

3. TAX CORRUPTION DRIVERS

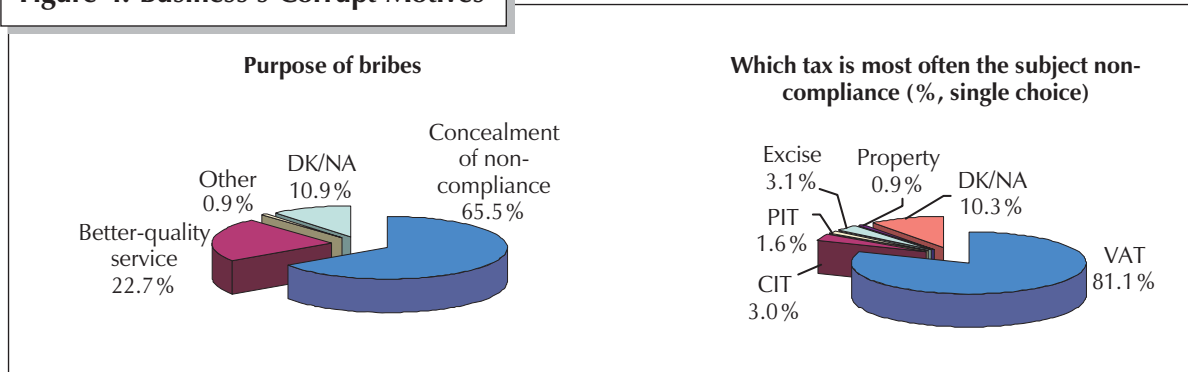
3.1. WHAT BUSINESS PAYS FOR

The question about the kinds of corrupt service on offer is the starting point of the analysis of what motivates and drives tax corruption from the perspective of business, and of the subsequent identification of effective countermeasures. Businesses pay for two groups of services:

- (a) those related to tax fraud and other offences under the tax legislation; and
- (b) 'preferred customer' or better-quality service.

As the tax officers see it, the purpose of corrupt transactions is primarily to conceal fraud and other tax offences, i.e., generally speaking, non-compliance (see Figure 4). The proportion of bribes aiming at better-quality service is however fairly high as well.

Figure 4. Business's Corrupt Motives

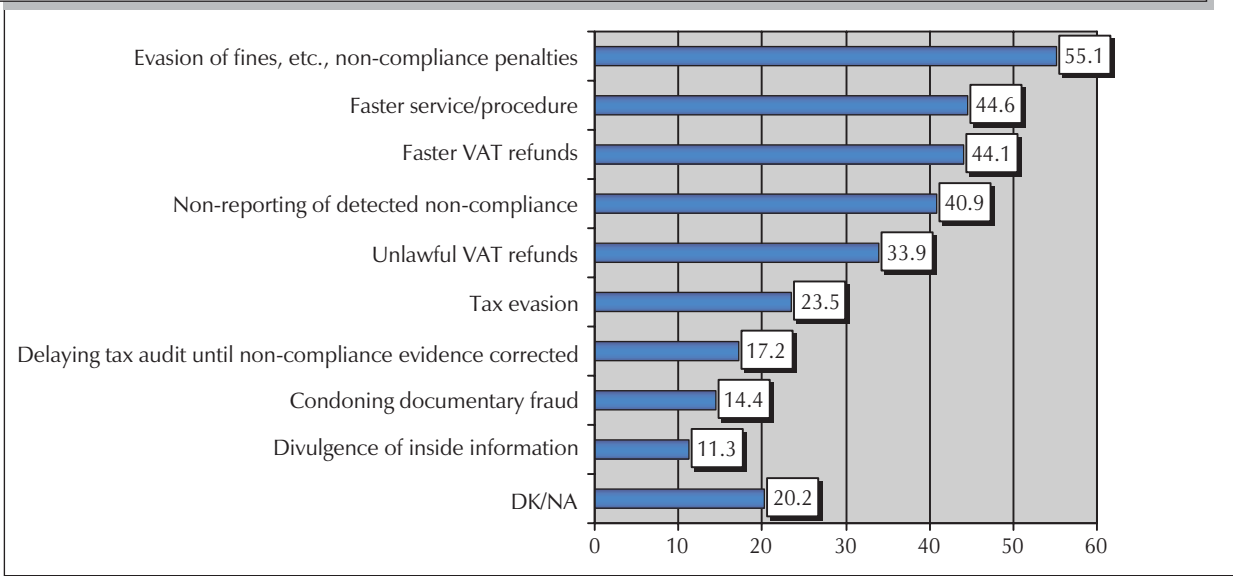


Source: Vitosh Research, April 2004. Base: 699.

