

TRENDS AND PROSPECTS FOR TAX EVASION

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1. General considerations

Tax evasion is one of the critical phenomenon that many countries face to a greater or lesser extent.

Since avoiding to pay taxes leads to erosion of the tax system's efficiency and to distortions in the management of planning and financing public expenditure, because of the gap between the potential tax and the taxes actually collected from taxpayers, we appreciate that tracing the evolution of this phenomenon must submit a priority.

Unfortunately, what can be done effectively in this area is to limit the maximum possible of this phenomenon, since eradication is impossible as tax evasion proved to be a disease difficult to heal.

2. Trends and prospects in the evolution of tax evasion in Romania

In Romania the proportions reached by tax evasion make this phenomenon so real that it became a daily presence in all income generating spheres. Tax evasion problem in our country gets major connotations because of the amplitude of the phenomenon, and because of capital shortages, either at macroeconomic level with difficulties in financing social welfare and economic restructuring programs, or at the microeconomic level, where the phenomenon of thin capitalization causes problems in funding the resumption of the operating cycle.

Thus, tax evasion and fraud occupies a significant part of the

underground economy. We can support the idea there is a high level of tax evasion in our country, without the risk of this being a mere political statement, because only stealing large sums from the payment of budgetary obligations by taxpayers, may be the key to the survival of 60% of people in Romania, given the fact that their income places them below the poverty line. On the other hand, the level of property investment is unnatural for people associated with different companies that register loss each year.

According to a report given by the U.S. State Department, financial fraud in Romania could amount to approximately 1.5 billion dollars¹.

According to this report, illegalities relating to VAT is 10% of financial fraud, in decrease compared to previous years when represented 45%. Measurement of tax evasion so far is made exclusively by approximate methods, policy statement being already widely used in Romania.

The difficulty of applying scientific and methodological tools and techniques for measuring tax evasion is mainly due to the many imperfections and features in the tax area, determined by dense and often ambiguous laws, and a massive tax evasion. Results of tax evasion phenomenon measurements are very approximate.

According to the Intelligence assessments, the level of evasion in contemporary Romania amounts to approximately 12% - 15% of GDP, while

¹ I. Vacarel and collective, Public Finance, Fourth Edition, Didactic and Pedagogic Publishing House, Bucharest, 2007, p.459

other analysts, based on more generous criteria of assessment, determine the level of evasion at approximately 40% of PIB².

According to the report of the Finance Ministry from 31.12.2008 **tax evasion in Romania was estimated at a level of 21% of PIB³**. The most common forms of tax evasion remained **undeclared work** (10.7%), seen particularly in construction, trade and services, and **tax evasion in VAT**, reaching in 2008 to nearly 24 billion lei, respectively 4.6% of GDP, over three times the amount of 7.4 billion lei in 2004.

However, the underground economy has increased its share in the period 2004-2008, from 14.5% of GDP to over 21%⁴ and taxation of this segment would have brought last year budgetary revenue of 58.116 billion lei representing 11.3% of GDP. Undeclared work is the most important part of economy, representing 50.8% of GDP.

According to studies and tests conducted by the Financial Guard at a national level, we can state that more and more new companies are attracted to underground economy, vital resources are removed from the country and foreign investors avoid or leave the area disappointed.

Thus, our country risks being caught in a vicious circle in which tax evasion lowers public revenue, undermines overall confidence and ultimately weakens the credibility of the state itself. The rather broad area in which tax evasion manifests itself nationally faces the bodies of financial control and tax duties with special problems.

For example, during 2008 the Financial Guard organs examined a number of 176,201 businesses, the number of fraudulent tax evasion

identified that were brought before the criminal investigation being 4391, this number being an increase of 84.88% compared to 2007, and of 88.13% compared to 2006 (Table nr. 1.1).

Analyzing the data presented in the table below, you can find that in 2008 there were confiscated or was ordered to transfer to confiscation goods and money without legal origin or that have resulted from illegal acts in the value of 131.417mii lei (RON), this value being higher in 2008 with 26.57% compared to 2007.

Identifying cases of tax evasion has led to the application of sanctions in the form of increasing the fines in case of delay and confiscations, the amount of such sanctions being 251,085 thousand lei (RON), being 30.36% higher than in 2006.

In our opinion, the current situation is even more dangerous as the damage to the state budget by such criminal acts that were identified during the year 2008 registered an increase of 56.78%% from the year 2007.

