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"MAGIC FORMULA" OF THE JOINT AUDITS IN RAISING REVENUE THROUGH WEEDING OUT CORRUPT PRACTICES (BASED ON ROMANIA AND MOLDOVA CASES)

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Abstract

Around one trillion Euros is lost to tax evasion and avoidance every year in the EU. In this context, governments have increasingly been tempted to turn to cross-border audits to secure needed resources and expertise to assist in ensuring international compliance with various taxes and other sources of revenue. However to manage international tax compliance revenue authorities are faced with the significant problem of corruption. The aim of this paper is to examine whether joint audits have to be applied in order to increase the efficiency of revenue collection. In order to narrow the field of investigation, the article focuses primarily on the situation faced by the Romania and Moldova.

Key words: *interstate tax audit, Joint audit, multilateral control, multistate joint audit, simultaneous examination*

INTRODUCTION

The tax audit landscape presents daunting challenges. The following key factors are driving those challenges: the accelerating pace of global enforcement and global information exchange across jurisdictions; the rapid development of digitalization and the growth trend in the number of taxpayers and volume of cross-border goods and services traffic; the evolution of electronic commerce and sophisticated financial arrangements; the increasing number and size of enhanced relationship tax compliance programs, etc.
Those challenges facilitated development of aggressive tax planning and tax fraud strategies with regards to looses in tax revenue due to profit shifting by multinational firm and wealthy individual. According to the report of OECD [21]: "Tax avoidance and tax evasion threaten government revenues throughout the world. The US Senate estimates revenue losses amount to 100 billion dollars a year and in many European countries the sums run into billions of Euros."
The increased variety and quantity[4] of international tax conflicts, due to taxpayers' engagement in international tax evasion or aggressive tax avoidance, have prompted contemplation of a more enhanced collective cooperation among states over international tax. Perhaps not surprisingly, therefore, OECD and EU member states have seen a surge of issues associated with significant cross-border transactions rising in recent years. It is worth keeping in mind that international cross-border approach of Romania, Moldova and other European countries is affected by EU practices. In this regards, the question of appropriate and effective tools and policy, within European context, is at the heart of this quest.
Based on the literature review, it was noticed that a few research results exist on the joint audit. Actually no empirical studies of joint tax audit exist at all. However there are many

[4] The amount of tax audits and disputes with international references is constantly growing in a globalized world. This significant increase has been confirmed by the most recent OECD's statistics, over the past five years (see OECD, "Mutual Agreement Procedure Statistics for 2011" (April 4, 2013), available at http://www.oecd.org/ctp/dispute/mapstatistics2011.htm According to OECD's evidence, the amount of MAP caseload among OECD member states has remarkably increased by 63% between 2006 and 2011 (from 2,352 to 3,838) and continue to grow each year; and the time to complete a MAP case has also increased from 22,1 months in 2006 to approximately 25,39 months in 2011, although this represents 2,09 months reduction in the average completion time (from 27,3 months in 2010).

studies that have indicated that audits are an effective tool for deterring tax fraud.

In responding to the changes indicated above and recognition of effectiveness of audits, group judgment and decision-making quality, and negative impact of corruption, countries (many of which are members of the OECD's Forum on Tax Administration - FTA) are pressed to move from unilateral tax audit models to "simultaneous" audit models and further towards "joint audits" in the hope that this approach will allows for the effective tax system which is expected to be more efficient and productive. Movements for the further development of joint audits will allow business community and tax administrations to improve tax compliance and fight tax evasion, tax avoidance and corruption at the international level.

MATERIALS AND METHODS

The aim of this paper is to examine whether joint audits have to be applied in order to increase the efficiency of revenue collection in Romania and Moldova. This research is relevant for three groups of persons: governments and policy makers, consultants and companies, and academic stuff and researchers. Firstly, we characterize the historical background and growing interest for cross-border tax audits in order to highlight the main advantages of providing joint tax audits (Section I). We also identify the conditions under which entering into a joint audit is beneficial to both the tax authority and the taxpayer (Section II). We provide and analyse statistical information on the tax revenue, tax burdens from point of view of time to comply, tax rates, nr. of tax payments and nr of taxpayers per auditor, as well as shadow economy, corruption, inclusive taxpayers registration indicators; tax capacity and tax effort (Section III - IV) in order to stress and demonstrate the needs for joint audits in an European Community of States and their role on weeding corrupt practices.

In order to narrow the field of investigation, the article focuses primarily on the situation faced by Romania and Moldova, as well as other European countries competing in international markets. In doing so, a large amount of statistical data was collected, synthesised, and analysed. This paper is a combination of a descriptive study and analysis of statistical information. Also, we analysed non-stashed and data concerns' drawn from the OECD, World Bank, IOTA information and other sources of technical expertise. The reference section provides a full list of the reference sources.

RESULTS AND DISCUSSIONS

I.The Growing Interest for cross-border Tax Audits

Taking into account increasing trade of cross-border activities and investments in both business entities and individuals that are operating more globally, and challenges in tax environment from traditional methods of ensuring compliance at national level to more coordinated action of ensuring compliance at international level, we decided to examine the forms of cross-border tax audits. Analysis of the cross-border tax audits will allow for better understanding of states'[5] and taxpayers' goals, their historical evolution will enable better perception taxpayers' and tax authorities' needs for more coordinated actions.