The most common corrupt services include: the evasion of fines and other non-compliance penalties; faster service ('jumping the line'), and in particular, faster refunds; unlawful VAT refunds; tax evasion. The tax officers are almost unanimous in their view that VAT fraud is the most common tax offence. Among the most common corrupt services, they cite unlawful VAT refunds, fines evasion, underreported sales and the evasion of taxes and social security contributions (see Figure 6).

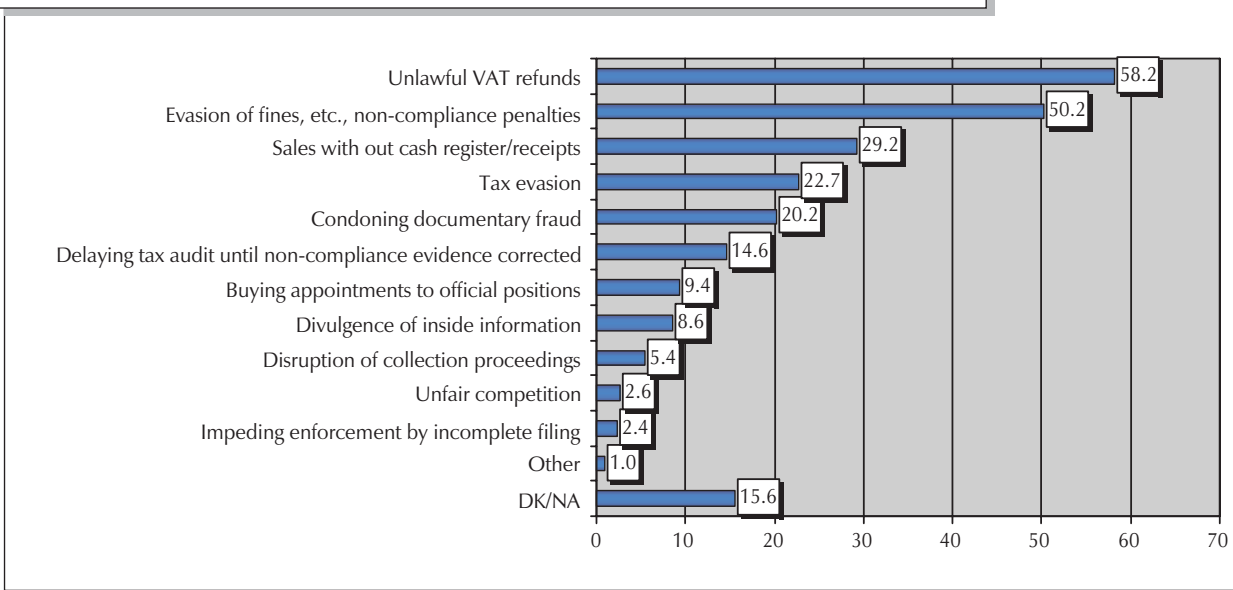
This 'inventory' of the most common corrupt services suggests several important policy implications. *First*, most of the 'services' are related to tax fraud. These include: 'turning a blind eye' to non-compliance detected; unlawful VAT refunds; complicity in tax evasion; trading inside information about imminent tax audits; delaying a tax audit to allow time for a cover-up or assets disposition. All of these involve mainly the

Figure 5. Services Provided for Bribe Money (% of respondents; 5 most common)



Source: Vitosha Research, April 2004. Base: 699.

Figure 6. Top-Three Corruption-Related Tax Offences (% of respondents)



Source: Vitosha Research, April 2004. Base: 699.

functional areas of Tax Audit and Operational Control, which is consistent with the perceived concentration of corrupt practices in these areas. This finding has an important practical dimension: anticorruption measures and resources should be targeted with priority at Tax Audit and Operational Control.

Second, the findings suggest that tax corruption in Bulgaria is not driven primarily by the heavy burden of direct taxation. According to the tax officers, tax evasion, and the related underreporting of income, is not the main purpose of corrupt dealings. Therefore, any further income-tax cuts would hardly produce a significant anticorruption

effect. According to the World Economic Forum's *Global Competitiveness Report* and the economic freedom index of the Heritage Foundation, the burden of direct taxation in Bulgaria is low also on an international comparison basis²³—a view borne out by the survey of tax officers. In answer to the relevant questions, the tax officers did not place the tax burden among the country's main economic problems or the tax administration's main challenges. In order to weaken corruption drivers then, it would be more appropriate to simplify the rules and narrow the scope of the various income-tax exemptions and allowances, so as to limit tax officers' discretionary powers in interpreting and enforcing the law.