Since tax evasion is negatively impacting state revenues, depriving the state budget of some of the revenue entitled to him, thus affecting negatively the budget implementation, I think it is important to know the main areas in which tax evasion is committed. For this, I presented in the figure below (Figure no. 1.1.) the amount of damage to the state budget in 2007 in the main areas of activity. As we see the greatest damage to the state budget by committing evasion acts were recorded in the production and marketing of oil, fuel or other petroleum components (39%).

² C. I. Gliga, Tax evasion. Regulation. Notes. Law, C. H. Beck Publishing House, Bucharest, 2007, p.154

³ www.anaf.mfinante.ro

⁴ National Courier, no. 5374, 06 March, 2009.

Table no. 1.1. The value of fines, confiscation and criminal allegations made and applied by the Financial Guard

- thousand ron -

EXPLANATION	2005	2006	2007	2008
I. TOTAL AMOUNTS				
- Established	286.497	281.943	376.805	382.502
- Received	132.098	151.690	189.544	168.069
of which				
Fines				
- Established	162.395	192.606	272.983	251.085
- Received	121.691	138.848	178.583	156.599
Confiscation				
- Established	117.097	89.337	103.822	131.417
- Received	9.039	10.386	10.817	11.470
II. CRIMINAL REFERRALS				
- Number	2009	2.334	2.375	4.391
- Value of the loss	697.104	745.773	1.400.023	2.194.971

Source: Activity Report of the Financial Guard in 2008, p.5

Along the field of petroleum products, alcohol and alcoholic beverages have been favorite targets of the actions of tax evasion, in order to avoid duty and VAT payment.

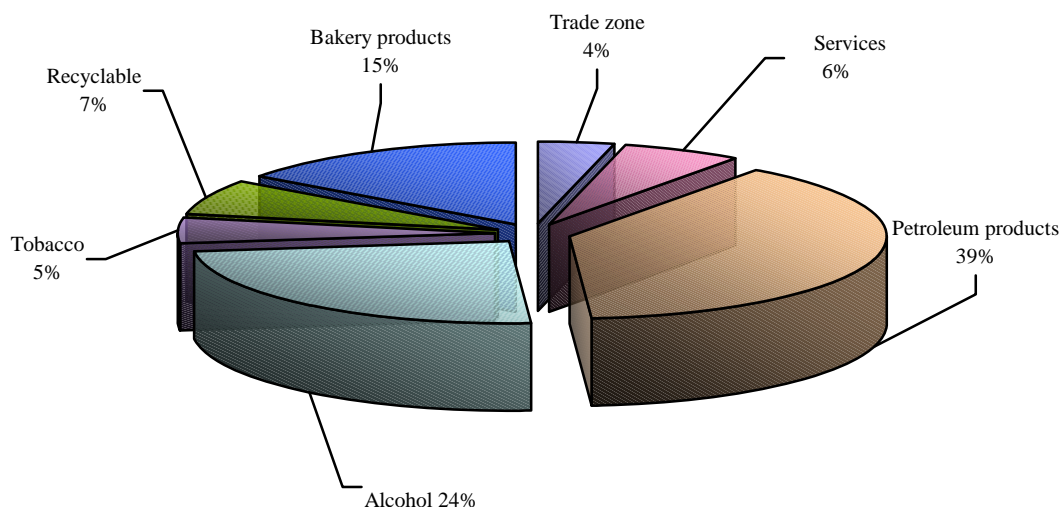
Alcohol illegal factories seek a quick profit and operate for only 2-3 months and then move their headquarters to other parts of the country to avoid being discovered. Fraud of the state budget has been identified also in grain trade, in milling and bakery products (15%), in trade with recyclable

(7%) in the production and marketing of cigarettes and tobacco products(5%).

Another area where there has been evasion from the establishment and payment of tax obligations is the sphere of provision of services (6%).

In reality, most of these services are not provided, realizing only a fictional circuit of documentation. In the importation of such services there is an apparently legal transfer of currency abroad.

Figure no. 1.1. The amount of damage identified in main areas of activity



Source: Activity Report of the Financial Guard in 2007, p.10

From January 1, 2007, since Romania is a full member state of the European Union, economic analysts have concluded some important aspects of the development of tax evasion after accession.

For example, VAT receipts fell in 2007 compared to previous year due to new procedures for payment of the value added tax in trade with other EU countries, a fact that some Romanian businesses have prospered from, eluding the state.

Evasion of VAT is present across the EU precisely because the tax rate is not regulated at EU level and differences between countries are exploited. International VAT Association estimated VAT losses between 60 and 100 billion euro per year in the EU ⁵.

