The Second International Scientific Conference on Economics, Management and Information Technologies – ICEMIT 2025
CONFERENCE PROCEEDINGS

The evaluation of tax evasion and tax morale in the Republic of Croatia

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Article info

Original scientific paper

DOI:
https://doi.org/10.71159/icemit2533H

Acknowledgement: This work has been supported by the University of Rijeka project number ZIP-UNIRI-116-2-23.

Abstract

In the Republic of Croatia, as in many other countries, tax evasion occurs in various forms, from non-payment of income tax and value added tax to the concealment of income or the transfer of assets in order to reduce the tax burden. The aim of this paper is to analyse the attitudes and opinions of citizens about tax evasion and tax morale in the Republic of Croatia. The conducted research has shown that the citizens of the Republic of Croatia are aware of the large presence of tax evasion in the system and that they are familiar with its negative impact on the economy. In addition, citizens believe that the current tax laws are not sufficient to combat it and suggest changes in the tax system, equality among taxpayers, better cooperation with the tax administration, but also an increase in tax morale.
Keywords**:** *tax evasion, tax morale, Republic of Croatia, survey*

1. Introduction

The issue of tax evasion is as old as taxation itself. It occurs in various forms and is a consequence of participation in the shadow economy. Tax evasion involves the full use of all opportunities to reduce tax liability provided by law; it is the result of taxpayers' resistance to paying tax. There are two forms of tax evasion: legal or permitted evasion, and illegal or unauthorised evasion. It includes all illegal methods used by taxpayers to reduce the amount of tax they must pay, regardless of whether such actions are intentionally concealed or mistaken. Moreover, the relationship between citizens and the state regarding taxes directly affects social balance and the functioning of democratic institutions. In this context, tax evasion not only represents financial losses for the state budget, but also signals a breach of trust between the state and taxpayers. Šimović (2007) found that illegal activities consist of manipulation of accounting documents, fictitious reporting of income, failure to declare part or all of one's income, and other forms of concealing real tax liabilities. Increased levels of tax evasion led to a decrease in citizens' trust in the tax system and government institutions. This creates a vicious circle, where increased evasion requires stricter controls, which in turn increases administrative costs and further burdens the government system (Fishlow and Friedman, 1994). The pioneers in the estimation of tax evasion were Allingham and Sandmo (1972). They demonstrated how the expected utility approach (taxpayers as gamblers) can be applied to the 'economics of tax evasion' within the broader field of the economics of crime. Subsequently, Srinivasan (1973) and Yitzhaki (1974) continued work on estimation and the development of the theory of optimal tax policy. The purpose of this theory is to provide suggestions on how to design an efficient tax system so that the cost of taxation is reduced as much as possible.

Tax evasion presents a significant challenge to the stability of financial systems worldwide. It results in substantial losses of government revenue, ultimately reducing the capacity to provide public goods and services. Globally, tax evasion is increasingly linked to the use of tax havens and complex international transactions, which require state cooperation and the harmonisation of tax regulations within international organisations such as the OECD and the EU (Prebble, 2005). There are many reasons why tax evasion occurs. One is that paying taxes reduces the purchasing power of the taxpayer. Although paying taxes supports the stability, protection, growth, and development of the state, tax evasion occurs in almost all countries. Taxpayers often view taxes as a burden and are therefore prone to evasion. Resistance to paying taxes can be stronger or weaker, depending on factors such as the size of the tax burden, the intended use of tax-collected funds, and the method of conducting the taxation procedure. At the same time, tax morale, or the willingness of citizens to comply with their tax obligations, plays a key role in shaping efficient tax systems.

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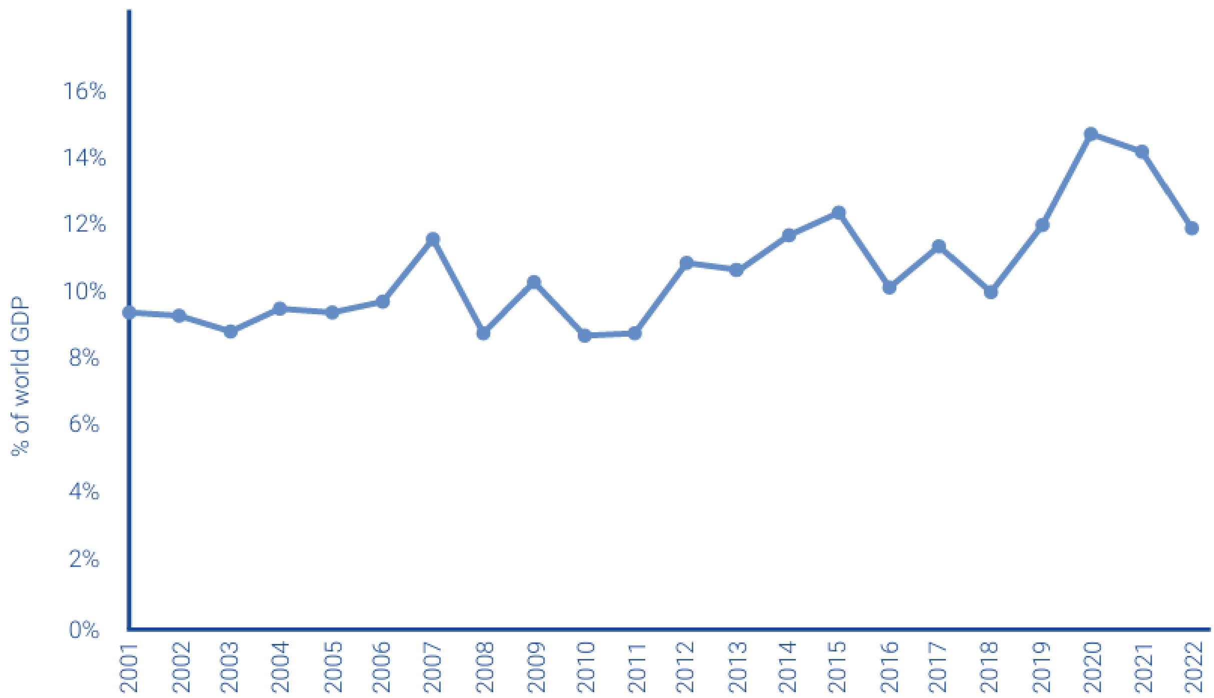
Although numerous definitions and studies have addressed the estimation of tax evasion in various countries worldwide, ongoing market dynamics necessitate continual new insights. Therefore, the aim of this paper is to analyse the attitudes and opinions of citizens regarding tax evasion and tax morale in the Republic of Croatia. In addition, based on empirical results, possible solutions to prevent tax evasion will be proposed. The contribution of this paper lies in two elements. The first is an empirical analysis of the current status of citizens' attitudes and opinions about tax evasion and tax morale in the Republic of Croatia, while the second is the provision of policy implications for preventing tax evasion.