Third, VAT fraud is the most common. However, the VAT burden is largely passed on to the end consumer. It is hardly a driver for VAT corruption. What triggers that is rather the tendency of engaging in unlawful price competition and, above all, the desire for windfall profits. Thus, anticorruption measures should focus on the VAT legislation and administration. This would allow a fairly high concentration of available sources to achieve a visible anticorruption effect. A more detailed analysis of VAT fraud follows in Chapter Four.

Fourth, expediting procedures, and especially, the faster refund of tax credit, is among the corrupt services most in demand by business (see Figure 6). This suggests that there is a significant short-term anticorruption potential in simply improving the quality of service and making it faster. A number of measures have been taken in recent years to expedite the VAT refunding process by, among other things, providing a shorter statutory time-limit and introducing special incentives for the users of a VAT account. As a result, confirmed by a World Bank survey, the average waiting time for a VAT refund has come down, from 59 days in 2002 to 41 days in 2004.²⁴ Nonetheless, the tax credit arrangement is still a major generator of tax corruption.²⁵

The level of corruption seeking better quality of taxpayer service is a direct function of the administration's effectiveness. There is still a rather wide gap between the respective expectations and requirements of the service providers and the service recipients, which is largely due to bureaucratic inertia laying the emphasis on the administration of taxes, rather than on the servicing of taxpayers. On the other hand, there are apparently quite a few taxpayers who cannot live with any rules and are prepared to pay extra for just about any time saved. According to 73.5 per cent of the tax officers, taxpayers often expect too much of them; and 77 per cent claim that the taxpayers are not aware of their rights and duties and do not have a proper understanding of the law. Most of the tax officers (62% of the respondents) also say that the taxpayers are frequently dissatisfied with the level of service. On the other hand, quite a few have shared personal experiences of taxpayers' arrogance in the belief that a bribe can solve any problem.

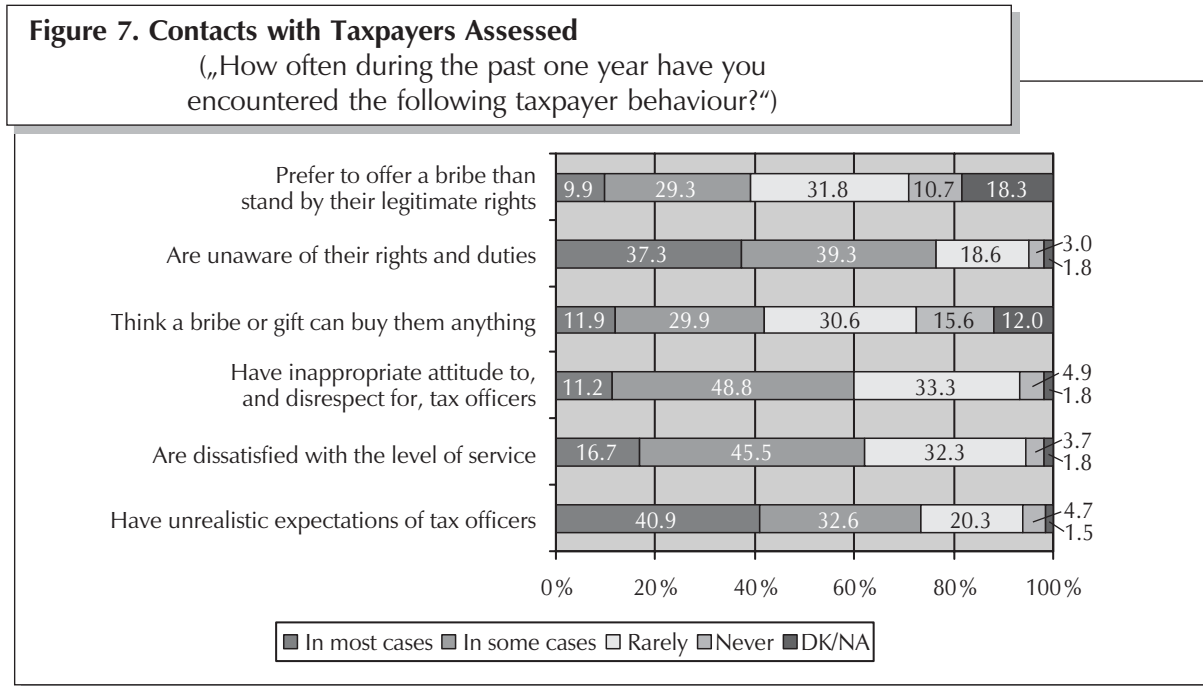
The above results suggest the existence of serious communication problems between tax officers and taxpayers, and accordingly, the introduction of service level standards would have a significant anticorruption effect. A more precise definition of

²³ Global Competitiveness Report 2003 ranked Bulgaria 8th of 79 countries (the further down the scale, the higher the tax burden) in terms of corporate tax rates (GCR 2003, Table 2.25). Heritage Foundation (2004, p. 117) assesses the corporate tax burden at 1.5 (low) on a five-point scale.