To meet the needs of a government, tax audits vary widely in sophistication, professionalism and coverage. Thus audit procedures considered unacceptable by one country may be standard for another. To highlight the advantages of cross-border tax audits, we divide them in three categories, according to interest of parties in these tax audits:

-Multistate joint audits, in which the interests of taxpayers in checking tax administrations of several states are investigated;

-Interstate tax audits, in which interest in such an inspection comes from at least two or more states involved in the process of initiating a tax audit;

-Joint tax audits, where either a taxpayer may request a proposal for a joint audit to a

[5] States - states of the same jurisdiction or states of different jurisdiction.

participating country, or the participating country may suggest joint audit cases.

Multistate Joint Audits. A multistate Joint Audit is an audit conducted by the Multistate Tax Commission (MTC)[6] of the United States that audits multistate business for several states at once. The audits encompass sales and corporate income taxes. They are initiated by the taxpayer, who must write a request for a joint audit by the Commission on behalf of participating states [5].

The decision to perform an audit is made by the MTC audit committee that provides an audit authorization form to each state, if they agree to perform the audit. The states have the option to participate in the audit or to refuse. Preference for participation is given to taxpayers having nexus[7] with ten or more states participating in the MTC joint audit program and who meet one or both of the following criteria:

-The taxpayer's audit will involve issues that would benefit from consistent interpretations among several states;

-The taxpayer has recently registered for tax purposes with at least 10 participating states, has never been audited by those states, and seeks the guidance on compliance that an audit would provide.

In deciding whether or not to place the requesting taxpayer in the program's audit inventory, the MTC Audit Committee will consider the follow factors: 1. Does the taxpayer meet or exceed the preference criteria above?; 2. Are audit staff resources available within the MTC Joint Audit Program?; 3. Does the taxpayer have a sufficient size and geographic scale of operations to justify the use of MTC Joint Audit resources for an audit?; 4. Are at least seven states willing to participate in the audit? According to Multistate Tax Commission data, 25 states of US participate in the Joint Audit Program (23 for income tax audits, 19 for sales & use tax audits, and 1 observing state).

Interstate tax audits. Interstate tax audits are made by tax administrations of several states on the tax liability of one or more related taxable persons by the process of:

-*Simultaneous examination:* an arrangement between two or more states. Examinations are made simultaneously, each authority on its territory, as part of its legal competence of the tax affairs of one or more taxable persons. Some of the factors for case selection include the common tax payment compliance regulations, complementary or related interest, with a significant exchange of any relevant information that they obtain. A legal basis for such examinations offers a wide range of tools for cross-border tax cooperation and can be found among others in: Article 12 of Council Regulation (EC) No. 1798/2003 of 7 October 2003 on the exchange of information in the field of value added tax and repealing Regulation (EEC) No 218/92[8]; Council Regulation (EC) 2073/2004 of 16 November 2004 on administrative cooperation in the field of excise and Directive 2004/56 EEC of 21 April 2004, which amended Directive 77/799 EEC on mutual assistance by the competent authorities of the states or based on the provisions, in accordance with the Article 26 of the Convention on avoiding double taxation and preventing tax evasion[9]; Article 5 of the CIAT Model Agreement on Exchange of Tax Information; Article 8 of the joint Council of Europe and OECD Convention on Mutual

[6] The Multistate Tax Commission (MTC) was created in 1967 through the Multistate Tax Compact, an agreement created and ratified by each member state. The objectives of the Commission are to help make state tax systems fair, effective, and efficient; encourage the adoption of uniform tax law and regulations; reduce state compliance burdens on business; and protect state fiscal authority.

[7] A **nexus** in general means a connection. The term nexus is used in tax law to describe a situation in which a business has a "nexus" or presence in a state and is thus subject to state income taxes and to sales taxes for sales within that state. Nexus describes the amount and degree of business activity that must be present before a state can tax an entity's income. If a taxpayer has nexus in a particular state, the taxpayer must pay and collect/remit taxes in that state; *See* http://biztaxlaw.about.com/od/glossaryn/g/nexusdef.htm

[8] Regulation (EEC) No. 218/92 provides for the appointment of individual tax officers to exchange information directly with tax officers to exchange information directly with tax officers in other member states.

[9] OECD (2010) Update on the Model Tax Convention on Income and on Capital OECD Paris, www.oecd.org/dataoecd/23/43/45689328.pdf and in October 2008, the United Nations also introduced the standard on information exchange for tax purposes in the UN Model Tax Convention, http://unpan1.un.org/intradoc/groups/public/documents/un/unpan002458.pdf

Administrative Assistance in Tax Matters[10] and Article 12 of the Nordic Convention[11].

-*Multilateral control*: a coordinated control of the tax liability of one or more related taxable persons organized by two or more participating countries with common or complementary interests which includes at least one Member State. The coordinator of the multilateral surveillance programme Fiscalis of the European Commission supervises the multilateral control[12]. The objectives of the Fiscalis programme are to ensure the proper functioning of the internal market by supervising the compliance of Community fiscal rules, protecting national and Community financial interests, combating of tax avoidance and tax evasion, including its international dimension, and enhancing the cooperation between Member States, and reducing, to the extent possible, the (administrative and taxable persons alike) burden of the implementation of Community legislation. The interstate tax audits encompass VAT and excises, income tax and capital gains tax, and insurance premiums. They are initiated by one of the EU Member States who invites other Member States to participate.

