

HIGHER SCHOOL OF FINANCE, INSURANCE,
BUSINESS AND ENTREPRENEURSHIP (VUZF) - SOFIA

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**OPPORTUNITIES TO IMPROVE THE CONTROLS
RELATED TO PREVENTION AND DETECTION OF
TAX AND SOCIAL INSURANCE FRAUDS**

ABSTRACT

For conferring a “Doctor” degree in a professional specialization

3.8. Economics

Supervisor:

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The dissertation was discussed and scheduled for defence by the Department of Accounting and Auditing at the Higher School of Insurance and Finance (VUZF) - Sofia.

The dissertation contains: introduction, presentation in three chapters, conclusion, list of references. The main text covers 146 pages. It includes 12 tables and 14 figures. The used literature includes: 66 sources in Bulgarian and 26 in a foreign language - in English, German and French. 83 sources from various websites were also used. The translation from the foreign language sources was done independently by the author. A total of 175 sources were attached.

The defence of the dissertation will take place on dd.mm.2021 from hours in the hall of VUZF, at an open meeting of the Scientific Jury, appointed by Order of the Principal of VUZF.

The materials on the defence are available to the interested parties in the library of VUZF - Sofia.

I. GENERAL CHARACTERISTICS OF THE DISSERTATION

1. Relevance of the researched topic

Economic processes today are characterized by their increasing dynamism. The open access to European and world markets poses a challenge to the country's tax administration to constantly improve its control over the tax system. This is necessary due to the growing opportunities for taxpayers to abuse the tax system. The difficulties in the adaptation of the institutions are related to the legislative changes that took place in Bulgaria in connection with its accession to the European Union (EU) in 2007, as well as the many innovations imposed annually in the European legislation.

The relevance of the topic is determined not¹ only by the above factors, but also by the fact that each tax entity is constantly striving to reduce its tax burden. However, it is in the hands of the tax administration to improve its control and apply appropriate detection and prevention methods to those taxpayers who reduce it illegally. They can reduce their burden through "tax tricks" and "tax fraud", with the former having existing opportunities in tax law to reduce the amount of taxes due, and the latter involving deliberate act and misleading the tax administration. for the financial activity of the subject, achieved through numerous mechanisms such as fictitious transactions, manipulation of the financial statements, payment of remuneration by the so-called "black boxes" and others. Of course, tax-insurance fraud should not be limited to the pursuit of reducing the tax burden and evading social insurance contributions. According to estimates by the European Commission in 2017, the amount of unreceived VAT from EU members is 137.5 billion euros, which is equivalent to 11.2% of expected VAT revenues in the community. For Bulgaria, the amount of unreceived VAT is EUR 625 million or 11.8% of the expected VAT revenues in the country, which is approximately 1.4% of GDP.

¹ European Commission 2019 VAT gap report. Available at: https://ec.europa.eu/taxation_customs/business/tax-cooperation-control/vat-gap_en [Accessed 05.11.2019].

2. Object and subject of the research

The object of research of the dissertation is the tax and social insurance control, related to the ability of the institutions to detect and prevent tax and social insurance frauds.

The subject of the study is the possibility to improve the control in connection with the detection and prevention of tax and social insurance fraud.

3. Research thesis

The main thesis of the research is that through the introduction of the best European practices, taking into account the Bulgarian specifics, the control related to the prevention and detection of tax and social insurance fraud will be improved.

4. Thesis and tasks of the research

The main thesis of the dissertation is to study the legal, organizational and methodological problems related to the prevention and detection of tax and social insurance fraud in order to offer guidelines for improving tax and social insurance control in Bulgaria.

Achieving this goal requires the following tasks:

1. Research of the theoretical essence and characteristics of the tax and social insurance control in order to establish the necessity of it for the functioning of the tax-insurance systems and the detection of frauds.

2. Study of the organization of tax and social insurance control in Bulgaria in order to identify the problems that reduce the effectiveness and efficiency of control in Bulgaria.

3. Exploring the possibilities for improving the control related to tax and social insurance fraud by examining the best European practices.

5. Limitations in the scope of the study

The present study is related to the existence of certain **limitations**. In connection with the great variety of types of taxes, forms of organization and control, as well as tax and social insurance frauds, and the impossibility of their comprehensive study in the dissertation, attention is focused mainly on institutional organization, forms of control and some tax fraud on Value-added tax, corporate income taxation, local taxes, and compulsory social insurance. In this regard, the methods of control and ethical issues related to tax and social insurance control have not been studied. The normative sources used are up to date at the beginning of 2020.

6. Research methodology

- **Comparisons**. The different theoretical formulations, views of the authors and different practices are compared on the nature and application of tax and social insurance control.

- **Analysis**. Analyses of the definitions of tax and social insurance control, taxation and tax and social insurance fraud are performed. European good practices are also analysed. In connection with them, the necessary guidelines for the development and solution of the problems of the control process are presented.

Other methods used in dissertation are analogy, induction, deduction.

In addition to the mentioned methods, a scientific research of bibliographic sources for the awareness of the scientific achievements at the world level, in relation to the subject and the object of the present research, is applied.

II. STRUCTURE AND CONTENT OF THE DISSERTATION

This paper covers: introduction, three-chapter statement, conclusion, list of references, in a total volume of 155 pages. The translation from the foreign language sources was done independently by the author. The structure of the research is determined according to the subject, the object, the goals and the tasks of the dissertation.