The paper is structured as follows. Section 2 presents global trends in tax evasion. Section 3 explains the methodology, while Section 4 presents the empirical findings. Finally, Section 5 summarises the main findings and highlights policy implications to prevent tax evasion.

2. Trends in tax evasion

Although trends in tax evasion are constantly changing and unfortunately increasing, offshore income remains a consistent component of tax evasion. It includes financial assets held by individuals outside their country of residence, mostly as bank deposits and portfolios of securities. Until 2017, most offshore financial institutions did not report information to foreign tax authorities, except on an ad hoc basis when information was requested for specific taxpayers who had aroused suspicion (Johannesen and Zucman, 2014). This was the reason why tax evasion remained at a high level. In the past 20 years, offshore financial wealth appears to have evolved at roughly the same pace as global gross domestic product (GDP). Figure 1 shows the trend in global household offshore financial wealth from 2001 to 2022.

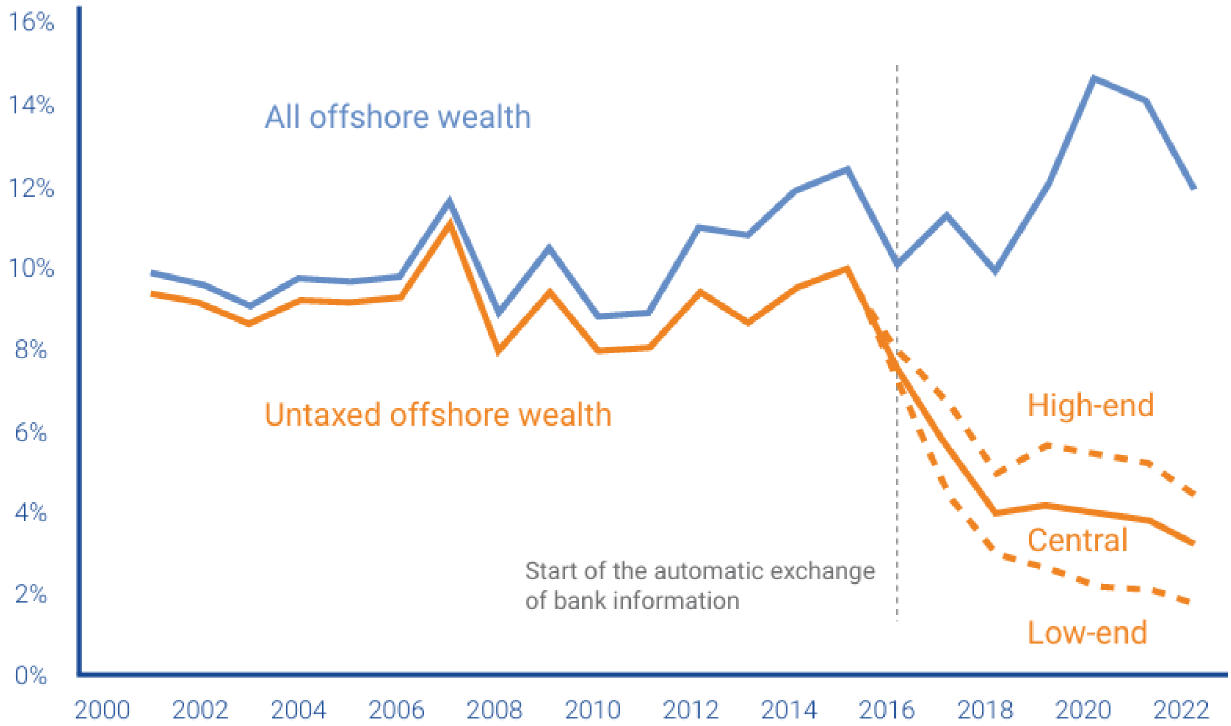
Figure 1. Global household offshore financial wealth, 2001 – 2022 (as % of world GDP)



Source: Global tax evasion report (2024).

From Figure 1, it can be observed that after 2018, global household offshore financial wealth began increasing very rapidly. Even the increasing transparency and exchange of information had no effect on the amount of household financial wealth. This indicates that banks and other financial institutions concealed the bulk of financial wealth by providing various services to their clients to hide assets from tax authorities. To address this, the Foreign Account Tax Compliance Act (FATCA) was implemented in 2014, and the Common Reporting Standard (CRS) was introduced in 2017. Both regulations require the reporting of income on all accounts to the tax administrations in the account holders' home countries. Figure 2 shows the unreported offshore household financial wealth based on three scenarios: low, central, and high.