If a Member State decides to accept the invitation, tax authorities of that state take part in the initial meeting[13] for such examination. After the initial meeting, Tax auditors of Member States who agree to the audit provide an intra-Community audit plan based on the agreements made, according to the competences and possibilities their own laws and regulations offer.

Joint Tax Audits. As outlined above, audits of multinationals and globally active high net worth individuals have traditionally been carried out separately or through simultaneously tax audits. Due to having to go through a similar exercise at least twice, traditional audits can lead to an increased burden on businesses, individuals, and governments. For this reason joint audits are seen [25, p.195] “as one way of reducing this burden”.

Joint tax audits are described as two or more countries joining together to form a single audit team to examine an issue(s) /transaction(s) of one or more related taxable persons (both legal entities and individuals) with cross-border business activities, perhaps including cross-border transactions that involve related affiliated companies organized in the participating countries, and in which the countries have a common or complementary interest; where the taxpayer jointly makes presentations and shares information with the countries, and the team includes Competent Authority representatives from each country [21].

The joint tax audit has been recognized by revenue bodies, taxpayers, and practitioners as preferential for both taxpayers and the tax authorities because it could allow the involved parties to focus on the issue, understand the facts in a more urgently manner, and thereby allow for expeditious resolution of any disagreements.

According to Joint Audit Participant’s Guide one of the advantages of joint audits in contrast to more traditional audits is that either a taxpayer may request a proposal for a joint audit to a participating country, or the participating country may suggest joint audit cases.

In deciding whether to perform a joint audit, the Competent Authority considers many factors including the following:

-Information available in two or more countries will allow a better risk assessment;

-Similar or related transactions of multinational companies will allow for deterrence of unnecessary complexity of multiple entities or respective taxpayers and clearer structured transactions;

-Willingness of multinationals for greater certainty and an enhanced relationship with revenue bodies on a global basis;

[10] OECD & Council of Europe (2008) The Convention on Mutual Administrative Assistance in Tax Matters. www.oecd.org/dataoecd/15/43/2082215.pdf with Supplementary Protocol (2010).

[11] Nordic Convention. Convention of 7 December 1989 between the Nordic Countries on mutual administrative assistance in Tax Matters. The Nordic countries are: Denmark, Faeroe, Greenland, Finland, Iceland, Norway and Sweden

[12] formed on the basis of Decision 888/98/EC of the European Parliament and of Council of 30 March 1998.

[13] The purpose of this meeting is to determine, the joint auditing strategy (risk analysis), the objectives of the Interstate tax audit and the objects to be audited.

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-Tax risk connected to specific business sectors or non-compliance taxpayer;
-Two or more jurisdictions agree that a joint audit would expedite factual development and issue resolution on double taxation or transfer pricing methods.
-The residency of the taxpayer is not clear, etc.
The 2013 IFA country reports show that up till 2013 there have been only a few procedures or pilot projects, with the notable exception of Finland, which is conducting five to ten joint audits a year. These reports also show that the cases most suitable for joint audit programmes are those dealing with transfer pricing, a taxpayer's residence determination, analysis of complex tax structures, examination of entities operating in tax systems where it is possible to follow money flows and identification of aggressive tax planning schemes [16].
As demonstrated by practices described in this section, tax administration is marked by a considerable degree of international cooperation even if it is known [15] that tax laws and policies of different countries are far from congruent.
There are many reasons for governments to engage in joint audits, including sharing of aggressive tax planning, risk profiling, compliance practices and collecting additional revenue. Even though that exist a variety advantages, tax authorities are still "feeling their way along with joint audits", as has been noted by Michael Danilack, deputy commissioner (international), IRS Large Business and International Division about IRS [33, p.1300].

II.Recognizing the Need for Joint Tax Audit: strengths and opportunities

As anticipated, the first countries to lead the way in joint auditing have been JITSIC members, with the US participating in joint audits with Australia as well as the UK, noting their commonly shared language. Engagement between countries that speak the same language is a natural place to start, and facilitates active participation and joint meetings for information gathering and taxpayer questioning purposes [13].
However some tax practitioners see a real possibility that joint audits will be used more widely in the EU, due to relatively active communication lines (e.g. between Belgium, France and Netherlands) or Fiscalis programme in the near future.
The joint audit project was carried out by representatives from 13 OECD countries (Australia, Canada, Denmark, France, Japan, Korea, Mexico, Netherlands, South Africa, Spain, Turkey, the UK, and the US). The group was asked to do so because revenue authorities displayed their willingness to enhance cooperation and coordination to achieve a reduction in tax avoidance and tax evasion, enforcement of transfer pricing regulations, enhanced confidence in the tax systems, as well as the development of strategies and competencies. As a consequence of the work from this group "Joint Audit Report" and the "Joint Audit Participant's Guide" were published in September 2010. The OECD report focused on legal framework for joint audit, challenges for conducting joint audits, case selection, and management of a joint audit.
A joint audit refers to a review process in which several states share the responsibility for conducting an audit report of one or more related taxpayers in a single Competent Authority team. Usually a joint audit is drafted to help compile an audit report on multinationals that operate across borders, but doesn't exclude the possibility to conduct auditing on high welfare individual taxpayers.
There are a number of strengths and opportunities why the legal instrument of a Joint Audit deserves special attention. Moreover, it has been believed that "everyone stands to gain from this approach" [13, p.12].
The most important aspect in this regard would be appear to be the following:
First, it can help split up the work of an audit across multiple competent authorities, which may reduce the overall time needed to complete the auditing process. The taxpayer benefits from them bring less administrative burden, resulted from one exam team conducting joint audits instead of two or more audits, which must be addressed separately. Timeliness of audits and government interactions are mutually beneficial for all

