

ANNA ĆWIAKAŁA-MALYS

Uniwersytet Wrocławski

IWONA PIOTROWSKA

Urząd Kontroli Skarbowej we Wrocławiu

AN ANALYSIS OF TAX INSPECTIONS EFFICIENCY IN
COUNTERING THE GREY AREA IN TRADE —
A CASE OF THE INTERNET

1. INTRODUCTION

For many years tax audit agencies and tax offices have been taking actions that are supposed to reduce the grey area in economy.

Illegal actions taken in the scope of an undertaken activity are aimed at avoiding taxation. Services subordinate to the Minister of Finance manage the actions that are aimed at:

— verification of solidity of declared tax bases and correctness of their calculation and payment of taxes through tax control;

— tax control and other verification actions taken by tax offices. In the grey area non-tax incomes appear in two areas:

- legally existing entities that understate or hide income which is taxable;
- non-registered entities whose income is totally hidden (not reported for taxation).¹

Tax inspection is focused on areas which constitute the biggest threat for the financial stability of a state. It is generally focused on:

— trade in liquid fuel, including gas and liquid gas, trade in remaining goods and products subject to excise duty (smuggling and illegal production);

— attempts to swindle out VAT tax returns, e.g. as a result of the so called VAT roundabout, managing business activity non-registered and not reported for taxation, including seasonal activity;

¹ Andrzej Parafianowicz, *Jak fiskus walczy z szarą strefą*, 12.11.2009, Interpellation no 11586 to the Minister of Finance with regards to actions taken with relation to grey area reduction.

— obtaining income from undisclosed sources and incurring the costs without coverage in disclosed sources of income.

2. REPORTS, OPINIONS AND EVALUATIONS REGARDING THE GREY AREA IN POLAND

According to Business Centre Club report, one of the nuisances of legally functioning entrepreneurs is the “competition from the grey area.” Frauds of entrepreneurs functioning illegally are mostly connected with hiding turnover or/and income. These irregularities concern a group of entrepreneurs that do not register an activity and do not reveal that they manage an activity.²

One of the easiest ways to manage business activity in the grey area is to manage it in the Internet. As has been stated by e-market analysts, e-trade is developing dynamically. Inspection authorities more often and more efficiently control entrepreneurs that conduct e-trade. It also applies to pseudo-entrepreneurs in the grey area.

According to professional analysts, trading assets (e-trade) in Poland in 2009 were estimated at 13–13.2 billion PLN (including an estimated value of trading on the biggest auction service Allegro — 6 billion PLN). It is estimated that the number of Internet shops in Poland equals 7.5 thousand (at the end of December 2009). As many as 50.9% of Internet shops in Poland are less than two years old. Estimated studies show that only 16.2% of respondents have never done Internet shopping and more than 30% declare that they do it at least few times a month.³

Entities trading in the Internet are inspected by fiscal and tax authorities on a regular basis. It also applies to entities that are not registered. For instance, from January to April 2006 tax control offices finished their proceedings concerning 13 entities (with the reduction amount of 3.745 thousand PLN), whereas tax offices — 91 entities (with the reduction value of 37 thousand PLN). For registered entities the reduction value amounted to 1.066 thousand PLN. The scale of tax settlements will be growing together with the increasing number of entities on the developing market.⁴

The Business Centre Club responsible for preparing the report in its conclusions and recommendations that were directed to institutions responsible for limiting the grey area included the following theses⁵:

² *Szara strefa. Raport na temat najczęstszych oszustw podatkowych*, Mirosław Barszcz, Business Centre Club, Warszawa, 11.01.2010 r., p. 6.

³ *Badanie polskich sklepów internetowych i konsumentów — e-Handel Polska 2009*, Dotcom River Sp. z o.o., Wrocław 2009.

⁴ Information about ‘grey area’ functioning in Polish economy and its connection by tax authorities, <http://www.mf.gov.pl/dokument.php?const=7&dzial=617&id=60227&PortalMF=>.

⁵ *Szara strefa...*, pp. 8–10.

- tax office is helpless when it comes to some of the practices used by pseudo-entrepreneurs because actions of the controlling bodies are foreseeable;
- all instructions of the Minister of Finance for tax and fiscal controlling bodies are focused on “sophisticated” methods of catching dishonest taxpayers on smaller or bigger slips and mistakes;
- lack of solutions to a problem of countering the grey area in a systemic way;
- controlling bodies are often used to solve social problems of ad hoc character which are treated as a substitute problem.

As an answer to the above accusations, in 2010 the Supreme Chamber of Control carried out a resort audit in the area of tax and customs duties execution from entities managing Internet trade. This control covered 24 units subordinate to the Minister of Finance, including 14 Tax Offices for the period from 1 January 2007 till 30 June 2009.⁶ All the Supreme Chamber of Control settlements are concurrent in some cases with these from the BCC report.