The dissertation has the following structure:

Introduction

Chapter One. Theoretical characteristics of tax and social insurance control

- 1.1. The essence of taxation and the need for control
- 1.2. General characteristics and specific features of tax and social insurance control
- 1.3. Characteristics of tax and social insurance fraud

Chapter two. Organization of tax and social insurance control in the Republic of Bulgaria

- 2.1. Institutional organization of tax and social insurance control in Bulgaria
- 2.2. Analysis of the forms of tax and social insurance control in Bulgaria
- 2.3. Problems of tax and social insurance control in Bulgaria

Chapter three. Guidelines for improving the control related to tax and social insurance fraud

- 3.1. Good practices for tax and social insurance control in Europe
- 3.2. Study of the good European practices for tax and social insurance control
 - 3.2.1. Good practices in the institutional organization of tax and social insurance control in Europe
 - 3.2.2. Good practices in the forms of tax and social insurance control in Europe
 - 3.2.3. Measures to combat tax and insurance fraud in Europe
- 3.3. Basic guidelines for improving tax and social insurance control in connection with the prevention and detection of tax and social insurance fraud in Bulgaria

Conclusion

References

III. SYNTHESIZED PRESENTATION OF THE DISSERTATION

Chapter One

Theoretical characteristics of tax and social insurance control

Chapter one examines the theoretical characteristics of tax and social insurance control. The essence of the taxation, the need for control related to it, the general characteristics and the specific features of the tax and social insurance control, as well as the characteristic of the tax-insurance frauds are analysed.

Point 1.1. examines the historical development of taxes around the world, information about which dates back to 1700 BC.

In this regard, the introduction of various types of taxes known to this day, such as tithes, per capita tax, turnover tax, import and export duties, excise duty, income tax, Value-added tax, is considered.

It is emphasized that in the dictionary of the Bulgarian language against the word "tax" is the following definition: "A statutory amount that is paid to public authorities."² To a large extent, compulsory social insurance contributions also meet this definition. Therefore, they are usually considered as part of the tax system, and control in this area is called tax and social insurance control.

Adam Smith's theories on the principles of taxation are analysed. It is stated that taxes must comply with four principles: proportionality of taxation, certainty of taxation, convenience of taxation and economy (profitability).

Opinions of other authors on the nature of taxation are also studied. Amongst them are Charles de Montesquieu, John Stuart Mill and Joseph Stiglitz. Based on the study of the nature of taxation, it is concluded that modern taxation must comply with the principles of neutrality, horizontal and vertical fairness, the principle of affordability and the principle of benefit.

In connection with the principles of taxation, the main functions that it must perform are also analysed. These include fiscal, social (redistributive) and economic.³

² Contemporary dictionary of the Bulgarian language. (1995). Gaberoff Publishing House.

³ Taxation. (2016). Enciclopedia Britannica.

The importance of taxation regarding the prevention of the so-called "Market failures", with an emphasis on the role of taxes as the main mechanism of the state to influence the market was reviewed.

In this regard, the need for control related to the functioning of the tax system was studied. It has been established that data on the application of control over the collection of taxes from the treasury have existed since before Christ in the Roman Empire. This is due to the fact that people try to avoid paying taxes and thus damage the state treasury.

Based on the research and analysis made in point 1.1. it is concluded that the theory and practice of taxation are aimed at one - an effective tax system that manages to collect the necessary revenues for the budget. In order for this to be done, it is necessary for it to comply with the basic principles and to exercise control to the necessary extent. Despite the different types of taxation that apply, they have one thing in common - people will always try to avoid them, whether the tax systems associated with them are effective, fair, neutral or able to provide sufficient public goods to the population. These aspirations can also explain the need for control. It is this tool, through the constant improvement of which the goal can be achieved, namely a complex and unloved system such as the tax system to become a well-functioning mechanism, the possibility of manipulation of which is minimized, and thus economic damage on the state and society.

In point 1.2. the general characteristics of the tax and social insurance control are being studied and its specific features are analysed. The aim is to emphasize the basic elements of the control system that ensure its continuous effective and efficient functioning.

The object of the tax and social insurance control can be defined as the economic and labour activity, as well as the movable and immovable property of the persons and the companies. Its subject can be the lawful determination of the taxable activities, profits, turnovers and property of individuals and legal entities, the tax bases and reliefs related to their calculation, as well as the reliable declaration of tax-related information and the establishment of legal deadlines for its provision.⁴

In its essence, the tax-insurance control can be defined as a control regarding the observance and implementation of the normative acts in the field of the tax and social insurance

⁴ Nikolova, B. (2012) Modelling in the system of tax control, Varna, p.17.

legislation. It is an activity of comparing the factual situation with the current legislation and control over the exact implementation of the tax-insurance procedural norms.⁵

The main objectives of this type of control are to establish and monitor compliance with tax legislation, to stop evasion and non-payment of taxes and compulsory social insurance contributions by individuals and legal entities, as well as to determine the actual amount of these obligations. It also aims to prevent other economic violations by companies influencing the tax system, such as: inaccurate financial reporting and manipulation of accounting information, registration of fictitious turnovers in order to drain VAT from the treasury, as well as incorrect calculation of excise duties in order to avoid their payment. In addition to all this, the tax and social insurance control is responsible for the prevention and detection of tax and social insurance violations and crimes, and the imposition of appropriate sanctions if necessary.

For the study of the essence of tax and social insurance control, the research on the topic of the essence of control of a number of authors is presented, among which are Prof. Robert Anthony, Robert Miller, Prof. D.Sc. Mihail Dinev, Prof. D.Sc. Kalyu Donev, Assoc. Prof. Dr. Yordan Tomov, Prof. Dr. Ognyan Simeonov and Prof. Dr. Ali Veysel.

Prof. Anthony examines control in the context of **management control, which he says is:** "The process by which managers ensure that the company's resources are procured and used effectively and efficiently to achieve the organization's goals."⁶

According to Prof. Anthony, every control system must contain four elements:

- Detector or observer to detect what is happening.
- Assessor who evaluates the fulfilment of the pre-set criteria.
- A regulator or modifier that, if necessary, influences the system in order to meet the criteria, the so-called "feedback".
- Communication network, whose role is to transmit information between the other three elements of the control system.