Figure 2. Unreported offshore household financial wealth based on three scenarios (as % of world GDP)



Source: Global tax evasion report (2024).

Based on these data, it can be concluded that offshore tax evasion has declined dramatically compared to the period before the automatic exchange of bank information. According to the scenarios, in the low-end scenario, untaxed offshore wealth represents around 1.8% of world GDP; in the central scenario, around 3.2% of world GDP; and in the high-end scenario, 4.4% of world GDP.

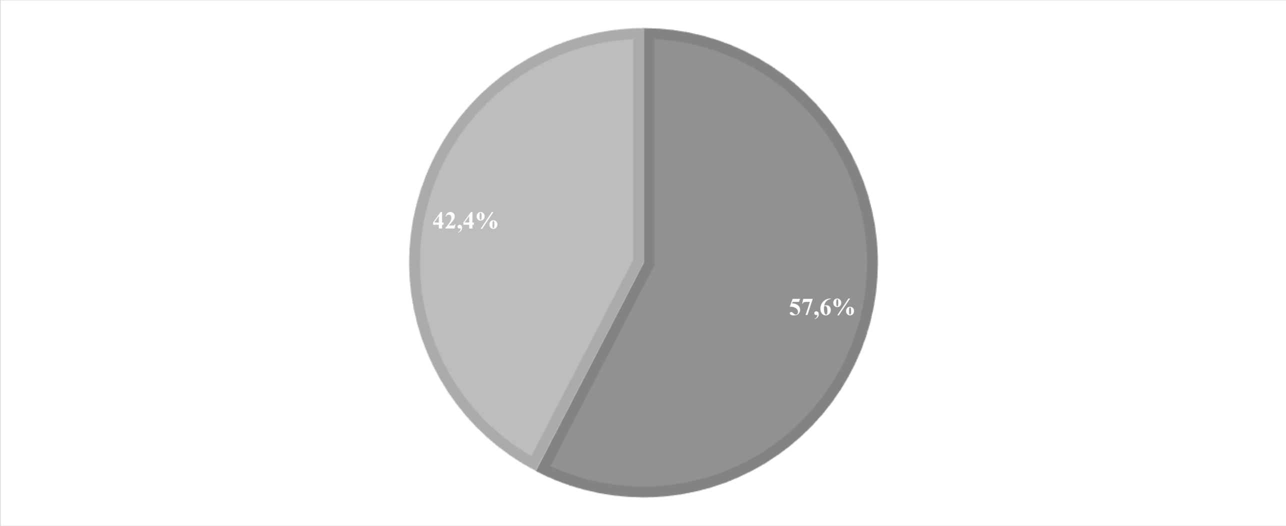
In Croatia, tax evasion appears in various forms, including work in the shadow economy, wage payments in cash or in kind reported at the minimum wage, with the remainder of income paid in cash, among others. Madzarevic-Sujster (2002) investigated the level of evasion of individual direct and indirect taxes for the period 1994–2000 in Croatia. The analysis showed that the lower estimate of tax evasion as a percentage of GDP was about 5.5%, while the upper estimate, which partially follows the trend in the overall tax burden, ranged from about 11% to about 7.5% of GDP in 2000. Consequently, this shortfall in revenue resulted in an increased deficit. This can be financed either by a further increase in taxation or by borrowing, placing an extra burden on future taxpayers.

3. Methodology

This research analyses the experiences, attitudes, and opinions of citizens regarding tax evasion in the Republic of Croatia. For this purpose, a survey questionnaire was created and administered electronically using the Google Forms platform. At the beginning of the questionnaire, a definition of tax evasion was provided to familiarise respondents with the concept addressed in the survey. The research was conducted online via social networks from 6 to 26 March 2024. The estimated time to complete the survey was five to seven minutes.

A total of 151 respondents of different genders, ages, education levels, and places of residence completed the survey questionnaire. Of all respondents, 57.6% (87 women) and 42.4% (64 men) completed the questionnaire, as shown in Figure 3.