parties involved in tax audits. Furthermore, competent authorities could resolve more tax issues without resort to litigation.

The joint tax audit has been recognized by revenue bodies, taxpayers, and practitioners as preferential for both taxpayers and the tax authorities because it could allow the concerned parties to focus on the issue, understand the facts in a more timely manner, and thereby allow for expeditious resolution of any disagreements [27]. In other words, the advantages of joint tax audits are that they make international legal business easier.

Second, it may improve the accuracy in quality of work. An essential characteristic of the joint audit is the auditor's provision of intensive mutual supervision. Moreover proper technical qualifications, practical experience (e.g. experienced personnel in the fields of transfer pricing, double taxation, aggressive tax planning), and expertise in the matter are necessary and required of auditors involved in each participating country to ensure high quality joint audit reports. However, furthermore, important decisions cannot be made by a single auditor; this method reduces the risk of mistakes.

Third, it guards against conflicts of interest among participating parties, especially in the case of the developing countries where low tax morale persist, as it prevents future targeting of taxpayers. Allowing independent review of reports by international auditing members, it may helps to diminish inspectors' potential to protect corrupt taxpayers from audit. Providing joint examinations, countries will respond to high wealth taxpayer corrupt behaviors through legitimate and educated ways.

Fourth, it may decrease or minimize taxation costs, by applying direct contacts, direct exchange of information and the competences of Competent Authorities requested for a joint tax audit which will allow for real-time and less expensive collection of information. Decreasing the costs of collecting taxes will help reduce the budgets deficit and increase social trust in good governance.

Fifth, various studies[14] have indicated that audits are an effective tool for deterring tax fraud. Consequently, joint audits can help in identifying further areas of collaboration where improvements to tax administrations' supervision exerted on risk-based audit selection can be made. On one hand, revenue administrations will focus on high-risk taxpayers, particularly those who have undertaken a significant amount of tax planning combined with having processes and systems that are not robust. On other hand, companies will undertake risk process and control reviews to lower their risk rating to avoid being rated high risk by revenue authorities.

Having in their disposition more than 600 multilateral tax information exchange agreements[15] and formal coordination on cross-border joint audits, global tax administrators are more equipped to pursue tax underpayments than in any other time in history. To catch the offenders [18] and [19], they will be mining e-file data submissions, cross-referencing data with XBRL-based financial disclosures, and using powerful analytics to accurately determine the audit risk of companies so they can focus their audit resources on companies with the highest potential return.

Sixth, structured cooperation in joint audits may enhance the impact of national tax compliance administrations' programs and revenue collection, detecting and redressing individual cases of noncompliance. As commissioner Douglas Shulman noted (2009) "joint audits would be a part of a global effort to crack down on cross-border tax evasion, spurred in the last year by tax-evasion cases involving banks in Liechtenstein and Switzerland" [7].

Seventh, increased global enforcement and global information exchange across jurisdictions encourage companies to work more effectively with revenue administrations. The OECD's proposals for

[14] *See:* Spicer and Thomas (1982); Alm and McKee (2006); Devos (2013)

[15] On the global front, the OECD notes that over 80 countries have committed to "international co-operation in tax matters." Since 2008, the number of multilateral tax information exchange agreements between countries has grown from only 44 to over 600.

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enhanced relationships with large companies[16] underscore that trend. Voluntary engagement on enhanced tax compliance programs helps companies to understand tax authorities experiences in order to identify and address risk issues in an effort to identify and address potential controversy. The control of tax risks and prevention of errors is a joint duty of both revenue administration and taxpayers. It has noted by Jack Grocott [14, p.15] that "with more communication between countries, multinationals are founding that revenue bodies in different countries are showing more consistency and transparency in their treatment of similar issues" and recognized by Forum [20, p.8] that "taxpayers who behave transparently can expect greater certainty and an earlier resolution of tax issues with less extensive audits and lower compliance costs".

In addition to this a new supervisory burden method will result in "right"[17] amount of taxes payments and relevant state budget revenues.

