

MEASURES PROMOTED IN ROMANIA AGAINST TAX EVASION IN THE CONTEXT OF ECONOMIC AND FINANCIAL CRISIS

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1. General considerations

In 2008, the world economy went into the greatest economic crisis after the great recession of 1930, affecting both developed and emerging countries and demonstrating the degree of interdependence of world economies.

Starting with the last quarter of 2008, crisis propagated into our country as well, given that Romania's economy grew unsustainable (7.3% in 2008) which fueled an excessive deficit of current account of around 11.6% of GDP in 2008^{1,1}.

As in other countries, the management of economic boom proved to be difficult, the fiscal policy grew imbalances by spending revenues from additional growth, which led to higher fiscal deficits.

In a time of crisis, a tax evasion phenomenon takes place, and stopping this phenomenon is very difficult. According to economist Daniel Daianu, "given the fact that tax evasion would normally be stopped by an economic growth, in crisis conditions tax evasion

increases and can not be countered"².

In his opinion, while the underground economy, that is generating tax evasion, is developing, the effect of collecting contributions to the state budget will be much lower.

So, it proves necessary to search for best ways to improve the collecting system, and to attract into the system the

revenues from underground economy. More and more new companies are attracted in the underground economy, vital resources are removed from the country, and disappointed investors bypass or leave the area.

Thus, given that Romania has been affected severely by the global economic crisis, our country risks being trapped in a vicious circle in which tax evasion lowers government revenues, undermines general confidence and ultimately weakens the credibility of the state itself.

2. Legislative measures to combat tax evasion

In order to collect as much money to the state budget and to combat tax evasion in Romania, the controversial flat tax was introduced in May 2009. The purpose of introducing this tax was only to replace a volatile tax base with a controllable one. In these conditions it is found that although a company does not record profit, it is obliged to pay at least a tax of 2,200 lei per year, and this amount can increase to 43,000 lei per year, depending on the turnover of the economic agent in the previous year.

The Ministry claims that from approx. 680,000 taxpayers, only 2000 of them contribute to gathering of 85% of budgetary revenues^{3,3}. But that simple statement is neither enlightening nor convincing. Before making a major decision regarding changing the tax system, it should be considered if

¹ According to data provided by the Ministry of Finance

² Romania Libera, 2 February 2009

³ www.gandul.info / finance, Government wants flat tax for real estate, tourism and pubs, April 3, 2009

companies that did not pay taxes actually recorded losses (and which would be the causes), fall under the tax evasion or are inactive.

We believe this is essential, as the inclusion of all economic agents that register losses in the category of fraudsters is a big mistake. But if indeed tax evasion can be proved, then it should be analyzed why, even if the profit tax rate is very low, just 16%, businesses are likely to fail to declare income. Perhaps the whole tax system and tax administration methods should be reviewed.

Also, in our opinion, confusion is often made between cash - flow and profit when it is analyzed the activity of loss making companies. If a company has cash available in the cash register for business development but without making profit this does not mean that company makes tax evasion. In many cases, the main company chooses to fund its subsidiary in Romania, even if this registers loss, for reasons of building a market position or because the group achieves that synergy that generates profit.

In our opinion, the flat tax is regressive in nature, because income taxpayers that obtain great income are advantaged and those whose income is below the average range in the field are disadvantaged.

Also the amount fixed for taxpayers ignores economic and social conditions in which activity takes place, it does not take into account the overall economic situation of the taxpayer, nor encourages competition. This amount does nothing but to discourage the continuation of any other activities. During 2009 a total of 133,326 businesses have suspended their activity, a number that grew by 1009.59% compared to 2008⁴. (Figure no. 1.1.).

According to official data of the National Trade Register Office (ONRC), in the first quarter of 2010, the number of companies that have suspended business activities increased by 356.32% compared to 2009, but since April 2010, there was a decrease in this aspect. Compared with 2009, the number of companies that have suspended business activities during 2010, declined by about 50.6%⁵.

Analyzing the consequences of the introduction of flat tax, we must recognize that this measure did not have only harmful effects but also had beneficial effects. One of these beneficial effects was that it succeeded, if not to eliminate, at least to limit tax evasion.

We refer to situations where eligibility of deductible expenses was mimicked, unlawfully extended (for example expenses that are not or can not be functionally associated to income) or to the situation where some revenues were not recorded, in both cases reducing the tax base.

Another positive aspect is, the increase of coincidence between scheduled public revenue and charged public revenue, this resulting in increasing macroeconomic financial stability.

