CONCEPTUAL APPROACHES TO TAX EVASION IN ROMANIA

Mihai Aristotel UNGUREANU
Mirela CĂLUGĂREANU
Mădălina CARAUS
Anne-Marie BARTALIS *

Abstract

Concisely, tax evasion involves the avoidance of lawfully assessed taxes owed to the general consolidated budget of Romania. Although literature related to tax evasion created the notions of "legal tax evasions" and "illegal tax evasion", this distinction between the two concepts is incorrect as tax evasion = breaking the tax laws, and therefore cannot be legal by definition. As tax evasion cannot be measured, tax authorities can only provide estimates in their reports. Measures taken in order to detect, fight against and prevent tax evasion serve the purpose of controlling the consequences of this socio-economic phenomenon.

Keywords: state budget revenues, fiscal risks, tax evasion, measures to fight and prevent

JEL Classification: H20, H21, H26

1. Introduction

Fighting against and preventing tax evasion represents every state's strategic objective. The global financial crisis determined a rising trend in tax evasion by diminishing the tax base or by concealing it. In this case, improving the tax collection system for the general consolidated budget of Romania can mainly be achieved through firm and permanent actions aimed at fighting against and preventing tax evasion.

2. Provisions regarding the tax evasion offences

The concept of tax evasion is subject to multiple definitions, their content being based on the historic period one refers to. According to the Explanatory dictionary of the Romanian Language, tax evasion refers to the avoidance, through any means, by a person or corporation organized under the Romanian law, of lawfully assessed taxes

---

* Mihai Aristotel Ungureanu is Professor at the Romanian American University, Bucharest. E-mail address: m_a_ungureanu@yahoo.com
Mirela Calugareanu is PhD. student at the Lucian Blaga University of Sibiu, Sibiu
Madalina Caraus is PhD. student at the Lucian Blaga University of Sibiu, Sibiu
Anne-Marie Bartalis is PhD. student at the Lucian Blaga University of Sibiu, Sibiu

owed to the general consolidated budget of Romania. Dictionary of the modern Romanian language defines tax evasion as a practice of avoiding to pay the true tax liability, whereas the Explanatory dictionary of the English language provides a similar definition. Tax evasion consists of all legal and illegal practices through which the interested parties understate their taxable income in order to partially or fully circumvent tax obligations [Saguna, Tutungiu, (1995)]. From a tax doctrine point of view, it is believed that understating the taxable income and breaking the equal tax justice for all principle can either be legal or illegal [Muzellec, (1993)]. The academician Iulian Vacarel considers the tax evasion to be avoiding to include a part of the taxable income in the tax base [Vacarel, (1999)]. According to Law no. 87/1994 on fighting tax evasion, Tax evasion is the avoiding by any means, totally or in part, from the payment of taxes, duties and other amounts owed to the state budget, local budgets, the state social insurance budget and the outside the budget special funds by the natural and juridical persons, Romanian or foreign persons further on called taxpayers. Unfortunately, Law. no. 241/2005 on preventing and combating tax evasion, which is still in effect, does not provide a definition for tax evasion. The literature distinguishes between the notions of legal/licit tax evasions and illegal/illicit tax evasion. Moreover, French and Anglo-Saxon doctrines make the same categorization. In the recent articles authors refer to legal tax evasion as tax optimization. Most of the opinions expressed on this matter define licit tax evasion as the practice of circumventing the legal provisions of the tax law, by speculating the imprecise/ambigous articles in the law. More recent voices state that legal tax evasion represents a tax optimisation mode through which the taxpayers gain competitive advantage through the favorable interpretation of legal loopholes. Our opinion on tax evasion is that the above-stated views on legal tax evasion are incorrect as the literature clearly states that tax evasion involves breaking the tax law.

Tax evasion developed as a hard to control socio-economic phenomenon mainly determined by: imperfect tax laws, low standard of living, the culture and public conscience of the population, aggressive taxation policies and corruption.

According to article 9 paragraph 1 of Law no. 241/2005, the following deeds are deemed tax evasion crimes and are punished with imprisonment from 2 to 8 years and the interdiction of certain rights:

a) hiding the taxable asset or source;
b) omitting, in full or in part, to indicate in the accounting books or in any other legal documents, the commercial operations performed or the realized income;
c) including, in the accounting books or in any other legal documents, expenses which do not rely on real operations, or other fictitious operations;
d) the alteration, destruction or hiding of accounting books, storage memories of cash registers or any other means of data storage;
e) keeping two sets of accounting books, using documents or other means of data storage;
f) avoiding to make financial and tax audits or the customs checks either through failure to declare or the fictitious or inaccurate declarations regarding the headquarters or branch offices of the checked persons;

g) substitution, damage or estrangement by debtors or third persons of any assets seized in compliance with the provisions of the Fiscal Procedure Code and the Criminal Procedure Code.