3. THE PLACE OF E-TRADE IN THE GREY AREA

Although e-trade has been functioning in our country for many years, the control of this branch of economy became a priority of fiscal audit in 2008. A year later constant monitoring was introduced to particular sectors. One of the vital disadvantages of the existing system is that fiscal audit agencies work on their own. They take ad hoc actions within the framework of search programmes created independently. However, there is a lack of cooperation and correlation between particular actions.

Since the publication of Supreme Chamber of Control report there has been a growth in a number of e-trade controls. For instance, in 2007 in fiscal audit offices inspections of this sector constituted 1.2% of all controls, however, in the first part of 2009 it was almost 3%.⁷

Internet activity (including that in the grey area) has been monitored by tax authorities. In Tax Chamber in Bydgoszcz (since 1 January 2009) and in Tax Chamber in Wrocław (since 1 June 2011) there exist units in which there are specialised units that work in this sector and support administrative units.

One of the tasks of these specialised units is to identify systematically entities operating with the use of the Internet which fail to fulfil tax duties. Analyses concerning these entities are transferred to a proper Head of the Revenue Office and are used in the explanatory and verification course of action during tax proceed-

⁶ Information about audit results as regards tax and custom duties execution from entities managing Internet trade, Supreme Tax Chamber in Kielce, Kielce, June 2010, p. 6.

⁷ P. Lipiec, T. Jaroszek, *Szara strefa e-handlu — eCommerce.edu.pl — cała wiedza o e-commerce*, <http://webcache.googleusercontent.com/search?q=cache:qNo92KgNnto...>

ings and inspections. One of the aims of these actions is to eliminate irregularities and mistakes of taxpayers that conduct business activity using the Internet and to reveal this group of taxpayers that constitute the grey area.

According to the data from Bydgoszcz Internet trade unit of Tax Chamber, it follows that in the Kujawsko-pomorskie voivodship, in 2009, the authorities inspected 76 entities as regards business transactions made in the Internet. In 41 cases there were some mistakes. The total sum of irregularities was estimated to 781 thousand PLN.

In the first half of 2010 tax offices in Kujawsko-pomorskie carried out inspections of 53 entities concerning Internet trade and in 31 cases there were mistakes found. The amount of detected irregularities was estimated to 520 thousand PLN.⁸ However, data regarding the first six months of 2011 show the increase of inspections in this area (75 inspections) as well as the increase in the amount of irregularities detected (almost 540 thousand PLN).⁹

The effectiveness of tax controls carried out by tax offices in Kujawsko-pomorskie is shown in Table 1.

Table 1. The effectiveness of tax inspections of tax offices in Kujawsko-pomorskie (2009, first part of 2010 and 2011)

Period	The number of inspected entities in e-trade	The number of mistakes detected	The sum of irregularities detected
2009	76	41	781.311 PLN
first six months of 2010	53	31	519.471 PLN
first six months of 2011	75	50	539.013 PLN

Source: study on the basis of Referat Handlu Internetowego IS w Bydgoszczy.

From the analyses of units responsible for Internet trade it follows that while carrying out inspections of taxes as regards e-trade, major irregularities were detected by tax offices¹⁰:

— understating the income by not showing transactions made with the use of auction portals and Internet shops,

⁸ *Administracja podatkowa działa na rzecz ograniczenia szarej strefy i poprawy poziomu dobrowolnego wywiązywania się z obowiązków podatkowych — Referat Handlu Internetowego*, http://www.izba-skarbowa.bydgoszcz.pl/index.php?option=com_content&task=view&id=2829&Itemid=1, 03.10.2012.

⁹ *Postępowania podatkowe w sprawach danych osób sprzedających na Allegro*, Piotr Szulczewski PIT.pl, Barbara Sielicka Bankier.pl, <http://webcache.googleusercontent.com/search?q=cache:5MRDGrJN9e8J:www.pit.pl/urząd-skarbowy-wzywa--jak-zalegalizowac-ehandel-1362/+&cd=36&hl=pl&ct=clnk&gl=pl&client=firefox-a>, 3.10.2012.

¹⁰ *Administracja podatkowa działa na rzecz ograniczenia szarej strefy i poprawy poziomu dobrowolnego wywiązywania się z obowiązków podatkowych — Referat Handlu Internetowego*, http://www.izba-skarbowa.bydgoszcz.pl/index.php?option=com_content&task=view&id=2829&Itemid=1, 3.10.2012.

- managing non-registered business activity,
- lack of proofs of transaction,
- lack of advance payments for an income tax during the year,
- sale not entered into a cash register,
- sale concluded without issuing invoices.