Companies that make intra-community deliveries and acquisitions are required to pay VAT in the state from which they purchase goods and make the VAT bill, monthly or quarterly (depending on turnover), in the state of

residence, to regulate the payment, as shows the differences in VAT rates.

The information contained in the bill of VAT are checked after each month or quarter, based on centralization made by each state, but in this time the company can disappear without paying.

For example, each state of the ten that joined in 2004 had a loss of 3-4% of VAT, to the period before accession, on account of intra-community supplies and procurement. A similar decrease in VAT receipts held in Romania as well.

After the first five months of 2007, VAT revenues were at 97% of the amount collected the previous year ⁶ given that budget planning estimated an increase of 20% over 2006. It is widely acknowledged that in 2007 we had a growth exceeding 6%, an inflation of 4%, so VAT revenues would have had to increase in the year when Romania became an EU member.

On the other hand, that VAT receipts fell strongly was felt in customs revenues, especially the first three

⁵ www.hmrc.gov.uk

⁶ www.mfinante.ro

months of the year when legislation eliminated the obligation to pay import VAT at customs.

Beyond April 15, 2007, Customs resumed the collection of this indirect tax, after the government approved, by emergency order, return to the obligation to pay VAT at customs.

Thus, customs revenues decreased in 2007 from the previous year, reaching at only 40% of amounts collected the previous year.

Lower earnings may be explained, in part, through the mechanisms of evasion of VAT, facilitated by the delivery and intra-community acquisitions system.

We believe that the main cause is the elimination of duties on goods brought from the EU which means 75% of the total volume of goods⁷.

However, some of these amounts were recovered on the basis of imports from China, which experienced a large increase, reaching 89% in 2007.

Comparing the results recorded in 2008 with those from previous years one can observe an increase and diversification in the dynamics of the phenomenon of tax evasion, which in my view is a consequence of not taking operational measures to reduce and eradicate the phenomenon, a situation which is likely to create a solid basis for development of other forms of crime as well, posing a danger for the whole community.

Precisely for this reason, since "the methods of tax evasion change with amazing rapidity new methods of investigation must be taken at the same rate"⁸.

We believe that the evolution of tax evasion in Romania should be a concern for policy makers, especially since numerous signals coming from the

European structures show that actions to reduce the underground economy, which generates the phenomenon of evasion and corruption should be the priority objectives of the Romanian politics.

3. Prospects for development of tax evasion in the current economic crisis

Existing financial and economic crisis at national and global level causes increased tax evasion, which in turn affects public services, diverts public resources and delays growth, attacking the very driving force created by the reform process.

We appreciate that in a time of crisis there is a growing phenomenon of tax evasion, and that stopping this phenomenon is very difficult.

According to economist Daniel Daianu, given that tax evasion would normally be stopped by an economic growth, in conditions of crisis it increases and can not be countered.

According to him, given that the underground economy, which generates tax evasion, is growing, the effect of collection of contributions to the state budget will be much lower.

Countries around the world take fiscal measures to combat the effects of global financial and economic crisis. We can distinguish two main categories:

- **states** that focused on **tax relief** in general and labor costs in particular;

- **states** that focused on **stimulate economic areas** or certain industries, in particular.

No matter which category we talk but when the question of tax increases to go on the idea of additional taxation of consumption rather than income population.

If we refer only to Romania's neighbors, we see that Bulgaria adopted tax relief over five years for investment in disadvantaged regions or exemptions or income tax reductions for young families who pay interest on housing loans. In

⁷ www.banknews.ro.

⁸ ⁹ C. I. Gliga, Tax evasion. Regulation. Notes. Law, C. H. Beck Publishing House, Bucharest, 2007, p.154

Czech Republic, income tax rate was reduced from 21% to 20% and health contributions were reduced as well.

According to the study "Tax Response to The Global Economic Crisis"⁹ of Deloitte, United Kingdom reduced the VAT rate during the crisis from 17.5% to 15% and allowed to postpone payment of taxes for companies with losses; the Netherlands and Spain introduced incentive measures for methods of accelerated depreciation for investments made in 2009; Belgium reduced rate of VAT on new housing from 21% to 6%; in Greece annual tax for companies in the hotel industry was reduced from 0, 1% to 0.033% in 2009.

In most EU countries, including the proposed anti-crisis plans in Europe and U.S. fiscal policies occupy a key position.

The main purpose of these policies is to give companies or individuals an amount of money as large as possible, that will make on the one hand, the financing of businesses and, on the other hand, encourage consumption.