In the context of Anthony's research, **Prof. Dinev** derives five elements necessary for each control system: assessment of the norm for behaviour of a given system; determining (forecasting) the expected state of the system; measuring and establishing the actual state of

⁵ Tax law - a general characteristic of tax control. Available at: <http://www.lawsbg.com/lectures/69-danuchno-pravo/342-pravo-danuchno.html?start=8> [Accessed 12.03.2020].

⁶ Anthony, R. N. (1965). *Planning and Control Systems: A Framework for Analysis*. Boston, MA: Division of Research, Graduate School of Business Administration, Harvard University, p. 107.

the system and analysis of the factors that caused the deviations; comparison between the norm, the actual and the expected state of the system; drawing up a corrective program.⁷

For the completeness of the research on the topic, some of the developments in the field of internal control are analysed. Among them are the research of Robert Miller, as well as the international model of internal control COSO.

Robert Miller defines internal control as follows: “Internal control includes the organization's plan and all coordination methods adopted within a business to protect its assets, verify the accuracy and reliability of its accounting data, increase operational efficiency and promote of the observance of the prescribed management policies.”⁸ The elements of the control system that it proposes overlap with those proposed for the management control: detector or sensor element; selector (standard); control element and communication network element.⁹

In turn, the **COSO** model includes five elements necessary for the full functioning of the control mechanism: control environment, risk assessment, control activities, information and communication, as well as monitoring.

Based on the analyses made for the elements of control, the elements of the control system, proposed by Prof. K. Donev, in connection with financial control are also considered. In the literature, tax and social insurance control is considered as a type of financial control and it is quite natural to attribute to it the attributes characteristic of the control system in financial control. According to Prof. Donev, they are determination of the objects of control; selection of the control norm; identifying the behaviour of the object; comparison and juxtaposition of the regulated behaviour and result with the actually achieved; detection of deviations from the prescribed behaviour and result; preparation of a corrective program.¹⁰ These proposed elements are completely analogous to those proposed by Prof. Dinev.

As according to **Prof. Veysel**, in Bulgaria the term "control" is primarily associated with internal control, management control and tax and social insurance control, and for other areas related to control, other terms are used such as: inspection, supervision and audit¹¹.

⁷ Ibid., p. 30.

⁸ Moeller, R. (2005) Brink's modern internal auditing, Wiley, p. 70.

⁹ Ibid., p. 71-72.

¹⁰ Moeller, R. (2005) Brink's modern internal auditing, Wiley, p. 85.

¹¹ Veysel, A. (2015) Methodical guide on the basics of financial control, p. 10.

Based on the reviewed authors and the study, it is concluded that tax and social insurance control is a type of tax and social insurance audit, followed by the regulatory element necessary for each control system. This is completely natural in view of the fact that although in the Bulgarian practice many different concepts are used, such as audit, control, inspection, etc., the purpose is only one, namely the subject to meet the criterion. In this regard, it is deduced that both in the tax audit and in the tax control, the elements of the control system are present in the face of detector, assessor and communicator, and adding to the tax-insurance audit the regulatory element makes a fully functioning control system. This presupposes the good practices in the tax-insurance audit to be used in the tax and social insurance control. Emphasis is placed on the need to distinguish this type of audit, as a type of compliance audit, from that of the financial statements. For the purposes of studying the **specifics** of tax and social insurance control, it is compared with the audit of financial statements and the main similarities and differences between them are derived. In this regard, the practice of conducting tax control and audit in India and Pakistan, where it can be performed by independent financial auditors, is also considered.

In accordance with the analysis of the research of various authors and the concepts related to the nature of the control system and its features, it is clarified that tax and social insurance control is a kind of compliance audit, followed by the element of control "regulation". Therefore, the control must meet all the requirements for performing a quality tax audit, but also embody the elements of an effective and efficient control system. Only in this way can it fulfil its main goal, namely the detection and prevention of tax and social insurance fraud.

In point 1.3. a description of the tax and social insurance frauds was being given and their essence is analysed.

In economics, fraud is inherently: "the deliberate action of one or more management personnel, persons in charge of general management, employees or third parties, involving the use of deception to gain an unfair or illegal advantage."¹² With regard to the study of the nature of fraud, the norms related to it in the Criminal Code are considered, as well as the essence of "**error**" is derived in order to distinguish between the concepts of fraud and error.

Some of the most significant fraud theories are presented, such as Donald Cressy's Triangle of Deception and Wolf and Hermanson's Diamond of Deception. According to Cressy, every scam has three characteristics: pressure, opportunity, and rationalization. In

¹² Dinev, M. (2015). Control and regulation in social management, UNWE Publishing House, p. 144.

addition, Wolfe and Hermanson consider that in order to commit fraud, in addition to these three characteristics, a fourth is extremely important, namely "ability". It is associated with the statement that even if there is a good opportunity to commit fraud, there is pressure and rationalization associated with the individual, he must be able to recognize the exact moment for the commission of fraud. That is the only way to be realized.

The classification of frauds according to the various inherent features is also presented. Thus, they can be internal, external, criminal, civil, ordinary, documentary, accounting, social, political, economic, etc. The emphasis is on "economic" fraud, due to the fact that this category also includes tax and social insurance fraud.

Like other types of fraud, the tax and social insurance one also has many varieties. The main ones are frauds related to the income of individuals and legal entities; manipulation of expenses in order to reduce the tax base; tax relief fraud; forgery of books and records; fraud related to transfer payments and income distribution; VAT fraud; providing lower than real income, etc.¹³

The essence of the tax fraud is presented in the repealed old Tax code, which is: "misleading the tax authority in determining the tax base and the amount of tax liability by concealing data and circumstances relevant to taxation, as well as the deliberate provision of false and inaccurate ones in order to reduce the tax burden and/or tax evasion, double invoicing, the use of transfer pricing and other methods aimed at reducing the tax liability in violation of the rules for determining the tax base and the obligations of tax subjects".¹⁴ The normative definitions of tax and social insurance crime according to the Criminal Code are also analysed.