In addition to the mistakes mentioned above, we can also notice other appearing in this area:

- taxpayers managing business activity do not submit obligatory tax declarations,
- lack of VAT tax registration,
- frauds of a business activity.¹¹

In the framework of the Supreme Chamber of Control inspections — branch in Kielce — an inspection was commissioned, which means that tax audit offices and tax offices were obliged to carry out inspections of 92 entities managing Internet trade which seemed to show a high risk of irregularities connected with this kind of business activity (intentional selection)¹² and at the same time regularities in fulfilling tax obligations following from the tax law.

All tax offices (401) carried out inspections in 2007–2008 and in the first part of 2009. In total there were 2,750 inspections, which means that each year there were between two and three inspections carried out by each office.¹³

Information regarding the efficiency of inspections carried out in accordance with the Department of Tax Administration (DAP) of the Ministry of Finance is shown in Table 2.

Table 2. The effectiveness of inspections carried out, according to DAP (2007–first part of 2009)

Year	The number of inspections regarding Internet trade carried out by tax offices	Financial reductions found
2007	812	2.7 million PLN
2008	1,348	6.5 million PLN
first six months of 2009	590	4.1 million PLN
Total	2,750	13.3 million PLN

Source: study on the basis of information concerning the results of inspections on tax and customs obligations execution from entities managing Internet trade. Supreme Chamber of Control — branch in Kielce, Kielce June 2010.

¹¹ *Postępowania podatkowe w sprawach danych osób sprzedających na Allegro*, Piotr Szulczewski PIT.pl, Barbara Sielicka Bankier.pl <http://webcache.googleusercontent.com/search?q=cache:5MRDGrJN9e8J:www.pit.pl/urząd-skarbowy-wzywa--jak-zalegalizowac-ehandel11362/+&cd=36&hl=pl&ct=clnk&gl=pl&client=firefox-a,3.10.2012>.

¹² Information about audit results as regards tax and custom duties execution from entities managing Internet trade, Supreme Tax Chamber in Kielce, Kielce, June 2010, p. 6.

¹³ *Ibid.*, p. 10.

As a result, reductions amounting to 13.3 million PLN were discovered. Taking into consideration the number of all tax offices (401), this constituted on average between two and three inspections a year for each office.¹⁴

After inspections of 72 taxpayers, reductions amounting to 3.36 million PLN were discovered. The average reduction for each inspection amounted to 38.2 thousand PLN.

4. EVALUATION OF THE ACTIONS TAKEN TO REDUCE THE GREY AREA IN POLAND

The effectiveness of inspections ordered by the Supreme Chamber of Control carried out so far by fiscal control offices and tax offices (average reduction for each inspection of fiscal control offices and tax offices from 2007–2009 [first part of the year] constituted about 14% in 2007 and 50% in the first part of 2009 of evasion from inspections ordered by the Supreme Chamber of Control). In a report of the Supreme Chamber of Control it was highlighted that proper preparation is important for the effectiveness of inspections, which means the analysis of risk of irregularities that occur which — according to the opinion of the Supreme Chamber of Control — had not been done prior to inspections carried out by fiscal control offices and tax offices.¹⁵

Until mid-2008 (till the time of distinctive inspection of the Kielce branch of the Supreme Chamber of Control in the Ministry of Finance) Department of Tax Administration did not have the knowledge on the number of inspections carried out by tax offices in the area of Internet trade. At the time of inspection, DAP did not function either as a coordinating unit or supporting actions of tax offices in the above-mentioned area.

It follows from the fact that due to the difficulties in selecting entities functioning in this sphere, inspections carried out by tax offices resulted mostly from complaints and reports. In the opinion of the Supreme Chamber of Control it means the lack of planned actions directed at counteracting all irregularities existing in Internet trade.

What follows is that in particular years included in the inspection, the number of inspections carried out by the above-mentioned authorities was growing, financial results were also growing.¹⁶ From the analysis of control materials it was stated that inspections carried out in 14 tax offices concerned mainly:

¹⁴ Ibid.

¹⁵ Ibid., p. 11.

¹⁶ Ibid., p. 33.

- Internet trade managed as the sale of goods concluded by taxpayers on popular auction portals,
- taxpayers providing service with the usage of their own Internet page,
- entities that at the request of foreign tax administration confirm transactions between foreign and Polish taxpayers.

Tax control authorities and fiscal control authorities did not control e-services as specified in the directive 2006/112/WE from 28 November 2006 as regards common tax system from added value. Additionally, none of the tax offices carry out inspections on the basis of their own analyses and select, internally, entities on the basis of existing monitoring of Internet activity. Generally, the basis for carrying out inspections, tax proceedings, in relation with entities managing Internet trade was the information received from the outside (reports, information transferred by other authorities, above all by fiscal control office).¹⁷

The Supreme Chamber of Control, assigning controlling tasks to tax offices, together with the Ministry of Finance have analysed the risk of irregularities appearing in a group of 607 entities managing Internet trade. An analysis was conducted in terms of:

- reliability of declared tax basis,
- correctness of calculating and paying taxes and other dues from state budget,
- finding business activity not reported for taxation,
- finding income without coverage in disclosed sources of income.