III. The Even more Compelling Need of Joint Audits in Romania and Moldova

Looking for better national resources mobilization, the tax administrations are focus on increasing compliance by making it easier for taxpayers to comply with the least time or less tax compliance costs and improving the authority's ability to identify and collect revenues from noncompliant taxpayers. In this regards, on one hand Romania and Moldova seem to have a good records of the total tax rate and time to comply indicators comparing with EU 28 (e.g. 2013 time to comply indicator in Moldova, EU-28 and Romania is 181, 192 and 200 hours accordingly and total tax rate 40,4%, 42,7% and 42,9%). On another hand their systems are steel cumbersome from point of view of the number of tax payments indicator.[18] Accordingly to PwC: Paying taxes 2013 data Romania and Moldova are far to make their tax systems easier to comply having 41 and 31 tax payments per year comparing with 12 average in the EU-28. Multiple tax payments greatly increase the "pressure" and labor intensity per tax inspector, which can be efficiently split by working in a team.

When comparing the burden of taxation for international business, it is not sufficient to look at tax rates, numbers of tax payments, time to comply. The number of auditors available to enhance tax compliance also requires a careful review. According to Intra-European Organization of Tax Administrations (IOTA) data the number of active taxpayers per tax auditor staff is relatively high in Moldova (3200) comparing to EU-27, which was 2330 taxpayers per auditor (Romania indicator shows only 1200 taxpayers per auditor).

However the chances of being subject to a tax audit in Romania. To start with, few people are registered taxpayers – less than 20 percent of the population is registered in Romania, in contrast with over 80 percent of the respective citizen populations in Switzerland, Denmark, Sweden, Finland, Norway, Iceland and 50% in Moldova. Certainly we can find the dual impact of migration to affect the number of the active taxpayers[19] here. For example, about 20 percent of the population represents migrants. At the same time, those citizens represent about 35 percent of all national registered taxpayers, which can substantially change all indicators of the official reports. A similar situation exists in almost all former communist and Balkan countries from European countries.

[16] There are several reasons why enhanced relationship tax compliance programs are focused on large enterprises: First, a small number of large taxpayers account for the majority of gross income and profit taxes paid. According to the World Bank (2011, p.39) less than 1 percent of large enterprises are responsible for 60-70 percent of domestic tax collections. Second, large businesses have a complex tax situation. As a result of their tax corporate strategies, which involve complex issues of legal interpretation and calls for a specific treatment of risks, the transactions of the large taxpayers segment are placed, typically, in a gray area between tax evasion and tax avoidance.

[17] The debate of right is not over 'to pay or not to pay', but, rather, about what and where should be paid.

[18] The Total Tax Rate measures the tax cost (as a percentage of profit) born by the standard firm in the second year of operation, expressed as a share of commercial profit. The time to comply indicator captures the number of hours it takes to prepare, file and pay (or withhold) three major types of taxes: profit taxes, consumption taxes and labor taxes, including payroll taxes and SSC for a case study company. The number of tax payments reflects the total number of taxes and contributions paid, the method of payment, the frequency of payment, the frequency of filing and the number of agencies involved for a standardized case study company during the second year of operation. The Paying Taxes Indicators are calculated annually by PwC, the World Bank and IFC; see PwC. Paying Taxes 2013. The Global Picture at: http://www.pwc.com/gx/en/paying-taxes/download-order.jhtml

[19] Active taxpayers are registered taxpayers who are paying taxes.

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The differences in the number of active taxpayers per tax auditor staff can be explained not only by relatively high and low rates of personal taxpayer registration and workers international mobility, but also by a high rate of tax evasion (shadow economies[20] in more than 28% of nations)[21] and high levels of the corruption (score below 5) in almost all former communist and Balkan countries (Table 1).

Table 1. International comparison of size of the Shadow Economy and Corruption Perception Index

	2013, GDP per capita in $	Size of the Shadow Economy (in % of GDP)			
		Less than 10%	10% – 20%	20% - 30%	More than 30%
Corruption Perception Index	Less than 3				∗Ukraine (3.930)
	3.01 – 5		Slovakia (17.706) Czech Republic (18.871)	Romania (8.874) Italy (34.715) Greece (21.857) Croatia (13.401) Turkey (10.721)	∗Georgia (3.597) ∗Moldova (2.239) ∗Macedonia (4.931) ∗Albania (4.565) ∗Bosnia and Herzegovina (4.620) Bulgaria (7.328)
	5.01 – 7	Austria (49.039)	Portugal (13.435) Spain (29.150) EU-28 (33.358)	Lithuania (15.649) Estonia (18.852) Latvia (15.187) Cyprus (24.867) Malta (22.892) Poland (13.435) Slovenia (23.317) Hungary (13.388) ∗Israel(36.926)	
	More than 7	United Kingdom (39.372) Netherlands (50.816) France (44.099) Luxembourg (112.473) Switzerland (81.276)	Belgium (45.538) ∗Iceland (45.416) Sweden (58.014) Norway (100.579) Finland (49.055) Denmark (59.129) Germany (44.999) Ireland(48.608)		

Source: Based on Transparency International's (2007-2013) surveys[22], Elgin, C. and Oztunalz, O. (2010) and Schneider (2013) data

∗ Latest data are: Iceland – 2011; Israel – 2007; Albania, Bosnia and Herzegovina, Georgia, Macedonia, Moldova and Ukraine – 2008

Table 1 presents the size of shadow economies, the corresponding Corruption Perception Index and level of economic development rankings of 28 EU member states and 11 associated countries in 2013. A first glance at the results reveals that shadow economies are complex phenomenons present, to a large extent, in all types of economies, starting with 7.5% in Austria and ending with more than 40% in Georgia, Moldova, and Ukraine (EU-28 – average of shadow economy is 18.90%). While a clear negative trend can be observed over 2007 through 2013, it is evidence that one of the big challenges for every government is to adopt efficient incentive-oriented policy measures to make shadow economies less attractive [23].