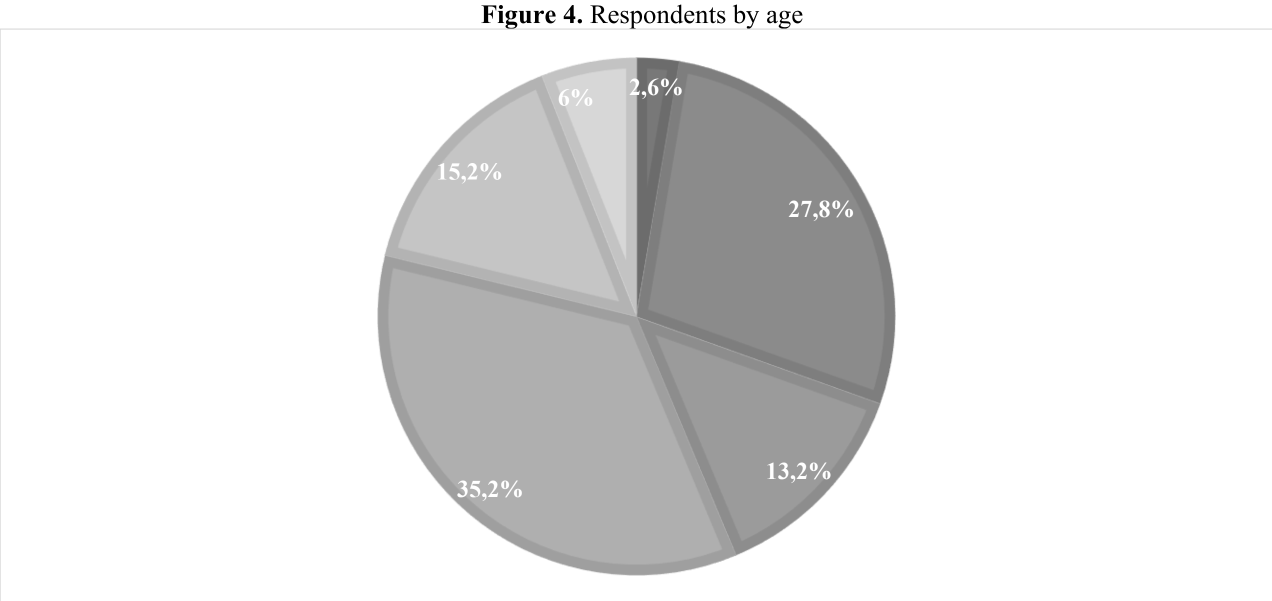
Figure 3. Respondents by gender



Source: Kopjar (2024).

The largest group of respondents is aged between 40 and 49 years, comprising 35.2% or a total of 53 respondents. This is followed by those aged between 20 and 29 years, accounting for 27.8% or 42 respondents. Slightly fewer respondents are aged between 50 and 59 years (15.2%), between 30 and 39 years (13.2%), and over 60 years (6%). The smallest group is under 19 years old, representing 2.6%, as shown in Figure 4 below.

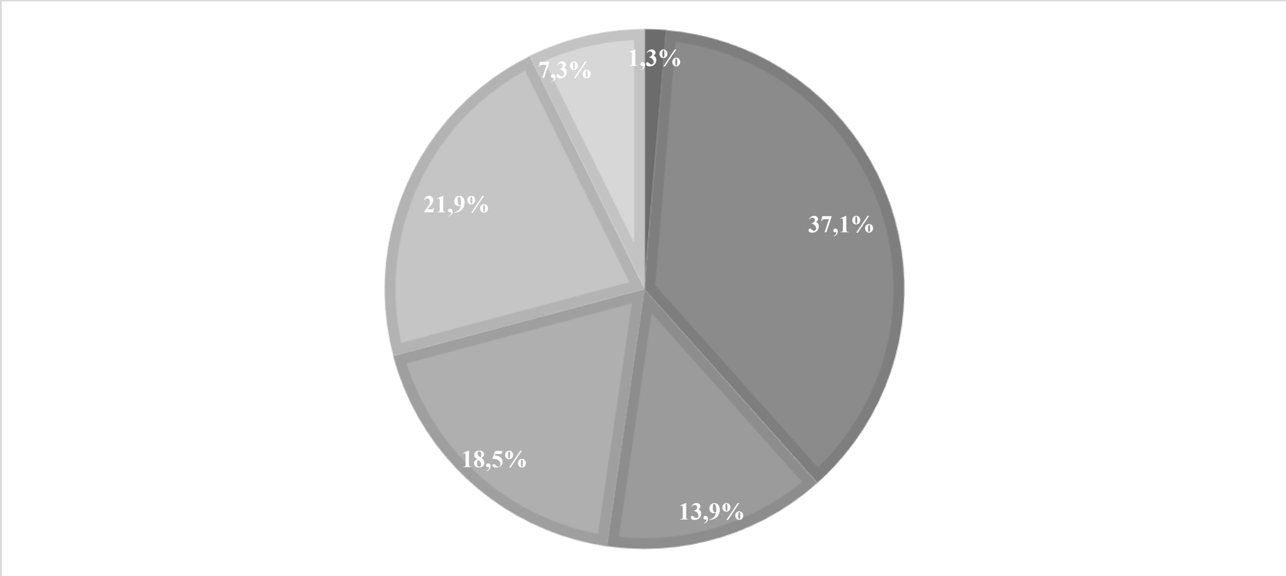
Figure 4. Respondents by age



Source: Kopjar (2024).

The largest group of respondents, 37.1% or 56 individuals, have completed secondary school. Following this, 21.9% or 33 respondents have completed graduate studies. Slightly fewer respondents have completed undergraduate studies (18.5%), higher education (13.9%), and postgraduate studies (7.3%). The smallest group, 1.3% or 2 respondents, have completed only primary school, as shown in Figure 5 below.

Figure 5. Respondents by highest level of education



Source: Kopjar (2024).