A deed constitutes tax evasion if it was performed with the clear intention of evading the payment of tax obligations. The tax payer's setting, in bad faith, taxes, fees or contributions which result in obtaining, without any lawful right, amounts as returns or refunds from the general consolidated budget or compensations due to the general consolidated budget; the punishment is imprisonment from 3 and 10 years and the interdiction of certain rights (art. 7 paragraph 1). Association with the purpose of committing these offences is punished with imprisonment from 5 and 15 years and the interdiction of certain rights (art. 7 paragraph 2). Law no. 241/2005 on preventing and fighting tax evasion also set the auxiliary offences related to tax evasion. The same normative act defined the situations for the mitigation of sentences, the interdictions, but also the deeds for which the minimum and maximum jail time has been raised. Law no. 241/2005 on preventing and fighting tax evasion defines fictitious transactions as being the alteration of reality by creating the false image that a transaction took place which in fact never existed. This is useful in the process of punishing taxpayers acting in bad-faith by using bogus shell corporations. In most of the cases, this tax evasion technique is used in order to artificially raise the deductible VAT in the whole supply chain. In some cases, this tax evasion scheme has been used to illegally claim VAT refunds.

Although by passing the Law no. 241/2005 on preventing and fighting tax evasion the authorities attempted to increase the scope of the legal means through which the State checks the economic activity of the taxpayers, we consider that more coherent, clearer and more efficient regulations are required and should also govern the tax authority's responsibility. We support our position based on the reality that there are many instances regarding transfers of shares undertaken in order to evade taxation, many cases of fake business addresses in order to avoid tax audits and numerous insolvencies with the aim of avoiding the payment of tax liabilities owed to the general consolidated budget. On the other hand, we argument that the law should accommodate a new chapter on fines and penalties for the offences presenting a low social risk.

2.1. Methods to estimate tax evasion

Literature holds different views regarding the dimension of tax evasion and the methods used to measure it. Almost all recent researches and articles conclude that tax evasion cannot be measured and that tax authorities can only provide estimates in their reports.

According to the Fiscal Council's calculations based on National Institute of Statistics data, tax evasion has a large share in the Romanian economy, accounting for 16.2% of GDP in 2013. VAT recorded the most widespread tax evasion for 2013, amounting to a staggering 12.21% of total GDP and generates 75% of the total tax fraud. Fiscal Council holds the view that VAT tax evasion represents the difference between the theoretical level of the implicit VAT from of the economic activity, including the unobserved economy, and the VAT revenues collected by the State according to ESA95 methodology. This assessment for the VAT tax evasion is not necessarily the result of tax evasion exclusively, and can be explained by other factors such as: (i) legal practices of VAT elusion, (ii) the entry of companies into insolvency, leading to a reduction of VAT revenues collected by the State, and (iii) the accuracy of the national accounts data, on which the theoretical VAT was estimated[1].

The theoretical VAT is calculated by identifying those categories of expenditures that should generate final non-refundable VAT. At the macroeconomic level, these expenditures can be divided into three categories :

- Final consumption expenditure of households and government;
- Intermediate consumption of goods and services required to produce other goods and services;
- Gross fixed capital formation (GFCF) (investments) made by companies (i) not subject to VAT or (ii) that produce goods and services exempted from VAT.

In order to identify the unobserved economy in Romania, the economy can be divided into two sectors: formal and informal. For the formal sector, it is considered the underreporting of labor force employment and also the tax evasion in the case of non-financial corporations, with an impact on gross value added underreporting. Tax evasion is calculated as the variation between the theoretical and the (actual) VAT collected. In the case of the informal sector, the evaluation of the unobserved economy is done by accounting for all activities performed by family associations and self-employed entrepreneurs. The appraisal of the social security contribution and the personal income tax evasion has taken into account NIS' estimation regarding the employees' remuneration corresponding to the added value related to the undeclared work and to the informal sector. Regarding the tax evasion on corporate income tax, it was considered the NIS[2] estimate on gross operating surplus of the unobserved economy (as a proxy for the profit corresponding to the unobserved economy) and its share in the total gross operating surplus of the economy. Regarding the excise duty evasion, according to the estimates of the Fiscal Council, cigarettes are attributed the largest contribution to the evasion as, on the average, the illicit trade with cigarettes accounted for a 20% market share in the period 2003 – 2013.

2.2. Measures taken in order to detect, fight against and prevent tax evasion in Romania

By analyzing at the data presented by the Fiscal Council, one can draw the conclusion that the degree of tax compliance in 2013 was 55.8%.