Many academic papers[24] study relationships between corruption and shadow economies, viewing them as complements and highlighting different mechanisms of how they can interact. The corruption often appears to be compared with an extra tax added to the regulatory burden of the official economy. Consequently, the increase in demand of bribes lead to more activities in the shadow economy.

Corruption[25] is among the greatest causes of the shadow economy's size and impact. This means that anticorruption measures may be ineffective if the reciprocal relationship between corruption and the shadow economy is not addressed.

In a cross-country analysis, the relationship between corruption and the shadow economy[26] appears to be positive. In more than one half of the countries analyzed, an

[20] Measuring the shadow economy is one method of determining the extent of tax evasion, because it provides information of the extent non-compliance. In this regards Joint Audits are seen as an efficient tax administrative tool that will discourage egregious tax planning, as it allows for identification of a fuller set of facts earlier, for all jurisdictions involved.

[21] A good portion of the migrant-net-profit is a result of the high cash flow volatility and the taxpayer's conscience of paying taxes. Low tax morale and weak ability of governments to collect their taxes may result in a higher tax evasion rate, thereby increasing the share of the shadow economy in both destination countries and countries of origin.

[22] No region or country in the world is immune to the damages of public-sector corruption; the vast majority of the 183 countries and territories assessed score below five on a scale of 0 (highly corrupt) to 10 (very clean). While no country has a perfect score even in Europe, one-thirds of analyzed countries score below 5, indicating a serious corruption problem (EU-28 – score average 6). - See more at: http://cpi.transparency.org

[23] The gap of shadow economy (max 35%) between analyzed countries is very high. However, it has to be pointed out that it is not only corruption that is driving up the shadow economy. For example Georgia has nearly managed to rule out corruption in the public institutions, being ranked 12th out of 43 countries in the European region, but the share of the shadow economy is still the highest among all analyzed countries. Changes in leadership and the existence of two separatist territorial entities (Abkhazia and South Ossetia) in the country facilitate the increase of this share. Similar situations are recorded in most former socialist countries, where there is a large discrepancy between the ruling oligarchy clans and the poor population, and the middle class is nonexistent or very small derived from the first. On the contrary, developed countries, especially the Nordic countries, register a small share of the shadow economy, except the PIGS countries (Portugal, Italy, Greece and Spain). For more statistical information see 2014 Index of Economic Freedom, Edited by Ambassador Terry Miller, Anthony B Kim, and Kim Holmes, Washington: The Heritage Foundation & Wall Street Journal, Nr.1, 2014. 490 p. http://www.heritage.org/index/book/executive-highlights

[24] Johnson et al. (1997, 2000), Shleifer (1997), Hindriks et al. (1999), Friedman et al. (2000), Hibbs and Piculescu (2005), Dreher and Shneider (2010), Buehn and Shneider (2012).

[25] As Phan Anh Tú (2012, p.17) noted 'the definitions of corruption developed by the World Bank and Transparency International are commonly used' they define it as "the abuse (misuse) of public power (entrusted power) for private gain." To continue the idea of defining *corruption* we will use this concept in meaning of the abuse (misuse) of potential tax inspectors to protect taxpayers from audit for private gain.

[26] This statement is mostly true for post-socialist countries.

increasing trend in the Corruption Perception Index is observed between 2007 and 2013; while this is promising, but not enough to reduct the damages of public-sector corruption.

IV.Joint audits weed out corrupt practice

It is fairly well known that tax collections are usually the main source of financing a suitable basis for development, relieve poverty, supply public services, and promote a wealthy social infrastructure for long-term growth. This kind of revenue must be a stable, predictable and independent source of financing for every country.

However, governments are loosing a significant amount of revenue, because of the inefficiency in collecting taxes (Table 2).

Table 2. Countries' Tax Capacity and Tax Effort

2011 (tax capacity – real tax revenue as % of GDP)	Tax Effort			
Tax capacity (as % of GDP): tax and social contributions/ tax effort	60.1% - 70%	70.1% - 80%	80.1% - 90%	More than 90%
Less than 35%	Albania (10.9%)			
35.1% – 40%	Bulgaria (13.9%)	Moldova (8.4%)	Israel (6%)	
40.1% – 45%	Lithuania (17.3%) Romania (14.7%) Slovakia (16.1%) Turkey (13.6%) Switzerland (16%)	Croatia (9.2%) Greece (9%) Poland (10.8%) Montenegro (9.3%) Serbia (9.3%) Spain (9%)	Hungary (8.6%) United Kingdom (7.8%)	France (2%) Italy (0.9%)
45.1%– 50%	Estonia (17.1%) Ireland (17.5%) Latvia (17.7%)	Czech Republic (13.8%) Germany (10.4%) Iceland (13%) Luxembourg (12.3%) Portugal (13.2%) Slovenia (13.9%) Ukraine (10.7%) **EU level**	Norway (6.2%) Netherlands (9.5%)	Austria (3.1%) Finland (3.4%) Sweden (2.7%)
50.1% – 55%			Belgium (6.6%)	Denmark(4.4%)
Over 55%	Cyprus (19.5%)			