Also, by introducing flat tax, the selection of viable economic agents was accomplished. We believe that businesses that do not obtain, on a continuing basis, a minimal profit (i.e. equal to the flat tax) must exit the market, this being an extremely useful and effective process of improving the economy.

In other news, we consider that nowadays, the field with the biggest exposure for tax evasion in Romania is the intra-Community trade in goods or excisable goods that are not declared and that taxpayers do not pay taxes for.

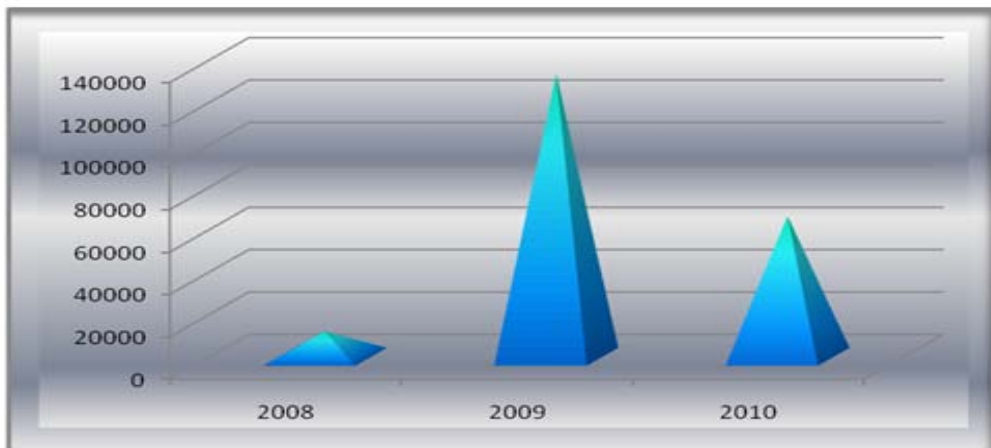
⁴ www.onrc.ro, Statistics of suspensions of activity, by county, from January to December 2008, January to December 2009.

⁵ www.onrc.ro, Statistics of suspensions of activity, by county, from January to December 2010, compared to January to December 2009).

Thus, to combat tax evasion in intra-Community acquisitions, in terms of declarative obligations on VAT, it should

be mentioned that they have become considerably more complex starting with 2007.

Figure no. 1.1. The dynamics of suspensions of activity during 2008 – 2010



Source: interpretation of data provided by the National Trade Register Office - Statistics of suspensions of activity, by county, from January to December 2010 compared to same period of 2009, Statistics of suspensions of activity, by county, from January to December 2008, January to December 2009

Starting June 1, 2009, legal persons carrying out such purchases are required to submit monthly VAT statement, even if they have a turnover below the ceiling of 100,000 euros. The State wants to check companies more strict and to combat tax evasion resulted from placing the products bought on the black market in European Union member states.

Clearly, the introduction of mandatory submission of monthly VAT statement is to limit the scope of "carousel" fraud type, and consequently, improve the efficiency of value added tax.

Another measure, considered one of the most important legislative measures to combat tax evasion, because it allows a better control in real time, of intra-Community operations, was introduced by the Government Emergency Ordinance nr.109/2009.

According to this ordinance, starting with 2010, economic agents that have made intra-Community deliveries and / or acquisitions of goods, supplies of goods in a triangular operation, procurement of goods by the recipient for subsequent

delivery to a triangular operation, as well as and provide intra-Community services and acquisitions of intra-Community services, must submit monthly the Recapitulative VIES 390 Declaration for both intra-Community deliveries / acquisitions of goods and services rendered within the Community.

Until 2010, the declaration had to be filed quarterly on the 25th of the month in question and shall extend only to intra-Community deliveries/ acquisitions of goods, but according to experts, the term of 3 months did not allow the control of operations until after a period of about 4 months, enough for fraudulent operators to disappear before the tax authorities should be able to detect fraudulent practices.

It seeks so to stop tax evasion through cross-checks, aimed to check correlations between intra-Community acquisitions declared by Romanian taxpayers by recapitulative statements on intra-Community acquisitions made monthly, and deliveries declared by

suppliers in the Union on behalf of the beneficiaries in Romania.

Also, all traders registered for VAT purposes in Romania, making intra-Community acquisitions and deliveries of goods are required to submit the Intrastate Declaration, for everything over 300.000 Ron thresholds for intra-Community acquisitions and supplies and for over 900.000 Ron for intra-Community deliveries⁶.