Based on the Fiscal Council's calculations for tax evasion, one can calculate the degree of compliance with the major tax categories as a ratio between the reported income submitted to the budget and the theoretical revenues or true income (reported income plus tax evasion). Tax revenue to GDP (taxes and social contributions) in Romania was equal to 27.5% in 2013, 13 percentage points of GDP lower than the EU

[1] Romanian Fiscal Council, Annual report 2013

[2] National Institute of Statistics

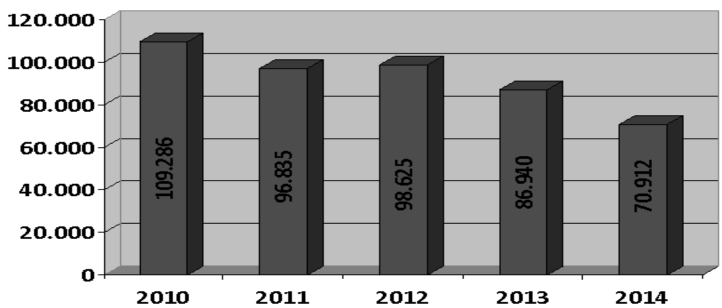
average (40.5%). Main causes for this poor performance are: deficitary tax collection system, an inefficient tax authority, ambigous tax laws and a widespread tax evasion. Although initial measures to reform the tax collection system have been taken by NAFA[3] and the institution underwent an extensive reorganization in 2013, we believe that the expected results are yet to come. The efforts to reform the tax collection system and to create a modern tax authority constitute, in our opinion, an essential requirement for ensuring the proper functioning of the state. We also acknowledge the fact that this is a long-term procedure, with medium and long term consequences. In this given context detecting, fighting against and preventing tax evasion is crucial for reaching the structural budget deficit targets set for Romania. Furthermore, lower tax rates can reduce the tax fraud levels. Measures taken in order to fight against tax evasion are closely linked to the underlying cause of this socio-economic phenomenon.

Among traditional approaches to reduce tax fraud we can invoke the following:

- tax reform – simplifying tax laws, creating a clearer, more coherent tax law and cutting on the number of tax returns;
- rethinking the working procedures;
- reducing tax rates;
- fighting corruption;
- creating campaigns aimed at promoting the importance of tax compliance;
- public expenditure transparency.

In order to support the need for such measures we have carried out a quick analysis of NAFA's performance regarding the efficiency of the tax audit department inside the institution. In the time period 01.01.2010 – 31.12.2014 the tax audit and tax inspection personnel carried out checks as part of the campaign to prevent and fight against tax fraud. The evolution of the tax audits is highlighted in Figure 1.

Figure 1 – Number of tax audits and tax inspections for the time period 2010 – 2014



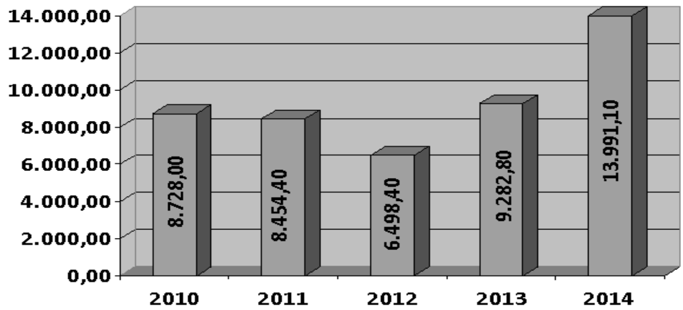
Source: data collected by the authors from NAFA's internal records

The data presented indicates that the tax audit department carried out 28% fewer inspections in 2014 when compared to 2012. Moreover, only 0.89% of the taxpayers have been subjected to tax audits in 2014. When looking at the figures related to the

[3] National Agency for Fiscal Administration

additional payment obligations set by the tax audit authority, we can see a rise of 153% for the time period 01.01.2012 – 31.12.2014. The dynamics of the additional payment obligations amount is exhibited in Figure 2.

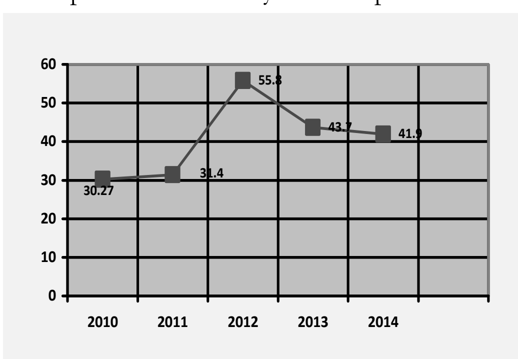
Figure 2 – Additional payment obligations set by the fiscal inspection department for the time period 01.01.2010 – 31.12.2014



Source: data collected by the authors from NAFA's internal records

Analyzing the key performance indicators of the financial inspections, one can observe the fact that year 2014 recorded a peak in terms additional payment obligations established – 13,991.1 mil. Lei. This indicates that the planning, selection and scheduling activities were improved. Taking into account the fact that the rate of collection of further payment obligations resulted by means of fiscal inspections is 12,68% for legal persons and 5.42% for natural persons, we believe this revenue source is not solid enough to sustain the reduction of tax rates planned by the Romanian Government.It is worth mentioning that the fiscal relaxation measures projected in the upcoming Fiscal Code are based upon the presumption that the impact will be compensated by creating a more efficient tax collection system. Reducing tax evasion plays an important role in achieving this objective. Another key indicator taken into account is *the degree of insured tax debt collection regarding the insurance policies enacted by fiscal inspection*. The evolution of this indicator for the time period 01.01.2010 – 31.12.2014 is included in Figure 3.