²⁴ FIAS (2004).

²⁵ See Chapter Four on VAT fraud-related corruption, and 5.2, on countermeasures.

services and of the time-limits for their delivery would narrow the opportunities for corruption pressure (by unnecessary delays) from tax officers and would set aside business's unfounded suspicions that delays are only used to extort bribes. It would be appropriate, however, to accompany service level standards with the taxpayers' reciprocal commitment to a code of conduct (see more on this under 5.2).



Source: Vitosha Research, April 2004. Base: 699.

The prices of corrupt services are also relevant to understanding taxpayers' motives to get around the rules. A bribe is essentially the price paid for a benefit for which the taxpayer is not eligible. The net benefit, i.e., the gross benefit less the bribe, is among business's leading corrupt motives. Therefore, corruption-related costs, for the purposes of tax evasion, as a percentage of the tax amount evaded are more important in understanding demand-side corruption drivers than other indicators, such as corruption costs as a proportion of annual sales (used by the World Bank) or absolute bribe amounts (used by *Coalition 2000*). The latter is actually more relevant to the analysis of tax officers' motives. (Indicators are discussed at length in Chapter Six.)

The probability of a bribe scenario is determined also by two additional demand-side factors. The first of them is the prospective briber's assessment of the bribe's effectiveness. The more reliable a tool bribes are, the more inclined businesses are to use them. However, Bulgarian businesses are undecided about the effectiveness of bribes as a problem-solving tool. Some 45 per cent of them are confident of getting what they pay for, but a considerable proportion (36%) believe that bribing one tax officer at a time may not be enough.

The second factor has to do with the extent to which bribes have become part of the cost of doing business. Approximately one third of the respondents claim that bribes are customary in their line of business and that informal payments are on the increase. Even more importantly, 27 per cent claim that there is an established 'pricelist'

of corrupt services, well-known to the players in the industry. All this is an indication of the high degree of institutionalisation of bribery as part and parcel of business tactics and business ethics.²⁶

The corrupt services analysed here, and their respective prices, shed light on business's corrupt benefits and motives. The prevailing opinion among the tax officers that corrupt transactions are more often than not initiated by the taxpayers would therefore seem to be valid. More than half of the respondents claim that the pressure for taxman-taxpayer collusion is more likely to come from the taxpayer. Still, 24 per cent concede that, seeking unlawful gain, each party is ready to meet the other half way. At that, the opinion prevails that the corrupt relationship is bilateral and direct, i.e., no go-betweens, such as friends or relatives or co-workers, get involved at any stage of the process. This goes to show that the risk of rejection or complications is regarded as negligible, i.e., the transaction costs of corruption are very low indeed.

The above notwithstanding, business does fall victim to corruption pressure from the tax administration. On average, over the last five years, one out of five businesses has complained about corruption pressure in the collection of taxes (see Appendix 3.5). An even more telling observation is that more than 90 per cent of those who experienced corruption did not take any counteraction. The reasons why include disillusionment with the system, and the unwillingness to waste time and effort, or indeed, the fear of reprisal.²⁷

The institutional opportunities for corruption pressure from the tax administration have to do with the long statutory time-limits for the delivery of administrative service. This is why, when a taxpayer gives a bribe in return for better-quality service, he or she has a greater reason to feel victimised than in the case of giving a bribe to get away with non-compliance. In both cases, of course, the objective is one: gaining an otherwise undeserved competitive advantage.

The second driver of corruption pressure from the tax administration are the weaknesses of the tax and financial reporting legislation, which allow the administration considerable discretion in the process of application and enforcement. To protect them from such corruption pressure, the taxpayers must be given a way to comply independent of a tax officer's say-so. If, to the prejudice of his interests, the taxpayer is prevented from coming to terms with the law, he will try to come to terms with the taxman, to the prejudice of the law.

But business is also, and primarily, victimised by corruption outside the context of a particular corrupt transaction. For a lot of businesses, the cost of unfair competition is so high that bribery is their only means of survival in the existing market environment. This is why, to assess the level of potential corruption, one must focus on the indicators which reflect the institutionalisation of bribery as an element of the business environment.

In summary, most corrupt transactions seek to advance the taxpayer's business interests. To regard business as invariably the victim or the losing party in such transactions is to ignore the demand-side drivers which have to do with business's tendency

²⁶ Vitosha Research (2004b, Appendix 3, Table 5).