The Government Emergency Ordinance no. 54/2010 on certain measures to combat fiscal evasion⁷ brought important changes and additions to the Tax Code and Tax Procedure Code to combat tax evasion in VAT and beyond.

Thus, as of August 1, 2010, the "Register of intra-Community Operators" was established within the National Agency for Fiscal Administration⁸, encompassing all taxable persons and nontaxable legal persons carrying out intra-Community operations.

VAT registration code issued by the Romanian tax authorities will be considered valid for intra-Community operations only after the registration of the legal entity in the Register of intra-Community Operators. In other words, the non-inclusion in this Register entails the impossibility of using VAT code for intra-Community transactions and hence the application of the specific regime for tax payers who are not registered for VAT. The purpose of this Register was to monitor more effectively the economic operators that carry out intra-Community operations.

⁶ Intrastate Declaration is regulated by Law no. 422/2006, Order no. 683/2008 of the President of the National Institute of Statistics on the establishment of Intrastate thresholds for collecting statistical information on intra-Community trade in 2009, and Order no. 685/2008 of the President of the National Institute of Statistics on the rules for completing the Intrastate Declaration

⁷ Published in Official Monitor nr.421 of 23 June 2010

⁸ The procedure of organization and operation of the Register of intra-Community Operators was approved by ANAF Order no. 2101/2010, published in Official Monitor., Part I, no. 429 of June 25, 2010

Emergency Ordinance no. 54/2010 on certain measures to combat tax evasion has brought some changes in the field of excise duties, particularly in terms of fiscal tax warehouses' regime and the obligations of authorized tax warehouse keepers.

Thus, among the conditions for authorization of fiscal warehouse keeper is that the taxpayer should not register delays in paying tax obligations to the general consolidated budget.

Also, the authorized warehouse keeper, the registered recipient and the registered sender are required to give to the competent authority a guarantee for the production, processing and holding of excise goods in duty suspension regime, and a guarantee for the movement of these products in duty suspension regime, to ensure the payment of excise duties that can become chargeable.

If these operators registered with the unpaid tax obligations for more than 30 days, administered by the National Tax Administration Agency, the guarantee extends to them as well and without any formality.

The guarantee is 6% of the excise duties for products that would result in one year, according to the technological capacity of production of the start-up warehouse. For authorized warehouse keepers, the guarantee shall be calculated by applying the 6% to the value of excise duty for output products from last year but not less than 6% of the excise duties for products that would result under the technological capacity of production.

The guarantee for the movement of excise goods under duty suspension regime made by an authorized sender is 100% of the value of excise recorded for the moved products.

Another problem the Romanian economy is facing is that of the surface economy which has an underground behavior.

We refer here to the so called "arrears economy" companies that assume financial and tax obligations, but do not pay them. This creates significant

economic disruptions - both for the economic agents and for the state budget.

Therefore, in order to discourage taking a tax credit instead of a bank credit, and in order to increase the degree of fiscal civism of tax payers, as of 01.07. 2010 by the Government Ordinance no. 39/2010 amending and supplementing Ordinance No. 92/2003 regarding the Fiscal Procedure Code, the notion of “increases due to delay” was replaced with that of “interest”.

Thus, from 1 July 2010, the system of accessories composed of two elements was reintroduced: **interests**, which are calculated by applying the rate of 0.05% per day of delay starting from the day following the due date until the amount due is paid, and **penalties of delay**, which are determined by the number of days of delay from the due date, as follows:

↳ 0% - if settlement is made within 30 days from the due date;

↳ 5% - if settlement is made within 60 days from the due date;

↳ 15% - after the expiration of 90 days from the due date;

As we can see in the Figure no. 1.2., arrears have reached at the end of 2005 to 6.4% of GDP, in strong reduction compared to previous years. Since 2005 there has been a significant reduction in the volume of arrears, their share in GDP reaching 2.9% in 2007. In 2009, arrears to be recovered were 3.4% of GDP, meaning that their share grew by 0.8% compared to that recorded in 2008.

At the end of 2009 the arrears to be recover to the budgets administered by ANAF were 17231.0 million lei, of which the arrears registered at 31.12.2008 amounted to 5601.5 million lei and arrears registered in 2009 amounted to 11629.5 million lei. In 2009 there was an increase in recoverable arrears with 32.5% compared to 31 December 2008 (13004.6 million lei), the highest growth (45.4%) occurring in state budget.