For the integrity of the study, a distinction is made between "tax fraud" and "**tax avoidance**". While the first term is criminal in nature, the second is characterized by planning tax events in such a way as to reduce tax liabilities in a lawful manner and through the use of "**legal tax tricks**". "Tax tricks" refers to the use of the advantages and disadvantages of current tax legislation.¹⁵

The definitions of "tax gap" and "VAT gap" are considered as one of the main indicators related to the efficiency and effectiveness of tax systems and the extent of tax fraud. According to them, the "tax gap" is the difference between the total tax revenue that should have been collected and that which was actually realized. The term "VAT gap" is defined as: "the

¹³ Dinev, D. (2006) Economic Fraud Part Two, Sofia, pp. 127-140.

¹⁴ Ibid., p. 71-72.

¹⁵ Dimov, O. (1995) Legal Tax Tricks, Sofia, p. 58.

difference between expected and actual VAT revenue and includes both losses related to fraud and tax evasion and the costs associated with the tax measures taken against them.” In this regard, the main types of fraud committed in the tax system are identified, which are related to VAT evasion, income tax evasion and fraud related to the social insurance system.

Through research and analysis, it is summarized that despite the many varieties and their complexity, frauds bring with them only one thing - damage to people, companies and especially the whole economy. Therefore, it is necessary to improve the control for their prevention.

Chapter two

Organization of tax and social insurance control in the Republic of Bulgaria

Chapter two is devoted to the organization of tax and social insurance control in the Republic of Bulgaria. The structure of the tax system in the country is studied, the forms of tax and social insurance control in it are analysed, as well as the problems related to it.

In point 2.1. the structure of the tax system in the Republic of Bulgaria and the main types of direct and indirect taxes, as well as compulsory social insurances, which are imposed in the country, are presented. The structure of the tax administration in its current form is shown in the person of the National Revenue Agency (NRA), the Customs Agency and the municipalities, as well as the administration of taxes by the various institutions.

For the purposes of the study, the development of the tax administration and the regulations related to it before the establishment of the NRA in 2006 are presented. The administrative structure of the NRA, represented by the Central Office and six territorial directorates, is presented, as well as its management structure.

The functions of tax administration, as well as the administrative structure of the municipalities and the Customs Agency were studied in the same way.

The question of the competence of the interpretation of the tax legislation is investigated. It is stated that in proceedings under the Code of Social insurance the competent state body is the relevant territorial directorate of the NRA or a municipal structure. In cases related to the definition and interpretation of the tax methodology, only the NRA is competent. In this regard, the question is raised whether it is necessary to collect different taxes from different institutions in the face of the NRA and the municipalities, when only one organization is competent to interpret the laws and give guidelines on the application of the methodology.

For the purposes of the study of the structure of tax revenues in the country, the plan of revenues in the State Budget for 2020 has been studied. . It is derived that the taxes that form the projected revenues in the budget, as a percentage of the total planned tax revenues for the year are corporate tax (10.9%); taxes on dividends, liquidation shares and income from legal entities tax (0.3%); personal income taxes (17.4%); Value-added tax (45.4%); excises (22.7%), tax on insurance premiums (0.01%); customs duties and taxes (0.09%).

The analysis shows that the largest relative weight in the revenues for 2020 from taxes are due to VAT, excises, personal income tax and corporate tax. In this regard, it is considered how the state budget has been implemented for the past years, ie. how much the revenues collected by the administration are in relation to the planned tax revenues and it has been established that the state manages to fulfil the goals set in its budget. However, reference is made to the fact that the official data do not include uncollected taxes due to tax and insurance fraud and arrears.

The study of the tax and social insurance system and its institutional organization shows that despite the different types of taxes imposed in Bulgaria and the complex institutional apparatus performing the task of their administration and control, the aim is to ensure an effective tax system that manages to collect the maximum amount of taxes due to the treasury. Although the programs set in the State Budget and the National Revenue Agency related to tax revenues in recent years have been overfulfilled, the great damage suffered by the national economy as a result of tax and social insurance frauds makes it necessary to analyse in depth the main forms of tax and social insurance control performed by the tax administration, incl. to prevent and detect fraud. This is necessary to establish whether adequate forms of control are applied in the current organization.

In point 2.2. the main forms of tax and social insurance control in Bulgaria are analysed in the face of the inspection and audit. For this purpose, the main forms of control in general, which are preliminary, current and subsequent, are first studied.

The main purpose of **the preliminary** tax and social insurance control is to "establish the legality and expediency of the processes, activities and actions" that will be carried out.¹⁶

The current control is carried out by the revenue authorities in parallel with the performance of activities and processes in the company. It has an operational character, and its

¹⁶ Donev, K. (2010) Theory of Financial Control, Science and Economics, pp. 99-100.

characteristic feature is "consistency". Also, it manifests itself during the overall functioning of the system and is able to influence the results of it.¹⁷

The subsequent type of control is done according to activities and processes in the organization that have already been completed. That is, this type of control is exercised over the results of events as its subject are past, completed actions, decisions, procedures, etc.¹⁸ The subsequent control aims to establish the legality of the activity performed by the companies and its effects.