²⁷ Vitosha Research (2004b, p. 11-13, Chart 8-9).

of seizing opportunities for unlawful gain whenever such present themselves. Nonetheless, the main causes of corruption, its drivers, and the ways to prevent it reside within the tax administration.

3.2. MOTIVES AND DRIVERS WITHIN THE ADMINISTRATION

Financial Incentives and Institutional Drivers

The main drivers of the spread of tax corruption, as seen by the tax officers, are shown in Table 4. Notably, pressure from taxpayers comes only seventh, which means that, while business may often take the corrupt initiative, it does not determine the tax officers' choice. The drivers at work within the administration are key. The tax officers are decidedly more inclined to look for the reasons and the responsibility for corruption in their midst, rather than among their clients. The top drivers cited by them include: low pay; professional ethics; legal gaps and loopholes; conflicts of interest; get-rich-quick ambitions; and bureaucratic red tape. In short, the tax officers are in no doubt that corruption is *the result of low pay levels combined with poor professional integrity and legal and organisational opportunities for corruption pressure*.

Table 4. Tax Officers on the Main Corruption Drivers
(%, up to three responses)

Tax officers' low pay levels	52.2
Tax officers' low professional ethics	35.2
The freedom of arbitrary interpretation allowed by the legislation	30.9
Conflict of professional and personal interests	21.5
Get-rich-quick syndrome	19.3
General wide spread of corruption	17.7
Pressure from taxpayers	17.6
Complicated and slow bureaucratic procedure	16.9
Demoralising effect of corruption in higher echelons	10.3
Obsolete and depreciated physical facilities	10.2
Frequent changes in the legislation	9.2
Understaffing	6.3
Ineffective internal control	4.9
High fees, taxes and fines	3.1
Tax law application weaknesses	2.9
Peer pressure	1.9
Weaknesses in service delivery	1.7
Ineffective risk assessment and tax audit targeting	1.4
Other	0.9

Source: Vitosha research, April 2004. Base: 699.

The tax officers' identification of the main challenges to their administration is also indicative. They can be summarised as: again, low pay, plus poor physical facilities, bureaucratic red tape and the instability and deficiency of the relevant legislation (Table 5). Tax officers from all functional areas identify low pay as *the* problem. The most sensitive to it, at 90 per cent, are the members of Operational Control. Another consensus issue is the inadequacy of physical facilities and the poor working conditions, worst affected by which are Tax Audit, Collection, and Appeals. These also suffer from the instability and deficiency of the relevant legislation, and the heavily bureaucratic working arrangements. The greatest number of those who perceive non-compliance detection weaknesses as a problem comes from nowhere else but Collection, Tax Audit, and Operational Control.

A tax officer's susceptibility to corrupt practices is also a function of the damage he or she might incur in the event of detection and punishment. It is interesting to note tax officers' expectations of what might happen to them should they accept bribe money or gifts. Most of them (61%) expect to be fired, and 32.5 per cent expect some other

Table 5. Challenges to the Tax Administration
(% of „Largely a challenge“ by functional area)

	TOTAL	TRS	Audit	OC	Collection	FaP	Appeals	Other	NA
Tax officers' low pay levels	75.5	72.2	77.2	89.6	77.8	68.2	42.9	70.8	100.0
Obsolete physical facilities	61.4	60.1	69.0	56.7	70.4	45.5	71.4	29.2	70.0
Complicated and slow procedure	58.7	53.8	65.5	58.2	66.7	54.5	42.9	45.8	80.0
Frequent legal changes	58.1	51.4	69.4	52.2	66.7	40.9	57.1	58.3	80.0
Legal gaps and deficiencies	52.5	39.9	67.2	59.7	59.3	38.6	57.1	58.3	50.0
Low taxpayer culture and awareness	51.9	60.1	45.7	46.3	51.9	45.5	42.9	41.7	60.0
Lack of cooperation from taxpayers	40.5	35.8	43.5	58.2	40.7	38.6	28.6	25.0	40.0
Non-compliance detection weaknesses	35.6	31.9	40.1	37.3	48.1	29.5	14.3	33.3	40.0
High staff turnover	27.8	29.2	27.6	28.4	29.6	18.2	28.6	25.0	30.0
Ineffective HRM	26.9	23.6	29.7	23.9	29.6	27.3	28.6	29.2	60.0
High tax rates	26.2	26.7	23.7	28.4	33.3	25.0	14.3	25.0	50.0
Corruption pressure from taxpayers	22.0	23.6	19.0	23.9	29.6	25.0	28.6	8.3	30.0
Misuse of official powers	20.9	20.5	20.3	22.4	33.3	18.2	14.3	20.8	20.0
Shortage of skilled professionals	16.9	13.5	21.6	14.9	14.8	15.9	42.9	8.3	30.0
Voluntary compliance weaknesses	16.6	16.0	16.8	19.4	18.5	13.6		25.0	10.0
Lack of professional integrity	12.4	10.8	11.2	16.4	25.9	18.2		8.3	20.0
Taxpayer servicing weaknesses	11.2	11.1	11.2	13.4	11.1	11.4	14.3	4.2	10.0
BASE	699	288	232	67	27	44	7	24	10