On the basis of the above-mentioned criteria there were 92 entities selected with the biggest probability of irregularities and then 5 fiscal control offices and 14 tax offices carried out inspections which were to check regularities in meeting the obligations following from tax law by above-mentioned entities.¹⁸

Until 31 December 2009 fiscal control offices and tax offices finished their inspections regarding 72 taxpayers (78% of those ordered by the Supreme Chamber of Control).¹⁹

Out of 14 tax offices under control, in 13 there were inspections carried out as regards Internet trade. They included 97 taxpayers of Internet trade generating financial results of more than 525 thousand PLN. The average reduction for each inspection was 5,421 PLN.²⁰

From all the inspections it follows that in the case of 54 taxpayers (75%) there were irregularities found, such as:

- managing non-registered business activity,
- understating incomes by not reporting the Internet sale in whole or in part,
- not paying taxes,

¹⁷ Ibid., p. 35.

¹⁸ Ibid., p. 36.

¹⁹ Ibid., p. 38.

²⁰ Ibid., p. 36.

— using Internet accounts of other people and lending accounts to people managing Internet sale.²¹

Average tax evasion which was discovered during the inspections carried out by tax offices was about 30 thousand PLN and for fiscal control offices 50 thousand PLN. As a result of these controls a sum of 12,627 thousand PLN of non-reported income was found as well as tax evasions (on account of VAT and income tax) amounting to 3,362 thousand PLN. Average amount of non-reported income for each controlled taxpayer was 234 thousand PLN and average tax evasion was over 62 thousand PLN (on average 38.2 thousand for each control).²²

The biggest group among the taxpayers who do not show (managing an activity without registration) or report their income (entrepreneurs hiding their income) constituted taxpayers with income not bigger than 400 thousand PLN.

From the analysis of the results of inspections it follows that the majority of those managing Internet trade (i.e. above all sale on Internet auctions) believe that there is great anonymity of these transactions. That is why a phenomenon of managing non-registered business activity by natural persons or not reporting parts of obtained income by smaller entrepreneurs is present.

Additionally, even though a unit sum of non-reported taxes for a person or an entrepreneur is not too high, taking into consideration their number (and anticipated increase), in total the lost budget income can constitute a significant amount.²³

Although average financial results in the controlled period are growing for each “own” inspection carried out by fiscal control office and tax offices, they are mostly lower than the effects of inspections ordered by the Supreme Chamber of Control (in 2007 they constituted about 14% of effects of ordered inspections, in 2008 — about 42%, and in the first part of 2009 — about 50%). The data show how important it is for the efficiency of inspections to specify controlling units. In Supreme Chamber of Control’s opinion an analysis of this kind was done before ordering inspections to fiscal control offices and tax offices and it was not done while the controls were carried out internally by these units.²⁴

The most important recommendations of the Supreme Chamber of Control, directed to heads of controlled tax offices, were²⁵:

— analysing risk in the area of Internet trade in order to specify the scope of monitoring entities concluding transactions in the Internet and taking actions in order to reveal cases of above-mentioned entities managing non-registered business activity,

— taking actions in order to objectively estimate risks of irregularities connected with Internet trade,

²¹ *Ibid.*, p. 39.

²² *Ibid.*

²³ *Ibid.*, p. 41.

²⁴ *Ibid.*, p. 42.

²⁵ *Ibid.*, pp. 44–45.

- inspecting Internet trade on the basis of risk analysis in this area,
- creating methodology of procedure in this area, creating and implementing internal methods of control and monitoring entities managing Internet trade,
- taking actions in order to effectively cooperate with other tax and customs authorities in the field of constituting the object of control.

5. CONCLUSIONS

Authorities of tax and fiscal control more often undertake controlling actions regarding entities managing registered and non-registered “business activity” in the Internet. The number and frequency of inspections are increasing as well as their efficiency counted as the number of irregularities found — reductions. Taking actions brings tangible profits for the State Treasury and for legally acting entrepreneurs — stability and balance on the market and elimination of illegal competition from the grey area. Authorities responsible for eliminating irregularities in tax settlements aim at solving Internet trade problems in a systemic way by monitoring entities functioning in the Internet, analysing risk areas, creating specialized units of e-trade, creating methods and techniques of estimating the turnover of activities managed in the Internet.

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Summary

For years there have been actions taken to reduce the grey area in economy. Not only the number of inspections and their frequency have increased but also their efficiency which is counted on the basis of detected irregularities — tax reductions. The efficiency of actions taken in the opinion of entrepreneurs is low and in Supreme Chamber of Control’s opinion it is still in constant evolution. The biggest problem is the lack of intensive cooperation between controlling authorities of various levels and a central tax system.