Figure no. 1.2. The share of arrears in GDP during 2005 – 2010



Source: Data provided by the National Tax Administration Agency

Of the total outstanding arrears to be recovered at the end of 2009, arrears held by large taxpayers were 27.1% and arrears owed by medium taxpayers had a share of 21.1%.

According to the Statistical Tax Bulletin of ANAF, in December 2010 the arrears to be recovered amounted to 20697.2 million lei, increasing by 20.1%

compared to those in the same period of 2009⁹.

3. Fiscal relaxation vs. fiscal increase

According to specialists, fiscal relaxation is not currently a solution, because the economy of Romania went on a downward spiral, and this decline

⁹ National Tax Administration Agency, Statistical Tax Bulletin, fourth quarter, February 2011.

can not be countered by easing fiscal policy.

Others, on the contrary, say that in times of crisis, taxation should be relaxed, as increased taxation creates more tax evasion. They believe that tax cuts would generate greater liquidity for companies, which could lead to increase of investments.

In our opinions, increasing the tax burden would cause primarily diversification and increase of evasion practices and secondly would restrict even further private initiative, this leading to reduced revenue to the state budget.

The state should not fight the fraudsters but must persuade them through his actions of the utility of private sector participation in its projects. It is difficult though to convince people to give up of their property, because rational man can not give up easily to what he thinks is appropriate for him for some public purposes that he does not always understands.

We appreciate that maintaining the flat tax at both individuals and legal entities would be the sign of fiscal stability, as a counterweight to the current economic turmoil, and its growth can lead to the restructuring of the investment already made in Romania and to lower Romania's attractiveness for new investors, be they Romanian or foreign, who may choose to invest in countries with more favorable tax rates.

We have almost the higher VAT in Europe, of 24%, we have very high local taxes, and excise duties are almost harmonized at European level. If the flat tax would increase now, it would automatically increase income tax and dividend tax and salaries tax and business environment in Romania would receive the decisive blow in the context of the economic crisis.

We also need to keep in mind that tax increases do not necessarily lead to an effective collection of higher revenues to the general consolidated budget. For example, increased social contributions

for salary cost would be, in this context, a harmful measure.

Amid economic downturn and market liquidity problems, such an increase would only increase the cost to companies with employees, and may speed up decisions on restructuring or redundancy of staff.

Thus, instead of increasing tax rates, we could think of ways to improve the collection system and of ways to attract into the system of revenues from the underground economy through reduced rates and deductions to encourage the declaration of income.

We appreciate that in the current economic context, implementing a strategy to gradually reduce social contributions should be an objective of fiscal policy, both to reduce evasion trends and to stimulate Romania's competitiveness, encouraging the attraction and maintenance of employment, especially of qualified employment, through the European integration and free movement of labor at the European level.

4. Conclusions

The crisis should involve a change of mentality in the fiscal policy in Romania.

For example, not only in the current financial crisis, but also in previous years, but especially in light of current economic situation, many countries have adopted tax legislation that allows direct negotiation of taxes, on a legal basis, between taxpayers and tax authorities.

If a taxpayer is in a difficult financial situation, the approach of Romanian authorities is the same in all situations: taxes must be paid, without delay, without the possibility of rescheduling until the

Or, in case of a potential widening of the liquidity crisis, such a measure could be really useful for well-meaning taxpayers who do not want funds from the state, but could be in a real inability to pay its debts to the state, because they have not collected their claims from third parties.

Also, to improve the collection system and to attract into the system the revenues from the underground economy, fiscal management policy requires a change of mentality in the sense of fluidity and transparency of the system, and improving assistance to taxpayers in resolving features that appear in the application of tax laws in their activities.

We believe that the success of a national tax system is linked not only to the obtain of enough money derived from taxation, but also to system's capacity to develop the tax base, to stimulate the economy, to achieve the performance to charge nationally an international business, to stimulate interest for investment, to create an open and stable business environment.

High taxes devalue the economic environment not only through the closing of businesses that can not cope with taxation, but also through the

development of underground economy practices, from tax evasion to smuggling.

In our opinion, we can win the flight with this "scourge" of the economy only if the government makes the mechanism for collecting contributions more efficient and manages to bring to light areas of the underground economy, which implies the improvement of the fiscal behavior of citizens and not least the improvement of the tax system.

This, however, can not be achieved unless politicians become responsible for their decisions, whilst the financial and fiscal control organs are well prepared and upright, punishing both those who violate tax laws in order to avoid the payment of contributions or does not pay tax liabilities, and those who make major mistakes of fiscal policy and of management and spending of public money.

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