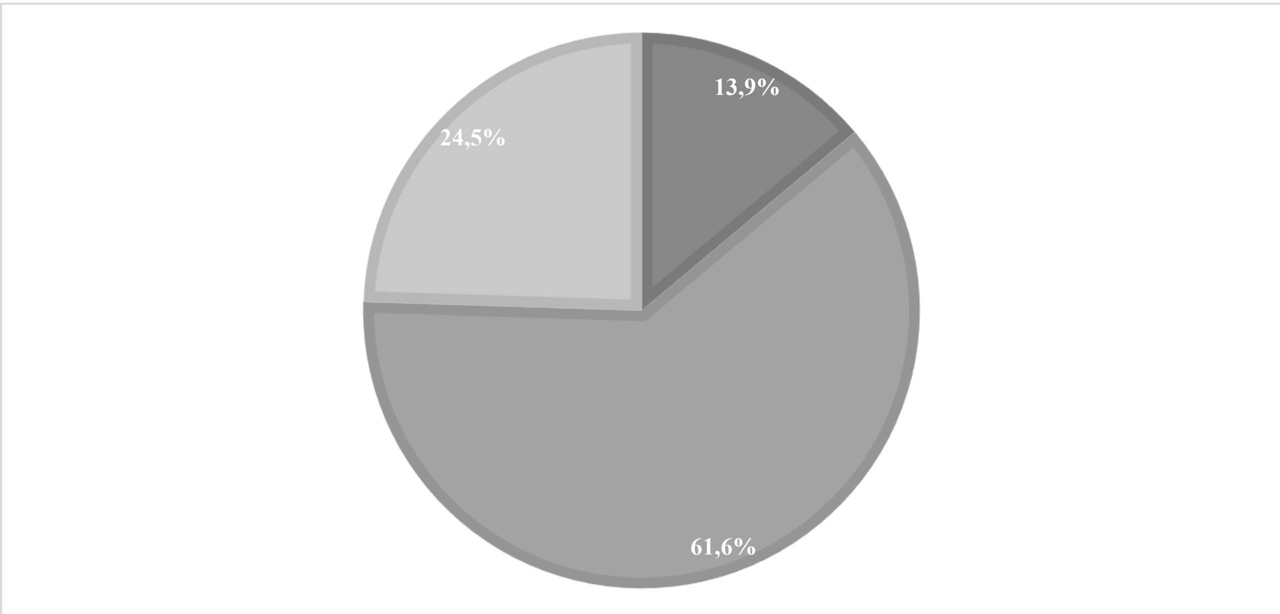
The largest proportion of respondents, 53.3% or 79 individuals, reside in Međimurje County. Following Međimurje County are Varaždin County with 12.6% (19 respondents), Osijek-Baranja County with 7.9% (12 respondents), and Primorje-Gorski Kotar County with 7.3% (11 respondents). Slightly fewer respondents live in the City of Zagreb (3.3%), Lika-Senj County (2%), and Zadar County (2%). In the other counties of the Republic of Croatia, the number of respondents ranges from one to two, while no respondents from Virovitica-Podravina County participated in the survey.

4. Empirical results

To achieve the main aim of this research, the first section of the questionnaire included questions about the respondents' experience with paying tax obligations and tax evasion. The results of this part of the research are presented below.

The first question in this section was: "Do you encounter the practice of not issuing invoices with value added tax displayed?" The results are shown in Figure 6.

Figure 6. Results of the practice for not issuing invoices with value added tax

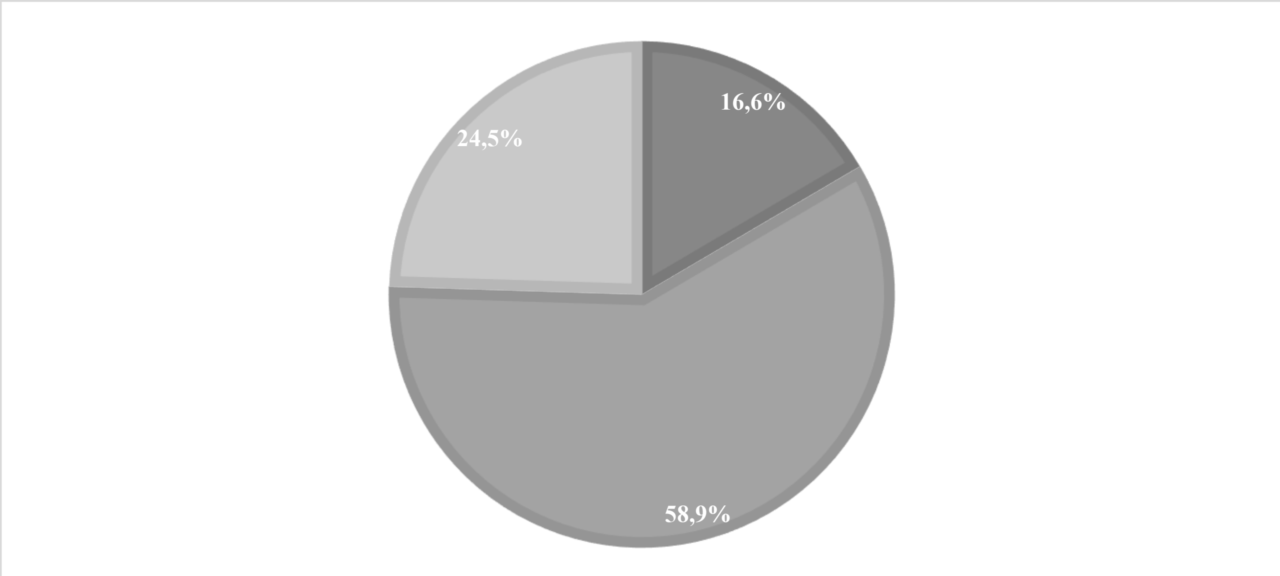


Source: Kopjar (2024).

When asked about the practice of not issuing invoices with the value added tax shown, 75.5% of respondents stated that they had encountered this. Of these, 13.9% (21 respondents) encounter this practice often, while 61.6% (93 respondents) encounter it rarely. A total of 37 respondents, or 24.5%, reported that they had never encountered the practice of not issuing invoices with the value added tax shown.

The next question was: "Do you encounter the practice of not issuing invoices in order to pay a lower price for the service provided?" The results are presented in Figure 7.