The concepts related to the inspection and audit applied by the NRA as forms of control are defined, as well as their characteristics, the main regulatory requirements related to their implementation, the deadlines for their implementation and the main regulatory documents issued at their beginning, implementation and completion. . In this regard, **inspections** are a type of "routine" activity, verifying significantly small facts and circumstances.¹⁹ The time required to carry out an inspection is relatively short, given that, in general, the inspections are aimed at less large-scale activities. The **audit**, in turn, is "a set of actions of the revenue authorities aimed at establishing tax liabilities and compulsory social insurance contributions".²⁰

In this regard, the main difference between the inspection and the audit is shown, which is that the audit establishes the actual amounts of taxes due, reveals tax violations and crimes and as a result of its implementation imposes sanctions that are preventive regarding conduction of new violations, and the inspections can establish data on undeclared and untaxed income, but the actual amounts of these liabilities cannot be established.

It was concluded that the audit is a kind of tax audit, given that the criteria for both of them are the tax and social insurance standards, and the goal is to minimize the risk of incorrect tax information. As a result of the conduct of both, the conclusion whether the tax-insurance legislation has been complied with was drawn, it is also determined whether the calculated and paid taxes and social insurances correspond to the normatively established ones. From this it can be deduced that in general the tax and social insurance control represents a kind of tax audit plus the issuance of an audit act, as the act actually has a control effect.

¹⁷ Dinev, M. (2015). Control and regulation in social management, UNWE Publishing House, p. 206.

¹⁸ Donev, K. (2010) Theory of Financial Control, Science and Economics, pp. 99-100.

¹⁹ Tananeev, E., Stoykova, P. (2012) Tax Control and Administration, Veliko Tarnovo, p. 91.

²⁰ Social insurance code, Prom. SN. no. 105 of 29.12.2005, last ed. and ext. SN. No. 18 of February 28, 2020, Art. 110, para. 2.

From the point of view of the scope of the audit and the tax audit, it can be concluded that the "tax audit" is a kind of "full audit" due to the fact that it covers the audit of all aspects of the company's accounting activities, while "inspection" as a form of control performed by the NRA is a kind of "incomplete inspection". From another point of view, the "inspection" in its form carried out by the Revenue Administration is practically incorrect to call it so, due to the fact that the "inspection" in its essence involves only one procedure. In the case of the Bulgarian practice, for the more correct it could be called an abbreviated or partial revision.

In this regard, it is logical to suggest that the procedures performed in one of the two main forms of control applied by the revenue administration in the face of the audit and the procedures performed in a tax audit be the same or very similar to each other.

Based on the analysis and research of the forms of tax and social insurance control applied in the country, it is concluded that it is applied by the revenue authorities to the tax subjects in two main forms - inspection and audit. By themselves, they can be likened to a kind of "review" and "audit" of the basic characteristics they possess and the functions they perform. In this regard, it is necessary to study in depth the problems of tax and social insurance control in Bulgaria, as well as the gaps in the actions of the revenue authorities in terms of limiting and preventing tax and social insurance fraud in the country.

In point 2.3. the problems related to the tax and social insurance control in Bulgaria are studied. In this regard, the main problems of the tax-insurance system are defined and analysed, including low tax collection, the need for change in the institutional organization of tax control in the country, the need for written rules and methodology for conducting inspections and audits , and the procedures related to them, as well as the limited set of procedures used in carrying out the main forms of control in comparison with the tax audit.

It was clarified that in view of the fact that the dissertation focuses on the Social insurance code (SIC), as the main regulatory framework governing tax and social insurance control in the country, the study uses the terms tax system and tax and social insurance system, as well as tax control and tax and insurance control as interchangeable. This is also due to the fact that the compulsory insurance applied in the country to a large extent has the character of taxation in view of its imperative character.

The collection of the different types of taxes in the country is considered, and it is deduced that three of the most significant amounts for the treasury taxes are VAT, social and health insurance revenues, and corporate tax. According to the Revenue Agency for the period 2000 to 2017, VAT of over BGN 16 billion has not been paid in the country. However, it is

not clear whether these figures also fully cover the damage to the economy caused by tax and social insurance fraud or whether this is the amount that the tax authorities have been able to establish through the control methods they apply. In this regard, in 2015 the size of the "tax gap" for Bulgaria was 3.2 billion euros.²¹

Regarding **social insurance frauds**, it is presented that they are committed mostly through payment by the so-called "black boxes", as in Bulgaria, for BGN 1,000 undeclared income from employment per person per month, depending on his year of birth and category of work, the damage to the economy per year is over BGN 2,000. The scale of this type of fraud can be seen from a study by the Centre for the Study of Democracy, published in 2011, according to which 23% of workers on an employment contract receive money "under the table" that are not declared.²² Also, according to NRA data from 2019, the state annually loses over BGN 400 million from hidden income as a result of such payments.²³

With regard to **corporate tax evasion**, it has been found that the most common types of fraud aimed at damaging the treasury through corporate tax are fraud in companies' financial statements. In order to pay a lower corporate tax under the Corporate income tax act (CITA), legal entities manipulate their income and expenses accordingly and thus reduce the tax base on which the tax is charged. This happens through:

- non-registration of income from transactions and operations
- recognition of revenue in an incorrect future reporting period
- recording income as capital expenditure in order to capitalize it and not including it in the income statement
- early recognition of revenue
- incorrect valuation of assets
- registration of fictitious expenses in order to reduce the tax base.

It is derived that in addition to the collection of taxes, compulsory social insurance and the detection of tax and insurance fraud, the effectiveness of the tax system depends on its **institutional organization** and the forms of control applied in it. In this regard, the collection of taxes from the National Revenue Agency, the Customs Agency and the municipalities was analysed, and it was established that the municipalities do not collect more than one third of

²¹ Murphy, R. The european tax gap. (2019) University of London, p.3.

²² The dynamics of the hidden economy in Bulgaria. (2011) Centre for the Study of Democracy, p. 81.

