

# **Methodology for risk analysis of tax frauds and tax evasion**

## **I. Summary:**

Methodology for risk analysis of tax frauds and tax evasion is an element of an analytical strategy for improvement of the revenue collection in the republican budget, intended to serve as an indicator and as a preventive instrument on a micro level (economic entity) as well as on a macro level, manifested in positioning of risk sectors for each type of tax fraud and tax evasion

## **II. Essence:**

The essence of the methodology is expressed in the possibility commodity-material and cash flows reported to the Revenue Administration to be actually divided, without any additional administrative burden on the economic entities, thereby achieving greater transparency of the economic activity of the economic operators, on the one hand, and attribution of fundamental research element within the context of removal of the risk of tax fraud and tax evasion through formulation of indicators which are correct for the analysis and the environment, on the other.

## **III. Goals:**

Based on the foundation of their focus and applicability, the objectives of the methodology for risk analysis of tax fraud and tax evasion are concentrated on the preventive nature of this same methodology.

The goal which should be adopted, is not a subsequent, but a preventive indication of committed financial crimes, and this in particular is the main advantage of the methodology, the possibility to show to the revenue administration and the authorities involved in the prevention of tax crimes as well as to the economic entity itself that the activity which it performs is in contravention of the economic feasibility and in most cases – contrary to the rules governing the activity.

## **IV. Elements:**

The elements underlying the analytical model of the methodology for risk analysis of tax fraud and tax evasion, reflect both the direct ones, contributing to implementation of the analysis of the economic activity of economic entities, as well as the indirect, performing the mathematical

analysis according to pre-established algorithms. Algorithms which describe any potential deviation from the customary commercial (economic practice) practice of the economic operators.

By their nature and importance, the direct elements of the methodology for risk analysis are reduced to an additional output of the currently submitted information or information processed by the economic agents, and for the purpose of analysis the same is only codified. The direct elements by their descriptive characteristics are derived from the information currently submitted by taxable persons under VATA through codifying the descriptive information of the columns from the records of purchases and the sales journals, as for the purposes of the analysis of the evaluation of the effectiveness compared to the present moment and for the feasibility in the development of an environment regulating tax and social security processes. The direct elements of the methodology for analysis we divide into two groups in relation to the possibilities for their current introduction, as follows:

1. **MAIN** elements, representing and grouping in themselves all those direct elements of the methodology for risk analysis of tax fraud and tax evasion, on which there are not any fundamental differences and there is a common assessment of their utility, but also they do not require a significant modification or structuring of entirely new procedures in the tax and social security process. The codification of information filled out by economic operators in the journals of purchases and sales for the purposes of VATA in the column „**Type of the supply**“ enters solely in this group of elements, as follows:

**By type of the delivery:** through codification of currently submitted information which has no analytical value at the present moment. Codification, which could be examined in main directions of the realized deliveries and sales on major descriptive groups:

- 00 - Annulled document
- 01 - Supply of goods
- 02 - Supply of materials
- 03 - Delivery of supplies
- 04 - Supply of assets
- 05 - Supply of services
- 06 - Advances

The codification of the currently submitted information will output its analytical value and will unify the standard and the methodology for risk analysis with regard to the risk traders.

2. **PERSPECTIVE** elements, constituting an additional part of the direct elements of the methodology for risk analysis of tax fraud and tax evasion, which would be currently inappropriate, in relation to the legal framework and detailing of the benefits, to be introduced in the context of the short terms, within which could happen the implementation of the main elements of the methodology. In terms of the opportunities which they could provide on an analytical level they certainly deserve their analysis and development. The composition of that group of direct elements includes the introduction of an entirely new column for the journals of purchases and sales, describing the method and/or way of payment for each of the performed deliveries.

By way of payment: through introduction of an additional column in the journals of purchases and sales, describing information about the way payment for any supply carried out by the economic entity:

01 - in cash

02 - to an account

03 - under contract

and precisely the ground with code "03 – under contract" is the basis for the introduction of an additional element in the description "by type of document" in the journals of purchases and sales, through which the information for the subsequent payment will be analyzed.

#### **VI. Impact assessment:**

Every proposal for amendment or modification of any system should be evaluated within the context of its acceptability and efficiency. In this regard, in the analysis of the impact assessment of the methodology for risk analysis of tax frauds and tax evasion we have derived four basic criteria for assessment of the impact on the regulated environment, namely:

- **impact on the economic agents in terms of their administrative processes:** essentially the introduction of the direct primary element of the methodology will not aggravate or impede the administrative processes of economic entities in any way in view of the fact that the same ones currently fill out the information in the column "Type of the supply" in even larger volume than the one proposed in the methodology;

- **impact on the economic agents in terms of the costs of introduction of the methodology:** in terms of the costs of introduction of the methodology in relation to the economic agents, the same will not

affect the agents as a financial burden in any way, which is evident from the statements received from the developers of the software systems of the economic agents, considering their aforementioned opinion that this is their responsibility and it will not aggravate the financial situation of the companies in any way;

- **impact on the economic agents regarding the development of the necessary changes, which are main direct element of the methodology:** concerns the costs of the developers themselves, and as in the previous answers and the statements expressed by the developers, the same will not have any effect and will not aggravate their unity;

- **impact of the methodology on the administrative activities of the revenue administration and the benefit of it for the same:** essentially this is the most important part of the evaluation and therefore the main goal of the methodology, namely its preventive nature, should be taken into account in analyzes. Evaluation which is also given during its discussion with NRA, regarding precisely this preventive nature, which will affect the economic operators and will restrict the tax frauds to an acceptable degree. Of course, the implementation of the methodology will also contribute to the indication and detection of any deviation from the usual economic viability in the activity of economic operators, which is the main value and utility of the methodology regarding the necessity of its implementation in relation to the revenue administration of the Republic of Bulgaria.

## **VII. Conclusion:**

The implementation and application of the methodology for risk analysis of tax fraud and tax evasion will contribute to the restriction of this type of financial crimes as regarding the risk analysis on part of the involved administration as well as regarding the preventive nature it would have towards the economic entities, recognizing its actions, resulting in transparency of the economic accountability of the latter.

The capabilities of the methodology for risk analysis of tax crimes, combined with effective inter-institutional cooperation would provide a more effective counteraction to this kind of financial crimes.

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