Source: Based on Fenochietto and Pessino (2013)[27] data

* (data for Bosnia and Herzegovina, Georgia , FYR Macedonia and Malta are not available)

Table 2 demonstrates that countries with the highest tax collection effort like France, Italy, Austria, Sweden, etc. recorded the highest tax collection and vice versa on the opposite side notices Albania, Bulgaria and other former socialist countries. Simultaneously we can see a trend that the share of the shadow economy is inversely proportional to tax effort (e.g. the higher the effort is, the lower is size of the shadow economy). More than that, tax effort is proportional to the annual increase in fees collected (e.g. Italy has the highest rates of increase per year in revenue collection derived from tax audits (3.24%) with an effort of over 90% and Belgium with 2.7% vs. effort of 80.1% to 90%, while Slovakia, Switzerland and many other countries, with the lowest tax effort, recorded a decrease of up to -1.92%).

From another point of view we can observe that more than one half of the analysed countries are losing up to 20% of their tax revenue[28]. Moreover, countries ranged between 60.1 to 70% tax effort can be found in the list of the countries with the corruption perception index between 1 and 5 and the shadow economy over 20%. Thereby we can conclude that there is a real potential both to enlarge the tax base and the volume collected, entirely on the group and on each country separately. Certainly in the terms of globalization, and elimination of borders in the EU framework and partly to neighboring countries, the shadow economy should not be eliminated by a country or person and require a comprehensive action programs aimed to reduce its weight, and joint audits have a role to play in this regard.

It is believed that the critical negative factor in efficient tax collection is corruption in revenue administration.

Numerous studies have identified the negative impacts on tax revenue that are due to corruption. For example, Dos Santos (1995) discussed the negative impact of corruption on tax audits' collections; Tanzi and Davoodi (1997) found that countries' institutional qualities have significant relationships with their tax revenues, corruption being a proxy for this quality; Tanzi (1998) suggested that the *Code of Good Practices on Fiscal*

[27] Fenochietto and Pessino estimated countries' tax effort and capacity using three models (half normal (HN), truncated normal (TN) and truncated normal heterogeneous (TNH)). We are using results of TNH model because it is including corruption and inflation to represent inefficiency /distinguish 'observable' heterogeneity, which is more relevant to our research. The mean of inefficiency depends on level of corruption and the decay on the level of inflation. Distinguishing 'unobserved' heterogeneity is interpreted as heterogeneity that should be controlled before estimating the gap (the difference between tax capacity and tax effort).

[28] However it can be observed that countries with high level of development are near their tax capacity. According to Fenochietto and Pessino (2013) this is particularly the case of Austria, Belgium, Denmark, Finland, France, Italy and Sweden (with tax effort higher than 90 percent). They also explain it through the crucial determinant of higher level of tax revenue of the demand for public expenditure.

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Transparency[29], "if followed, would have the effect of reducing corruption"; Friedman et. al. (2000) provided evidence that countries with more corruption tend to collect fewer tax revenues relative to GDP; Iman and Davinan (2007) performed an empirical study of which taxes would yield more revenue by simply reducing the incidence of corruption in the revenue administration; Fenochietto and Pessino's (2013) empirical analysis showed that less corruption is associated with a lower level of inefficiency in collecting taxes; and Barlow (2014) demonstrated that heightened integrity delivered increased profits.

Evidence from cross-European country comparisons has made it clear that corruption in revenue administrations is a serious problem. Advanced European economies, as a group, have a higher corruption perception index (greater than 7) than the rest of the economies analysed in the comparisons. Opposite results arise when EU accession countries are compared to other EU members states. However, even though the EU accession nations (many of which are now, or expected to be, members of the EU) made significant changes[30] to meet the requirements for EU accession, a comparison with the advanced economies show that EU accession countries are still faced with the significant problem of corruption (scoring below 5) (Table 3).

As shown in Table 3, corruption is hardly a problem exclusive to emerging countries. However, the higher is the level of corruption, the lower is the level of economic development – as measured by per capita GDP.

Table 3 demonstrates that the ex-socialist countries recorded the worst situation in terms of the corruption perception index (worst situation is in Moldova and Ukraine) [31]. It is believed that countries like Romania, Bulgaria, Czech Republic, Hungary and other ex-socialist countries experienced considerable success in this respect thanks to EU accession and implementation of the judicial reforms and increase of the independence of the national anti-corruption centers (e.g. Romania has been convicted more than 10,000 civil servants for corruption, and a large number of oligarchs, who seemed to be untouchable.