²³ The treasury loses BGN 400 million a year from hidden income. Union of Economists in Bulgaria. Available at: <https://bgeconomist.bg/данъци/>. [Accessed 18.04.2020].

the due taxes. As a result, the question has been raised whether the NRA and the Customs Agency should not be merged, and the function of the municipalities to collect taxes should not be transferred to the NRA, in order to increase the centralization of the collection of taxes.

For the purposes of the study, the essence of the sampling approach, the types of samples applied in practice, as well as the importance of their use in conducting control procedures are considered. The problem with the lack of methodology for forming the samples during the control procedures by the Revenue Agency is also presented.

In this regard, emphasis was also placed on the lack of a detailed manual with a methodology to the Social insurance code, which the revenue authorities should use when exercising control over the tax subjects. Although there is a manual to the SIC, it largely summarizes the code instead of giving practical guidance on how to implement it. The SIC and its manual, in addition to not paying attention to important procedures performed in an audit such as internal control assessment, risk assessment, analytical procedures and tests of controls, do not focus on some of the procedures for collecting audit-related evidence, such as observations, external confirmations, re-execution, investigative inquiry and completeness checks.²⁴

As a result of the research and analysis, it was found that the most common tax and insurance frauds in the country are related to VAT, non-payment of social and health insurance by paying employees from "black boxes", as well as manipulation of financial statements related to corporate tax evasion. In view of the subjectivity in the choice of procedures for the control by the revenue authorities, the need to study the possibilities for the development of a methodology to be applied by the NRA in the performance of the current and subsequent control, incl. inspections and audits was highlighted. It is also summarized that the basis on which to determine the samples through which the control procedures will be carried out must be established. This is because on the basis of the samples, the revenue authorities draw their conclusions about the surveyed processes in the enterprises. To this end, emphasis is placed on the need to study the implementation of the social insurance control practises in other European Union countries.

²⁴ Veysel, A. (2013) Audit Procedures in Performing a Tax Audit, ICPA, p. 6.

Chapter three

Guidelines for improving the control related to tax and insurance fraud

Chapter three examines the organization of tax and social insurance control in the European countries. On this basis, three countries were selected, which are given as a benchmark for implemented tax systems and the structure of the tax system in them is studied, as well as an analysis of their forms of tax and social insurance control was conducted. In addition, good legislative practices in European countries are presented in order to improve the control and prevention of tax and social insurance fraud. Based on the conducted research, guidelines for improving the control related to this type of frauds have been derived.

In point 3.1. good practices for tax and social insurance control in Europe are presented. To this end, the GDP of the countries in Europe is analysed in order to distinguish those with the largest gross domestic product and to examine the good practices related to tax and social insurance control in them. This is due to the fact that the functioning of large and powerful economies is virtually impossible without a well-functioning tax system that manages to collect the due taxes from individuals and legal entities.

Germany, Great Britain, France and Italy were selected as the countries with the largest GDP. In this regard, the tax gaps and VAT gaps of the countries in Europe are considered and based on the study and its results it is concluded that Germany and the UK are suitable countries for analysis in view of the size of economies and low VAT, and tax gaps in them compared to the other European countries.

In addition to two of Europe's major economies, a third country was analysed to determine how a well-functioning tax system is organized in a smaller country. In this regard, an indicator was used that assesses the effectiveness of tax systems, namely **the International Tax Competitiveness Index (IDA)**. According to the International Tax Competitiveness Index, Estonia is the country with the most efficient tax system.²⁵ The state ranks first for the sixth consecutive year, consolidating its position as the country with the best functioning tax system. That is why the tax system of this country has also been studied. Unlike Germany and the United Kingdom, which have populations of 83 and 65.7 million, respectively, Estonia has a population of 1.3 million, which is more than 60 times less than that of Germany and 50 times

²⁵ International tax competitiveness index 2019. Available at: <https://taxfoundation.org/publications/international-tax-competitiveness-index/>. [Accessed 25.04.2020].

less than that of the United Kingdom. Despite the fewer resources, this country has a stable tax system. These results are also supported by the size of its VAT gap. According to a study by the European Commission, Estonia's "VAT gap" for the last analysed year has reached a level of 5%. This is almost twice lower than the EU average. It is noted that the country's tax gap is also below the European average.

Based on the performed analysis of tax collection, incl. The VAT and tax gaps of the European Union countries, as well as taking into account the size of their economies, it was concluded that the three countries that have implemented some of the most effective systems of tax and social insurance control are **Germany, Great Britain and Estonia**.

In point 3.2. The European good practices for tax and social insurance control in Germany, Great Britain and Estonia, related to its institutional organization, the structure of the tax system and the forms of control, are studied. In addition, good regulatory practices implemented in European countries in order to improve the prevention and detection of tax and social insurance fraud are discussed.

In sub-item 3.2.1. the good practices in the tax-insurance control, related to its institutional organization, as well as the structure of the tax system are analysed and studied.

As a result of the study, it was found that the organization of the tax system of all three surveyed countries - Germany, Great Britain and Estonia is aimed at the **centralized collection of taxes** from one institution and their redistribution to their administrative institutions. While in the UK the Revenue Administration collects all taxes electronically, in Germany and Estonia there are tax / customs points where the residents of the countries pay the due taxes. On the other hand, in both the United Kingdom and Estonia, the tax administration is highly centralized, merging Customs and Revenue Administration. However, these two institutions are not united in Germany, which is completely normal in view of the more complex state structure of a federal nature. In addition, the institutional organization of the tax administration in other European countries, and in particular those with more developed economies, which are members of the EU, has been studied. Based on the study, it was concluded that the countries that have implemented a unified structure of the Revenue Administration and Customs, have higher tax collection and a correspondingly lower size of the average tax gap, which indicates higher efficiency due to the unification of structures in the tax administration.