Romania's fiscal strategy does not seem to be based on the identification of measures to improve funding and incentives to business, but on the increased budget revenues in order to keep budget deficit within limits as low as possible

Our country is the only state affected by the crisis that has tightened the taxation in all its components.

CAS was increased, an important contribution for employers, minimum tax (flat) appeared and VAT for intra-Community goods will be done within 30 days not 90 as so far. There are no significant tax incentives; state bears no penalty if it is late with payments for the companies; private investment and small initiative are not encouraged.

In our view CAS's increased by 3.3%, ahead of schedule increase of

excise on tobacco and alcohol, and expected growth of local taxes are attempts to collect as much as possible, regardless of business needs in facing the crisis.

Instead of boosting revenue budget, these measures, that are considered anti-crisis, will cause a **decrease in budget revenue**, because once the fiscal screw is tighten, traders seek "methods" to avoid payment of tax obligations to the state budget.

Among areas where predisposition to evasion is very high are alcohol and tobacco industry, where investors expect a real **boom in black market**.

Accelerated increase in excise duty will result in price increases, and this will lead to the creation of black market, fueled by cartels of smuggling cigarettes from Bulgaria or the former Soviet space.

Also increase excise duty on alcohol will push many businesses in the sector to tax evasion, without which, under the circumstances, would disappear from the market, given that the amount of excise duty on alcohol is 200 Euros higher in Romania, from the average in Europe, of 750 Euros per hectoliter¹⁰.

According to experts, after the **flat tax** application, about 35% of Romanian micro businesses will disappear from the market¹¹. This will result in loss of revenue to the state budget, and economic agents will turn towards other activities related to underground economy.

We believe that flat tax is regressive, and taxpayers who derive income above the average range in their area are advantaged by this, while people whose income is below the average are disadvantaged.

Also the fixed amount for payers does not take account of economic and

⁹ www.deloitte.com Tax Response to The Global Economic Crisis

¹⁰ dailybusiness.ro

¹¹ www.economie.hotnews.ro

social conditions in which the activity takes place, does not take into account the overall economic situation of taxpayer nor encourages competition.

Finance Ministry claimed that from about 680,000 taxpayers, only 2000 of them contribute to the formation of 85% of total revenue. But such a simple statement is not illustrative.

Before making a major decision regarding changing the tax system should be examined whether firms that have not paid taxes have really registered losses (and which would be the causes of these losses), falls in the evasion or are inactive.

We appreciate that this is essential because equalizing loss and evasion is a big mistake.

If, indeed, tax evasion can be found, then you should see why, in a very low tax rate on the income, of 16%, traders are likely to fail to declare income. Perhaps the whole tax system and tax administration methods should be reviewed.

Tax changes that have to be decided by Finance Ministry are all the more difficult as the revenue from the state budget for year 2009 were lower than last year.

According to specialists fiscal relaxation is not currently a solution, whereas Romania's economy has entered a downward slope and this decline cannot be countered by easing fiscal policy.

Others argue instead that, in times of crisis taxation has to be relaxed as increased taxation creates more tax evasion. They believe that reducing taxes would generate greater liquidity for companies, which could lead to increased investment.

In our opinion, the success of a national tax system is linked not to enough money derived from taxation, but to the system's capacity to develop the tax base, to stimulate the economy, to succeed in taxing nationally the international business, to stimulate

interest in investment, create an open and stable business environment.

4. Conclusions

Tax evasion is an extremely harmful socio-economic phenomenon and legislative permissiveness and that of the competent authorities, in conjunction with an extremely high degree of taxation, especially for a country in transition to a genuine, viable and real market economy, have led to the creation of an environment for stimulating the development of evasion practices and to taxpayers' ingenuity to invent various methods of circumventing the tax laws.

In this state of development of global economy, which have in the foreground the process of globalization and liberalization of the movement of factors of production, free movement of capital leads to the widening of tax evasion and guides capital placement towards tax havens, which enjoys customs extraterritoriality and avoid, at least partly, the national law, depending on conventions on double taxation.

Escalating tax evasion in our country has made major foreign investors from European Union countries and the U.S. to avoid business in Romania and a part of those who invested were forced to abandon the investment or transfer to other countries because of unfair competition made by evasion.

Romania is an emerging economy that has only recently gained the status of functional market economy, these features leading to the development and diversification of the evasion phenomenon throughout the period that followed the change in 1989. We believe that in order to reduce and counteract the phenomenon of evasion in the current crisis and beyond, the government should streamline the mechanism of contributions' collection and to bring to light dark areas of the

economy. We also consider that it measures, which confuses business. should abandon the periodic tax

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