Table 3. International comparision of Tax revenue and Corruption Perception Index

2011		Corruption Perception Index				
		Less than 3	3.01 – 5	5.01 – 7	7.01 – 9	More than 9
Tax revenue rate (as % of GDP)	Less than 25%		Albania Bosnia and Herzegovina Georgia FYR Macedonia			
	25.1% – 30%		Latvia Lithuania Romania Slovakia Turkey Bulgaria	Israel	Switzerland Ireland	
	30.1% – 35%		Croatia Greece Montenegro Serbia	Estonia Malta Poland Portugal Spain	Luxembourg Iceland	
	35.1%– 40%	Moldova Ukraine	Czech Republic Hungary	Cyprus Slovenia **EU-27**	United Kingdom Germany Netherlands	
	40.1% – 45%		Italy	France	Austria Norway Belgium	Finland Sweden
	Over 45%					Denmark

Source: Based on Transparency International's, Fenochietto and Pessino (2013) and Eurostat data

The same situation can be found in Bulgaria and other countries). Another important factor on fighting corruption is the implementation of the national monitoring and evaluation system that provided a more effective collaboration among all state institutions involved in this process.

However, it has been noted that international tax frauds can be tackled only if financial transactions through countries will "be looked at as a whole and not in isolation," and the fact that "integrity and confidentiality of information cannot be guaranteed in the

[29] The *Code of Good Practices on Fiscal Transparency* was approved by the IMF Board in 1998. The latest version (2007) available on the IMF website at http://www.imf.org/external/np/fad/trans/code.htm\#code

[30] These changes led to the adoption of many best practices in fiscal fairness, simplicity and transparency, which placed the EU accession countries ahead of other non-advanced economies in terms of fiscal compliance.

[31] Presence of Italy in the group of the most corrupt countries may seem a surprise. Certainly the fight against corruption in this country is more like a silent war between state institutions and organized criminal groups, infiltrated practically all state and private institutions at the various levels and has a history of hundreds of years. Italy's most "young" democracy of the developed countries that combines a plurality of ethnic and sociocultural groups, differentiated by language, traditions, customs, crafts, etc., each constantly trying to impose their supremacy and to "control" the country. Mussollini's dictatorship facilitated some of them and tried to exterminate others, and access to any position was conditioned by material or immaterial obligations to those you're promoted. At the same time we can see some progress in this respect, especially in the recent years.

exchange of information if there is corruption" [6] means that "the traditional concept of successive written requests and responses, in fact, does not suit multilateral auditing" anymore [9].

Joint audits may make it easier for states to respond to high wealth taxpayer's corrupt behaviours. Various studies[32] have indicated that audits are an effective tool for deterring tax fraud. Structured cooperation in joint audits may enhance the impact of national tax compliance administrations' programs and revenue collection, detecting and redressing individual cases of noncompliance.

Moreover, it is critical to have effective and comprehensive anti-corruption compliance tools at the EU[33] at the supranational level that will demonstrate to member nations and its associates that anti-corruption is an important objective for high risk countries[34] and one that is taken seriously. Community cooperation can help engender both the will to fight corruption and the capability to do so.

Furthermore, recognizing the impact and breadth of "corruption's damaging effects" is critical. The OECD has highlighted the role of tax auditors in combating corrupt practices of the private and public officials. In this context, the OECD Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors (2013) emphasizes that the role of tax auditors appears to be essential in order to assure the effective and vigorous application of laws. The recommendation made by OECD provides guidance to tax examiners and auditors to detect, deter, and prosecute all forms of corruption.

[32] J. Alm and M. Mc Kee, Audit Certainty, Audit Productivity and Taxpayer Compliance, 59(4) National Tax Journal, 2006, pp. 801-816; K. Devos, The role of sanctions and other factors in tackling international tax fraud, Common Law World Review, Vol. 42, 2013; M. W. Spicer and J.E. Thomas, Audit Probabilities and the Tax Evasion Decision: An Experimental Apporach, 2 Journal of Economic Psychology, 1982, pp. 241-245;

[33] According to the table 8 data, two third of analyzed countries face significant corruption problems Corruption Perception Index score below 7 comparing to the EU-28 which has an average of 6.

[34] According to OECD (2013), Bribery and Corruption Awareness Handbook for Tax Examiners and Tax Auditors - High risk countries include those which do not engage in effective exchange of information, have a low score on the Transparency International Corruption Perceptions Index or Bribe Payers Index, or have a high score on the Tax Justice Network Financial Secrecy Index).

CONCLUSIONS

The beginning of the new millennium is the right time to act. Many international problems can be addressed effectively only by an international cooperative effort. Even though the wheels of the joint tax audits turn slowly, there are reasons that may convince countries like Romanian and Moldovan to speed up the implementation of such audits:

-Commonly shared language - boarders;

-Tax efforts are far from countries tax capacity;

-The higher is the level of corruption, the lower is the level of economic development – as measured by per capita GDP, etc.

This study investigates the theoretical ideas related to the circumstances that could accelerate the successful implementation of joint audit. However much progress must be achieved before sufficient evidence exists to support a joint audit approach.

Nevertheless, we expect to see more joint audits across European communities, in which governments and taxpayers must make a radical act sooner, rather than later, to achieve their goals in reducing taxation costs and corruption, and increasing litigation and the amounts at stake. Despite the lack of knowledge, which has been a cost due to maintaining political confidentiality and autonomy, it has been demonstrated, not only by empirical research but also by the experiences of tax professionals and governments, that the further development of joint tax auditing systems is vital. Further research is warranted to focus on the feasibility of this implementation and the concomitant cost.

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