Figure 7. Results of the practice of not issuing invoices in order to pay a lower price

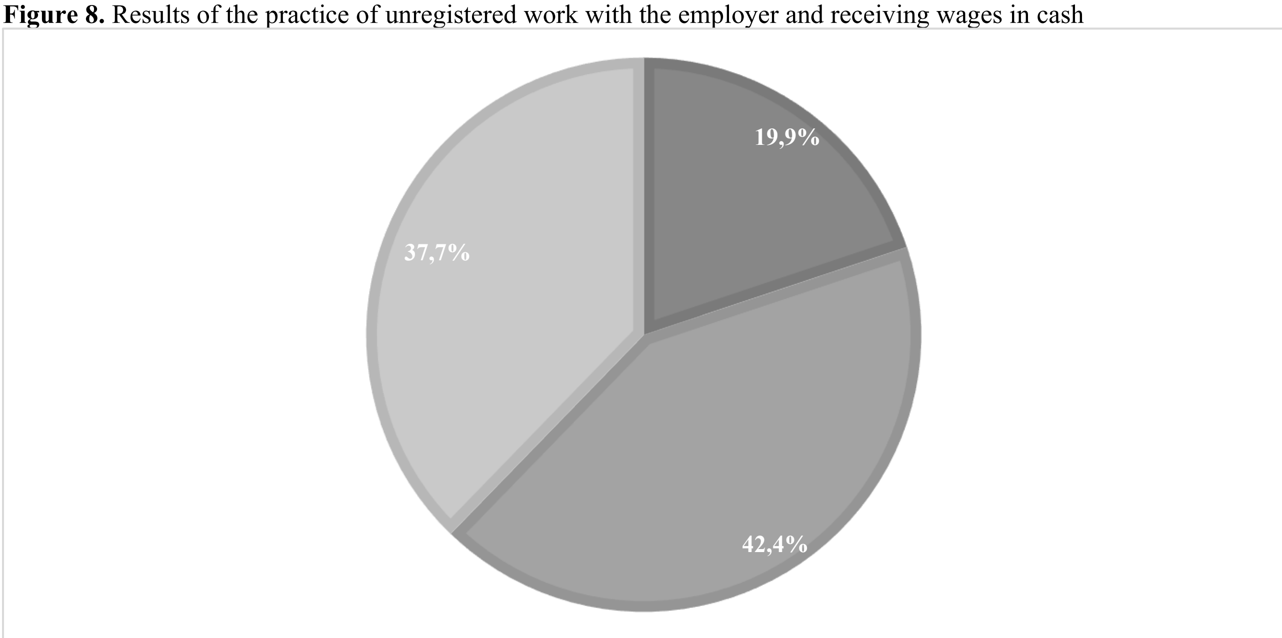


Source: Kopjar (2024).

When asked about the practice of not issuing invoices to pay a lower price for a service provided, 75.5% of respondents stated that they had encountered this. Of these, 16.6%, or 25 respondents, encounter this practice often, while 58.9%, or 89 respondents, encounter it rarely. Additionally, as in the previous question, a total of 37 respondents, or 24.5%, have never encountered the practice of not issuing invoices to pay a lower price for a service provided.

The next question was: "Have you encountered the situation of 'unregistered' work with an employer and receiving wages 'in cash' instead of into a bank account?" The results are presented in Figure 8.

Figure 8. Results of the practice of unregistered work with the employer and receiving wages in cash

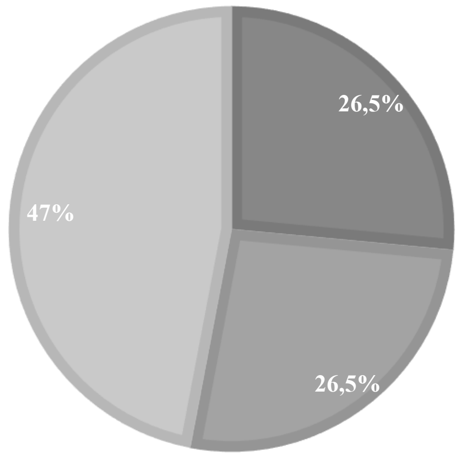


Source: Kopjar (2024).

When asked about experiencing "unregistered" work with an employer and receiving wages "in cash", 62.3% of respondents reported having encountered this practice. Of these, 19.9%, or 30 respondents, encounter it often, while 42.4%, or 64 respondents, encounter it rarely. A total of 57 respondents stated that they had never encountered "unregistered" work with an employer or receiving wages "in cash".

The next question was: "Have you encountered a situation in which your employer prescribed the minimum wage for you, and paid the remainder of your salary through the non-taxable part of your salary, such as bonuses, daily allowances, etc.?" The results are presented in Figure 9.

Figure 9. The results of the practice for minimum wage and non-taxable part of salary

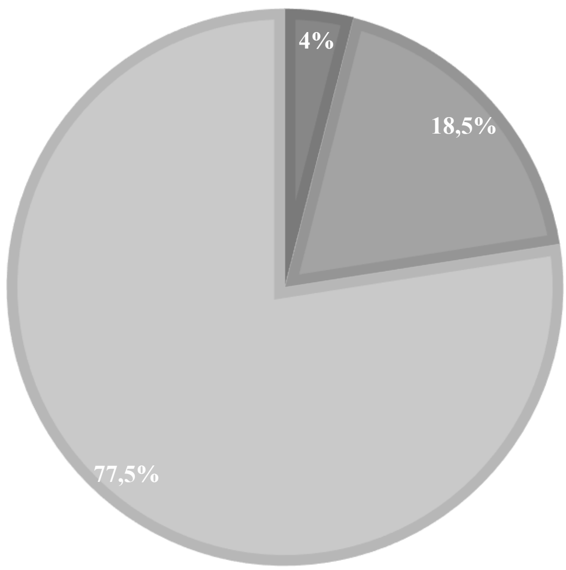


Source: Kopjar (2024).

When asked about experiencing situations where employers override the minimum wage and pay the remainder of the salary through non-taxable components, such as bonuses, per diems, and similar payments, 53% of respondents reported having encountered this practice. A total of 40 respondents, or 26.5%, stated that they encountered this practice often, while the same number indicated that they had encountered it, but rarely. In contrast, 47% of respondents, or 71 individuals, reported that they had never found themselves in such a situation.