kind of disciplinary action (Table 6).²⁸ Only 5 per cent believe that the money or gift would be confiscated. Another telling observation is that quite a few (18%) fear undue pressure on them should they be caught 'red-handed'.

Table 6. Tax Officers' Expected Consequences of Accepting Bribe Money or Gifts
(%, more than one response)

Removal from office	60.9
Subsequent dependence on the briber	38.1
Disciplinary punishment, other than removal	32.5
Undue pressure in lieu of disciplinary punishment	17.9
Confiscation of corruption proceeds	5.2
No adverse consequences	4.6
Other	0.4

Source: Vitosha Research, April 2004. Base: 699.

The issues relating to pay levels, and more broadly, to HRM, and to the legal framework and the organisation of taxpayer servicing and control are key to understanding and counteracting corruption in the tax administration. These are analysed at greater length in the following Chapter. Before that however, it would be worth looking into some elements of the value system, the moral standards and inhibitions, which trigger or deter corrupt behaviour.

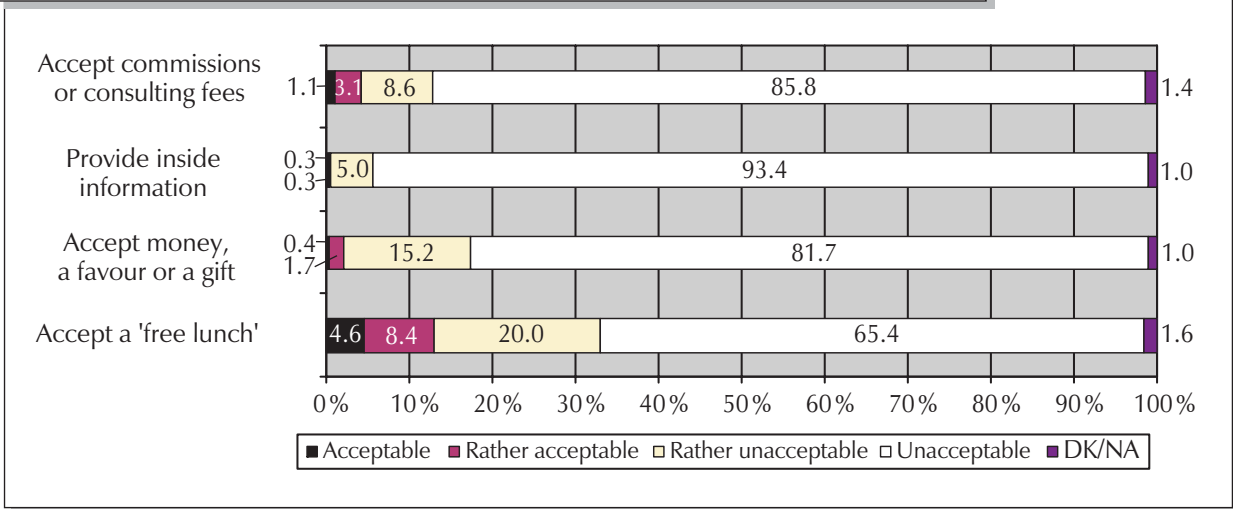
Moral Standards and Inhibitions

Overall, the survey found a high degree of tax officers' declared *personal intolerance* to corruption. For example, 81.7 per cent of the respondents believe that accepting money, a favour or a gift from a taxpayer, in any form whatsoever, is absolutely unacceptable (see Figure 8). Asked whether they would accept money or a gift in return for solving a client's problem, 67 per cent claim this would be incompatible with their professional ethic, and 22 per cent fear that it might harm their reputation. A mere 5 per cent would refuse to take the money or gift for fear of disciplinary action, in a rather striking indication of the low effectiveness of internal control and penalties. This result also suggests that, if corruption is so difficult to prove and punish, anticorruption efforts could achieve a greater effect by focusing on prevention and incentives.