All three countries have **reduced VAT rates** for basic necessities, which shows their social policy aimed at the population. In addition, in Germany and the United Kingdom there

is no minimum insurance threshold, but there is a minimum wage, which in turn facilitates business and reduces the risk of tax and social insurance fraud.

It was concluded that the merging of institutions leads to greater centralization, lower costs and higher collection. Emphasis is placed on the fact that the institutional organization of the tax system in Germany cannot be taken as an example in view of the specific state system, which is not typical for most countries in Europe.

Other important conclusions are that in order for a tax system to be effective and efficient, it must collect taxes either entirely electronically, as in the United Kingdom or through tax offices, and their number must be relatively low. As an example, in Estonia and Germany, one office is responsible for 47,000 and 127,000 people, respectively.

Other elements of a successful tax system that are visible in the study are the **lack of a minimum insurance threshold** (Germany and the United Kingdom; Estonia has a common minimum insurance income, but not by sectors), as well as reduced VAT on basic necessities (such as baby food and medical drugs).

In subsection 3.2.2. good practices related to the forms of tax and social insurance control in Germany, the United Kingdom and Estonia are studied and analysed.

In view of the research and analysis of the three countries, it was concluded that they apply many good practices for tax and social insurance control. The surveyed countries carry out control on the basis of **inspections and audits**, but Germany has also implemented **automatic inspections**, which is a big step forward in terms of speed, automation and low costs associated with their implementation.

The United Kingdom and Germany, on the other hand, have developed manuals on tax and social insurance control, which in the United Kingdom are extremely detailed and provide guidance on step-by-step how to conduct inspections and audits. In the United Kingdom, there are also manuals on sampling methods, which in turn is a guarantee of the quality of inspections. In addition, the UK has a control procedure in place which enable the taxpayer to detect infringements on its own, thus significantly reducing the cost of carrying out inspections and audits, as well as saving tax authorities' time.

Another good practice in the United Kingdom that has been highlighted is the existence of **specialized prosecution services** to conduct criminal investigations and trials in the event that such a case occurs. This is a significant advantage over countries where such bodies are absent, given that tax cases require highly qualified staff to deal with them, and therefore the staff working on them need to be experts in this matter.

In sub-item 3.2.3. the measures taken by European countries to combat tax and social insurance fraud in Europe are also examined.

In view of the variety of measures applied over the years by the various countries, it has been concluded that the main way to reduce social insurance fraud is to improve the Union's regulatory framework and to implement its various recommendations, regulations and directives on national levels in the Member States as soon as possible after their issuance. Emphasis is also placed on the objectives of Union directives relating to VAT, such as ATAD I and ATAD II, which relate to tax avoidance and regulatory harmonization between Member States, the reduction of tax fraud and the reduction of the shadow economy.

Another important step in reducing and curbing fraud is the need for improved collaboration and data exchange between countries, as well as reducing the levels of corruption. In this regard, emphasis is placed on the introduction of the **Eurofisc** system. In this context, civil servants from EU Member States are involved in the targeted exchange of information in various specialized areas related to cross-border VAT fraud. This applies to operational and general information, such as findings regarding new fraud schemes.

In point 3.3. The main guidelines for improving the tax and social insurance control in connection with the prevention and detection of tax and social insurance fraud in Bulgaria are presented.

It is noted that the study and analysis of the institutional organization of tax and social insurance control of European countries, the structure of their tax systems, forms of control and regulations in them to limit fraud, provide sufficient information to provide guidance on improving tax -insurance control in Bulgaria. Emphasis is placed on the fact that the practice of these European countries is applicable both to the tax revenues in the country and to the compulsory social insurances that are collected in Bulgaria.

A study of the experience and structure of the tax administration applied in the UK, Estonia and other EU countries shows that the merger of the **NRA and the Customs Agency**, following good European practices, would lead to greater centralization of the revenue process. The implementation of this guideline can reduce abuses, with a view to administering taxes at a higher level than a larger organisational structure. The merger would also allow the implementation of uniform control procedures in the performance of tax and social insurance control, which in itself would ensure its more effective exercise against taxable persons.

In connection with the **collection of taxes**, the low collection of local taxes by the municipalities is indicated. Emphasis is placed on the regulatory problems related to the

transfer of companies with tax liabilities to insolvent third parties in the country, leading to non-collection of taxes. Thus, in connection with the improvement of tax collection, the following guidelines were proposed: the payment of local taxes directly to the NRA, which will then redistribute them to the municipalities; the establishment of specialized institutions to conduct criminal investigations and court cases related to crimes against the tax and social insurance system; improving the regulatory framework with a view to suspending the transfer of companies with tax liabilities to third parties.

The next important guidelines that have been derived are for regulatory changes related to the reduction of **VAT fraud**. The steps that can be taken are to increase the size of the mandatory registration threshold, as well as to follow the European practice for combating VAT fraud and the Directives issued by the EU.

In connection with the need to **develop manuals with a methodology** for performing the main forms of tax and social insurance control, the practice in Germany and the United Kingdom is considered. Based on the researched facts, it is deduced that in order to improve the control it is necessary: to develop a detailed manual to the SIC and an official methodology for the application of the forms of tax and social insurance control; development of manuals and methodology on sampling in the implementation of control procedures; the introduction of tests of controls and analytical procedures in the audit proceedings performed by the NRA; the introduction of automated inspections by the Revenue Administration during the control proceedings.