The next question was, "Have you ever used loopholes in the law to avoid paying taxes?" The results are presented in Figure 10.

Figure 10. The results of using loopholes to avoid paying taxes

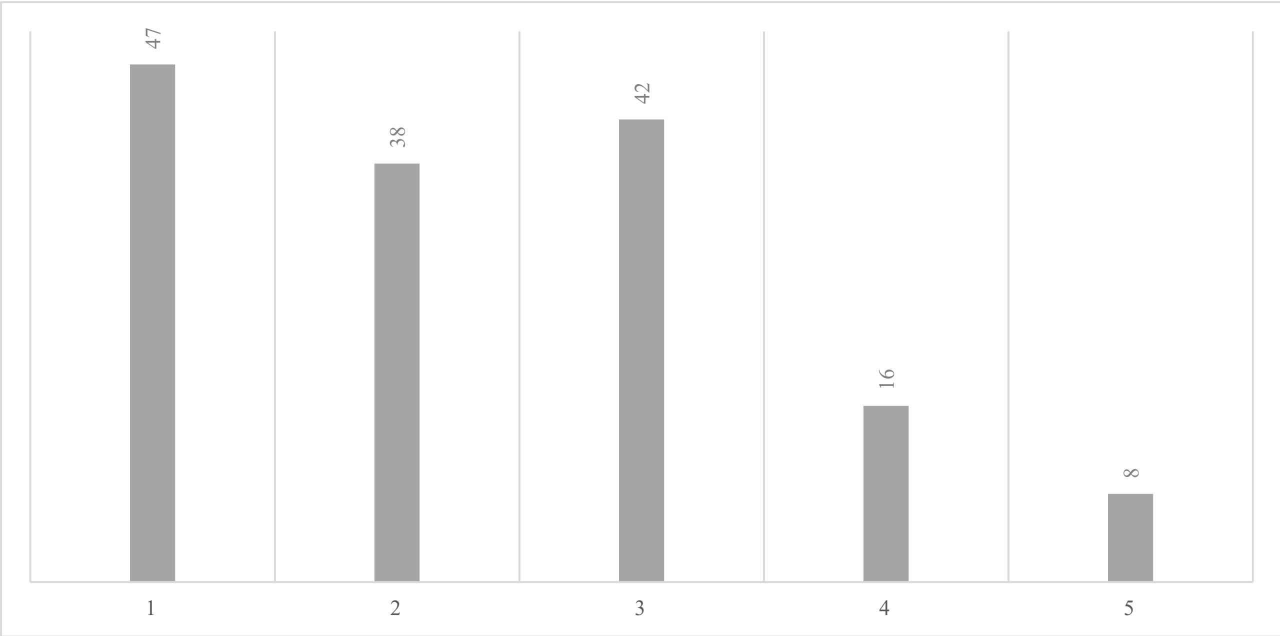


Source: Kopjar (2024).

When asked about the use of loopholes in the law to avoid paying taxes, 22.5% of respondents reported having encountered this. Of these, 4%, or 6 respondents, encountered it often, while 18.5%, or 28 respondents, encountered it rarely. A total of 117 respondents, or 77.5%, stated that they had never used loopholes in the law to avoid paying taxes.

The second section contained questions related to taxpayers' attitudes and opinions on tax compliance and the tax system. Respondents ranked their attitudes and opinions on a scale from one to five, where one represents "I completely disagree" and five represents "I completely agree".

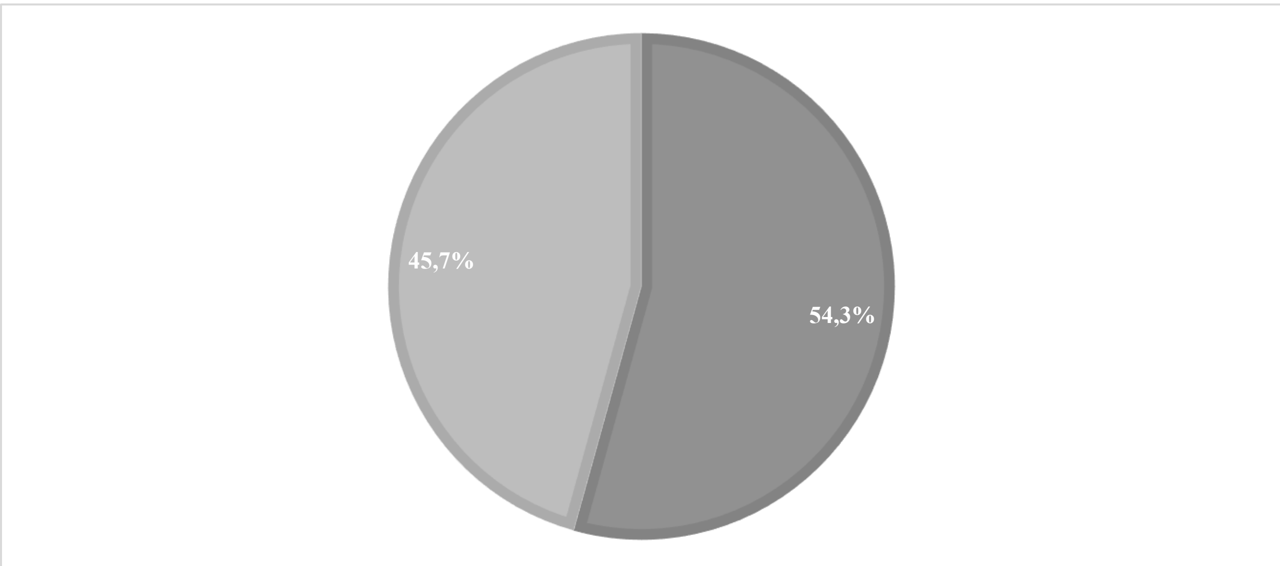
Figure 11. The results of respondents that refers to spending taxpayers’ money



Source: Kopjar (2024).