An important element in the analysis of tax officers' susceptibility to corruption is their understanding of what is acceptable, i.e., where they draw the line between tokens of gratitude and unlawful consideration. The strength of their moral inhibitions

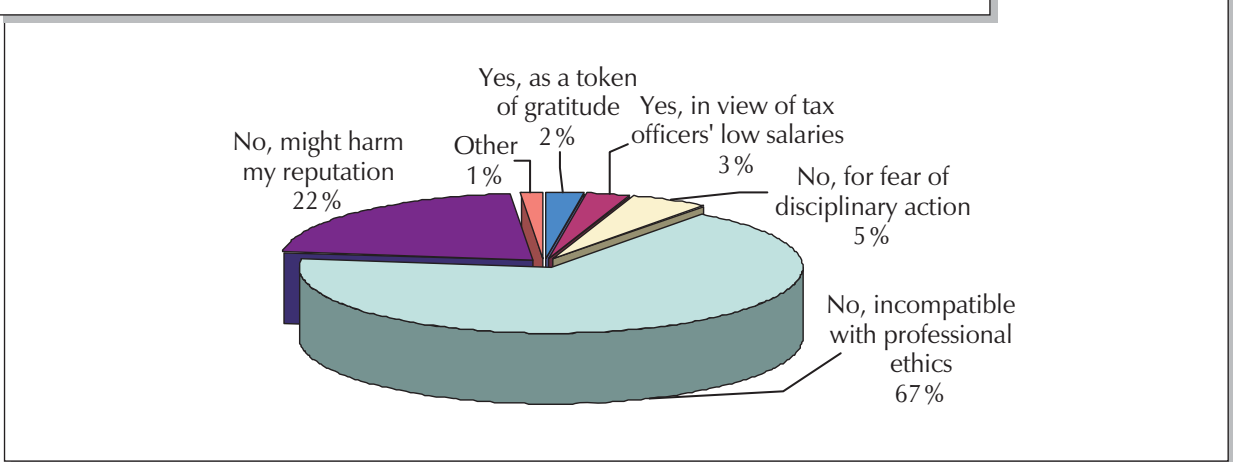
²⁸ An assumption that could be valid in this regard is that expected consequences reflect, in some part, the respondents' perceived probability of detection. For the purposes of identifying corruption drivers and recommending countermeasures, future surveys should therefore distinguish the perceived probability of detection from expectations about the severity of the likely punishment. (See Chapter Six.)

Figure 8. Is the Following Conduct Acceptable of a Tax Officer?
(% of responses)



Source: Vitosha Research, April 2004. Base: 699.

Figure 9. Would You Accept Money or a Gift to Solve a Taxpayer's Problem?
(% of responses)



Source: Vitosha Research, April 2004. Base: 699.

could be gauged from the distinction they make between *accepting a bribe* and *accepting a token of gratitude* (Table 7). Half of them would choose to regard money or a gift offered by a taxpayer as either a bribe or a token of gratitude depending on its amount or value. In this connection, more than one fifth believe that it would be appropriate to establish an upper limit for tokens of gratitude, and 28 per cent of these suggest that it should be set at BGN 50. Quite a few of the respondents believe that no amount or value could qualify as a bribe if it were not the subject of a prior arrangement or the tax officer's solicitation.

Table 7. Bribe vs. Token of Gratitude

	Is there a difference between a bribe and a token of gratitude?	How would a tax officer feel having accepted money or a gift from a taxpayer?						Base	
		Gratified	Uneasy	Obligated	Unimpressed	Other	DK/NA		
All respondents	100.0%	2.3%	23.3%	48.6%	2.4%	1.1%	22.2%	100.0%	699
Depends on amount or value	49.8%	1.7%	23.6%	50.3%	2.3%	1.1%	21.0%	100.0%	348
No difference	16.9%	2.5%	21.2%	44.1%	0.8%	0.8%	30.5%	100.0%	118
Token of gratitude, if for help with minor problems	12.4%	1.1%	25.3%	54.0%	3.4%	2.3%	13.8%	100.0%	87
Bribe, if upon prior arrangement	8.7%	6.6%	18.0%	54.1%	3.3%	1.6%	16.4%	100.0%	61
Token of gratitude, if unsolicited	8.3%	3.4%	34.5%	43.1%	5.2%	0.0%	13.8%	100.0%	58
DK/NA	3.9%	0.0%	11.1%	29.6%	0.0%	0.0%	59.3%	100.0%	27

Source: Vitosha Research, April 2004. Base: 699.

