fiscal year. The first report of this kind was submitted on 31.12.2010.

Also, in terms of reform, Tax Administration is developing a project, which is related to e-declaration, EDI.

EDI is a modern, fast and simple way to declare tax, which is carried through an on-line system, by which network the taxpayers may submit their tax statements to TAK, even pay them in this way.

TAK has managed to establish a functioning system of control, but its functionality is not strengthened yet. In order to prevent fiscal evasion through tax control mechanism, I recommend to:

- Review the control system in areas with identified weaknesses and appropriate measures are taken to overcome them;
- Further strengthening of tax control functional system,
- List of debtors is published on the TAK official website;
- All invoices are paid within due date, leaving no room to carry them forward in the following year.

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