The last but not least, an emphasis was placed on the need of **elimination of the minimum insurance income threshold and the reduction of social insurance fraud**. There is no minimum insurance income threshold in countries with an effective tax system. A study by the Institute for Market Economy shows that with an increase in the minimum insurance income threshold by nearly 26%, the damage to the economy would be BGN 544 million per year and over BGN 4.65 billion over a ten-year period.²⁶ According to the study, the minimum insurance income threshold needs to be abolished, as the effects that the state aims at its introduction would actually be achieved with an appropriate reform of the pension system. It was emphasized that the presence of a minimum insurance income threshold serves to increase the “grey” sector. In addition, the administrative increase in the minimum wage leaves many

²⁶ Institute for Market Economics. Are minimum insurance thresholds required? Available at: <https://ime.bg/bg/articles/nujni-li-sa-minimalnite-osiguritelni-pragove/#ixzz6LfSGdw6C>. [Accessed 28.04.2020].

of the low-skilled workforce out of the labour market.²⁷ In this way, eliminating it and introducing a tax-free minimum would reduce the number of tax and insurance social frauds in terms of fewer people resorting to them.

In addition, it is derived that in connection with the fight against payment of the so-called "black boxes", besides abolition of the minimum social insurance income threshold, activities that would improve control related to fraud, are the ability of the NRA to investigate private individuals, when initiating review proceedings against an enterprise. In this regard, it was concluded that the only way to improve tax and social insurance control in the country is to follow good practices in the European Union, timely action by Bulgarian institutions to improve the country's regulations and improve the institutional organization of tax and social insurance control in general.

CONCLUSION

The conclusion drawn from the study are as follows:

1. A change in the institutional organization of the tax and social insurance control in the country is needed, which is expressed in the unification of the National Revenue Agency and the Customs Agency. This is dictated by the example of other European countries with efficient tax systems such as the United Kingdom and Estonia. The unification of the National Revenue Agency and the Customs Agency is conditioned by the need for greater centralization of the tax administration, as well as the need to apply uniform types of control procedures to the different types of taxes administered in the country.

2. The legislation related to the collection of tax liabilities at the local level in Bulgaria is ineffective. This is supported by the fact that more than a third of local taxes and fees in the country fail to be collected by municipalities. The normative changes that are needed are for the NRA to start collecting local taxes and fees and subsequently redistribute them to municipal budgets. This is dictated by good European practices in this area and aims to increase tax collection as well as greater centralization of the revenue process.

3. There is a need for a change in the legislation on Value-added tax. The proposals for changes are based on the large amounts of VAT fraud in the country. They occur as a result of the many existing "fictitious companies" and the low thresholds for mandatory registration.

²⁷ Ibid.

The necessary regulatory changes are related to raising the threshold for mandatory registration in the VAT Act.

4. One of the main problems in the application of tax and social insurance control by the NRA is the lack of a detailed manual to the Social insurance code on the implementation of forms of control in the face of inspection and audit, as well as the lack of sampling methodology. It is necessary to develop manuals for the application of the forms of control following the good example of Germany and the United Kingdom. It is also necessary to develop a formal methodology for the formation of audit samples used during control procedures. The other main problem in the application of the forms of control in the Bulgarian practice is related to the non-use of tests of controls and analytical procedures in the revision proceedings. Their use in practice has proven the greater detection of irregularities that they bring with them.

5. It is recommended that the minimum insurance income threshold to be abolished and a non-taxable minimum be introduced. The proposal is based on research in some European countries with effective tax systems such as the United Kingdom and Germany, as well as on the basis of Bulgarian research on the subject. The lack of a minimum insurance income would reduce the size of the "grey" sector, the size of undeclared income related to employment, as well as return part of the low-skilled labour force to the labour market.

IV. BACKGROUND ON THE MAIN SCIENTIFIC CONTRIBUTIONS IN THE DISSERTATION

The **contributions** of the dissertation to the theory and practice can be presented in the following points:

1. An in-depth analysis defines the main guidelines for improving tax and social insurance control in Bulgaria: in the areas of institutional organization (based on the structure of the tax system) and in the field of regulations, which should result in increasing its level of efficiency.

2. An in-depth study of the types and forms of tax and social insurance control applied in the country has been carried out. Based on this, the main problems in the application of the forms of control are identified, such as the need for written rules and methodology for conducting inspections and audits, and the procedures related to them, as well as the limited set of procedures used in carrying out the main forms of control. compared to the tax audit.

3. An in-depth analysis of the damages from the main types of tax fraud committed in the country was conducted, as well as on the structure of revenues from tax and social insurance revenues in the state budget. Based on these data, conclusions have been drawn regarding the collection of taxes in the country, as well as the main problems related to the control in the tax and social insurance system have been identified.

4. Based on an analysis of official statistics related to the level of tax fraud and tax collection of countries in Europe, three European countries with the most effective tax and social insurance systems have been identified. A study and analysis of their institutional organization of tax and social insurance control was applied, as well as on the structure of their tax systems, and the forms of control they apply. In addition, good practices in the regulations of European countries related to the prevention and detection of tax and insurance fraud have been studied.

V. LIST OF PUBLICATIONS ON THE TOPIC OF THE DISSERTATION

Reports

1. Report in a scientific conference in Madrid, Spain on "Education, Law, Business" - "Madrid, 2020" - Madrid, 2020, on "Institutional organization of tax and social insurance control in Bulgaria "- p. 37-39. [Institutional organization of tax and social insurance control in Bulgaria ”- pp. 37-39.], ISBN: 978-2-5494-0322-3.

2. Report at a scientific conference in Steyr, Austria on "Science and innovation" - "Steyr, 2020", on "Efficiency of the municipal tax administration in Bulgaria" - p. 71- 74. [Efficiency of the municipal tax administration in Bulgaria "- pp. 71-74.], ISBN: 978-3-953794-29-5.

Articles

1. Article "Forms of tax and social insurance control in Bulgaria", SEPIKE journal 3/2020 - p. 40 - 43. [Forms of tax and social insurance control in Bulgaria ”, SEPIKE magazine, issue 3/2020 - pp. 40 - 43.], p-ISSN: 2196-9531, e-ISSN: 2372-7438.