What matters here is not how small or large and gift is, or whether a cut-off value has been set between bribes and tokens of gratitude. More important is whether money or gifts received by tax officers influence their performance in the taxpayer's interest. In this respect, more than half of the respondents who distinguish between bribes and tokens of gratitude and do not regard small or unsolicited gifts as a bribe believe that accepting money or gifts would make the tax officer feel *obliged* to the giver. This is also the prevailing opinion (54.4%) among the respondents who recommend that a cut-off value should be set. The conclusion is that even small tokens of gratitude given and accepted after a service has been delivered, and having therefore no immediate impact on the administrative transaction at hand, may lead to the establishment of a special relationship of corrupt affiliation, and thus, sustain the corrupt environment.

It is worth noting that both the Criminal Code and the Norms of Tax Officers' Conduct are unequivocal in this regard. Within the meaning of the Criminal Code, 'a bribe' is any *undue benefit*, whether tangible or intangible, promised or delivered, in connection with an official's action or inaction in the line of duty. The Norms of Conduct also advise against accepting gifts „lest the officer's impartiality be prejudiced.“ An exception is allowed only for articles of commercial advertising and souvenirs of minor value. Nonetheless, most tax officers do not consider themselves bound by any administrative rules against accepting gifts. Approximately 60 per cent claim that there are no such rules or that they are not aware of any. The remaining 40 per cent do know that their Norms of Conduct are against accepting gifts.

Another indication of the tax officers' attitude to corruption is how they perceive its broader public implications (Table 8). The gravest harm it could cause is undermine

the credibility of the tax administration, spread corrupt influences over honest and loyal officers, and cause damage to the Treasury. The harmful effect on the economy and business comes only second to these. This shows a significant discrepancy with the opinion of the business community, which sees the harm of tax corruption primarily in unfair competition and market distortion.

Table 8. The Three Most Harmful Public Implications of Tax Corruption as Seen by the Tax Officers (% of responses)

Undermines the credibility of the tax administration	77.3
Undermines uncorrupted officers' respect for the rules	47.9
Causes damage to the Treasury	46.4
Promotes the shadow economy	37.2
Harms the country's international reputation	16.7
Discourages inward investment	12.6
Demoralises society	12.3
Delays reforms and development	9.4
Prevents fair market competition	4.6
Thwarts private initiative	3.6
DK/NA	1.7
Other	0.4

Source: Vitosha Research, April 2004. Base: 699.

Last but not least, individual tax officers' tendency to corrupt behaviour depends on how they perceive the spread of corruption outside the tax administration. If they feel victimised by corruption whenever they have to deal with other administrations as clients, it is easier for them to justify their own corrupt behaviour at work. Thus, a tax officer's choice to accept or reject a bribe is largely conditioned by their personal experience and perceived level of corruption in society. Accordingly, the tax officers rank the wide spread of corruption in all spheres of public life among the main drivers of corruption in their midst, on a par with pressure from taxpayers (see Table 4). The tax officers rank corruption also among society's main problems, together with the inefficient economy and above such other problems as poverty and the deficiencies in healthcare, justice and governance. This is apparently the result of personal experience in dealing with the healthcare system and the law enforcement authorities. Approximately 35 per cent report sporadic or frequent occurrences of bribes they have had to give to medical practitioners, and 12.3 per cent have had to resort to bribes, gifts or reciprocal favours in their contacts with authorities under the Ministry of Home Affairs. The alternatives to straightforward bribery are common: for many in the public administration, being on friendly terms with a tax officer is more valuable than a bribe or gift. About a quarter of the tax officers in the survey report such experiences in their contacts with medical practitioners during the past year; 13 and 10 per cent, respectively, have had to promise favours to municipal servants and police officers. Interestingly enough, 8 per cent report such experiences with co-workers. Overall, the perceived wide spread of corruption throughout society is an important indication of tax officers' personal attitudes to bribery.

The review of moral standards and inhibitions raises the need for a focused training effort, combined with an appropriate monitoring and evaluation system, to enhance the tax officers' knowledge of the Norms of Conduct (only recently introduced) and of the existing legal anticorruption measures, and impress upon them a clear idea of the responsibility and liability involved. Of course, practice is the best tutor: if disciplinary action for corrupt behaviour, to say nothing of criminal prosecution, is non-existent in the administration's practice, no amount of training could help.

In summary, business has strong motives to try and evade compliance by bribing tax officers. Ignoring these motives could generate unrealistic expectations regarding the effectiveness of prescribed countermeasures, or indeed, distort the very process of 'diagnosis and therapy'. Taking account of business's motives is important in understanding what triggers a corrupt deal and why business itself has failed to take an active stance against corruption. However, the motives and drivers within the administration decide the outcome of a corrupt initiative. They must therefore remain the main target of anticorruption policies.