From Figure 11, it is evident that the largest number of respondents completely disagree with the statement, “Taxpayers' money is spent efficiently.” Respondents gave this question an average score of 2.34, indicating strong disagreement.

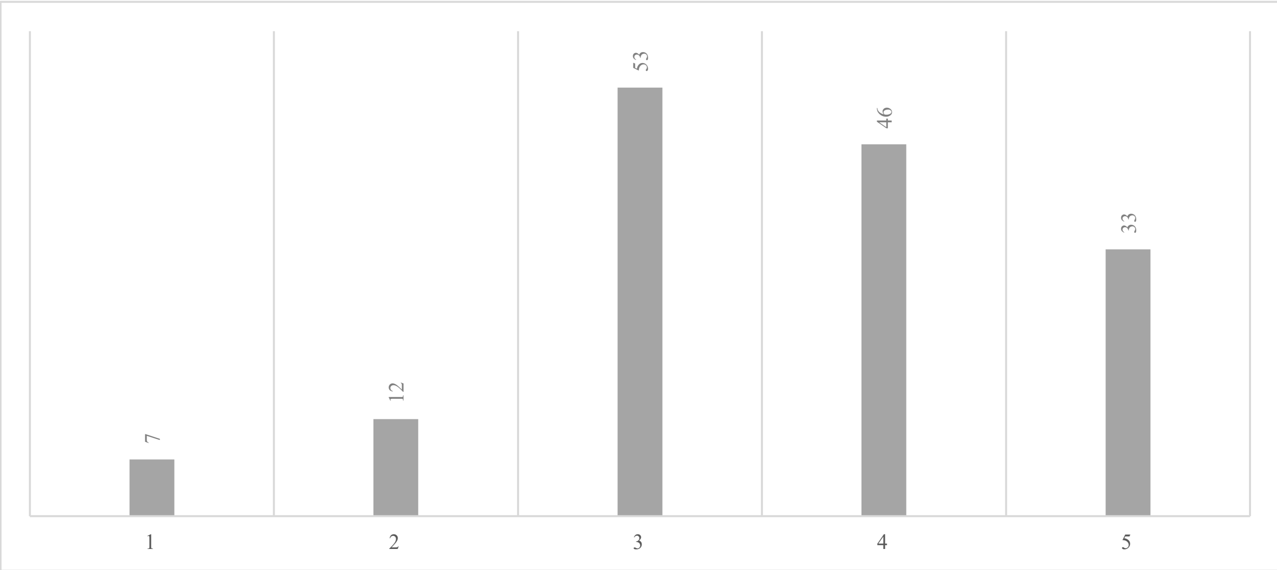
Figure 12. The results of willingness to tax evasion report



Source: Kopjar (2024).

Figure 12 shows the answers to the question, "Are you willing to report tax evasion if you have knowledge of it?" A total of 82 respondents, or 54.3%, stated that they were not willing to report tax evasion.

Figure 13. The results of the presence of tax evasion in the Republic of Croatia



Source: Kopjar (2024).

From Figure 13, it is evident that most respondents rated the presence of tax evasion in the Republic of Croatia with an average score. The average score for this question is 3.57, indicating that respondents believe the level of tax evasion in the Republic of Croatia is quite high.

5. Conclusion

Tax evasion, which takes various forms, reflects this resistance and poses a serious challenge for the state because it directly affects expected revenues. Combating tax evasion is becoming a priority for states, which are developing a range of measures to prevent it. These measures include institutional, legal, and socio-economic actions, and are based on encouraging voluntary compliance with tax obligations, raising tax morale, and increasing citizens' awareness of the importance of taxes for the common good. Cooperation between tax authorities and taxpayers is essential for a successful fight against tax evasion. Raising citizens' awareness of the importance of taxes and their role in supporting the entire economy are crucial steps towards building trust and fostering a collective effort against tax evasion. In the Republic of Croatia, emphasis is placed on preventive measures that raise awareness and encourage voluntary compliance with tax obligations, highlighting cooperation between all relevant actors as key to success in combating tax evasion. To gain insight into the experiences, attitudes, and opinions of citizens regarding tax evasion and tax morale in the Republic of Croatia, an empirical survey was conducted using a questionnaire.

The analysis of the survey results on respondents' experiences with settling tax liabilities and tax evasion indicates widespread practices that encourage evasion, such as not issuing invoices with value added tax displayed. The high level of tax morality among respondents suggests potential for voluntary settlement of tax liabilities, which could help reduce tax evasion. Although respondents recognise the negative consequences of tax evasion for the economy, they are not inclined to report such cases, making the fight against evasion difficult. Their proposals to reduce evasion emphasise the need for changes in the tax system and administration, while highlighting the importance of stricter controls and penalties as potential mechanisms to reduce tax evasion.

Tax evasion has a significant impact on the operations of a state because it directly reduces expected revenues. For this reason, states are combating tax evasion and developing measures to prevent it. Institutional measures address the relationship between the taxpayer and the tax authority, legal measures concern the stability of the tax system, and socioeconomic measures relate to the subjective factors influencing taxpayers. Another problem that states face regarding tax evasion is the inability to quantify and monitor it. States are seeking to promote the importance of voluntary payment of tax obligations and to inform the public about their benefits. It is crucial to make taxpayers aware of the importance of taxes and their impact, which contributes to the overall economy of a state.

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