Figure 3 – The degree of insured tax debt collection regarding the insurance policies enacted by fiscal inspection



Source: data collected by the authors from NAFA's internal records

The findings regarding the evolution in the degree of insured tax debt collection regarding the insurance policies enacted by fiscal inspection reveal the fact that some amounts are not fully insured. Possible causes for this situation are either the lack of interest from the tax audit personnel in tracking down the sizable goods, bank accounts and sources of revenue or the insufficient taxpayer wealth to cover the additional obligations established.

In order to detect, fight against and prevent tax evasion, in 2013 a new authority – General Directorate for Fiscal Antifraud (GDFA)- was established inside NAFA. This structure is responsible for countering fraud and evasion in relation to tax. As this is a new structure we couldn't carry out a comparative analysis of the results of this institution and we couldn't determine the exact contribution GDFA's activities had towards the revenue collection to the general consolidated budget. Data published by NAFA revealed that GDFA applied 19.420 fines and carried out controls at 24.160 taxpayers, meaning that 80% of the audited taxpayers were fined. One of the measures to prevent and fight against tax evasion is through exerting constraint in order to force the taxpayers' compliance with the tax laws, but in our opinion Tax authorities have a still a lot to do in the field of taxpayers guidance and assistance and improving the general level of service provided with the aim of improving the tax collection system.

3. Conclusion

We believe that no matter how tax evasion is defined and how we estimate its size, the effects of this socio-economic phenomenon impact the life of every Romanian citizen. Obtaining money from the Government on false pretenses or avoiding the payment of taxes to the general consolidated budget takes away resources from key areas such as healthcare, education, pension fund, safety of citizens and the Defense Department. As the estimated tax evasion remains at high levels, implementing measures taken in order to detect, fight against and prevent it should constitute a high priority for the tax authorities. In the current context we consider that anti-fraud measures are insufficient as this phenomenon will continue to exist as long as there is a market for goods and services, so we can at best contain and control tax evasion.

Our proposals regarding the anti-fraud measures that should be implemented are as follows:

- determining the fiscal behavior, based on risk analysis through electronic means;
- fiscal checks should take into account the correlation between the personal wealth in comparison with the reported revenues. This can be achieved by introducing the legal provision that each citizen should file in an Assets and Wealth declaration;
- identifying solutions through which the GDFA's additional amounts established can be collected by applying fiscal procedures;
- passing a new law regulating tax evasion. The new law should contain three main parts: fines and fines-related sanctions; offences and applicable punishments; responsibility of the tax audit inspectors for wrongfully enacting the law (error, overzealous behavior, bias);

- implementing the virtual private space as the compulsory communication platform for the legal persons, by using the electronic medium free-of-charge;
- setting up an Institute for Fiscal Studies inside NAFA in order to provide a high level of training for the staff.

In view of implementing the anti-fraud measures we also take into consideration the need to prioritize them based on the following constraints: financing needed – scope of effects – reaction time. As a success story we can nominate the recently implemented Fiscal Lottery, a project with positive returns compared to the insignificant costs involved.

It is our firm belief that the first project which should be implemented is setting up an Institute for Fiscal Studies inside NAFA, a project which would bring substantial benefits with relatively low budgeted costs, and would serve both the interests of the tax authority and taxpayers which would benefit from proper guidance and assistance, and not solely be the subjects of fiscal inspections.

References

Saguna D.D., Tutungiu M.. 1995. *Tax evasion explained*, Oscar Print Publisher, Bucharest

Muzellec R. 1993. *Finances publiques*, Sirey Publisher, Paris

Ungureanu Dragos. 2015. *Fiscal policy*, Universitara Publisher, Bucharest

Ungureanu M.A. 2013. *Financial policies and practices*, Universitara Publisher, Bucharest

Vacarel I. 1999. *Economic and financial policies then and now*, Economica Publisher, Bucharest

Law no. 87/1994 on Fighting tax evasions

Law 241/2005 preventing and combating tax evasion

Government Ordinance no 92/2003 concerning the Fiscal Procedure Code

NAFA performance report 2010, 2011, 2012, 2013, 2014

Romanian Fiscal Council, Annual report 2013