FORMS OF TAX EVASION IN ROMANIA. ANALYTICAL PERSPECTIVE

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ABSTRACT: *This study brings to the fore an analysis of the phenomenon of tax evasion in Romania. The perspective is broad, with a descriptive substrate, originally founded by highlighting the dimensions that define this phenomenon; later, the perspective is materialized by the presentation of tax evasion schemes that often takes the form of real complex fiscal and also financial engineering. The purpose of this work consists in the awareness of practitioners, academics and the public of the tax evasion forms useful in order to identify precise modalities to combat it. Since the volume of funds subject to the phenomenon of tax evasion is greater, the negative effects of macroeconomic environment.*

KEY WORDS: *avoidance; engineering; fiscal risk; fictive society; tax haven*

JEL CLASSIFICATION: *H20, H26*

1. INTRODUCTION

Tax risk is a separate component of the phenomenon of tax evasion, in essence, tax evasion is possible by the valorization of high fiscal risk elements. A relevant approach to tax risk is not effective without highlighting the forms of manifestation, the causes as well as the effects at the microeconomic and macroeconomic level.

From a global perspective, tax evasion is stealing fully or partly by any means, to pay taxes and other amounts owed to the state budget, local budgets, state social insurance budget and special funds off-budget, by Romanian or foreign individuals or legal persons. Its scope has similarity in terms of extensibility with the area and variety of taxes. Recent analysis has shown that tax evasion is strongly manifested in direct

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taxes, with an impact on their performance. Globalization of the corporate sector has favored the emergence the international dimension of tax evasion through international double taxation, the high heterogeneity manifested in the national tax regimes and thus different levels of fiscal pressure, which led to multiple opportunities for arbitrage. To evade tax, the taxpayer orients towards protected areas in fiscal terms. Gradually, there have been drafted tax and financial engineering schemes by the intermediary of which various combinations that ground on fraudulent behaviors. Thus, a company can capitalize on arbitrage offered by protected areas by declaring incomes as being made in another country in the form of billing by the parent company or subsidiary; transfer pricing mechanism is a modality for acts of tax evasion to take shape. Frequent manifestations of this kind have led to the need to exercise strict fiscal controls in the group consolidated financial statements of companies, particularly in light of the origin of declared income and tax regime applicable to them.

International tax evasion has developed in the context of directing excessive investment flows to emerging countries. In order to ensure that foreign direct investment act as an engine of economic growth, emerging countries have used, in addition to low labor cost, low tax advantage, by offering incentives to foreign investors. Recently, many studies have been channeled towards the tax advantages that support absolutely artificial, inconsistent devices to attract foreign investors. In general, the analysis revealed that foreign investment directed only under the tax advantages do not ensure economic solid growth, their character being temporary.

2. FORMS OF FISCAL EVASION

At the international level, there can be remarked multiple financial engineering schemes which reflect a high degree of creativity as for the combination of various elements in order to obtain fiscal advantages. The most frequent forms of fiscal evasion consist of abstinence and concealment; they represent, in essence, the grounds for the other forms of fiscal evasion. In case of the abstinence, the tax payer, discouraged by a high fiscal rate, is oriented towards an area with a low fiscal rate, and decides the cessation of any activity that could be subject to fiscal burden in his origin country. In comparison with the corporate sector, the mother company located in a country with a high fiscal burden will advise its subsidiaries to avoid dividend distribution, which will protect the profit accumulation. Concealment implies hiding the real revenues or disclosing them in an imprecise manner in order to elude fiscal rules.

While abstinence is related to the concept of lawful tax evasion, made under the protection of relocation or transfer pricing, risk concealment involves a higher tax evasion since evasion tends to become illegal. In general, international tax fraud is materialized through the following techniques: directing profits to a country with low rates of taxation through transfer pricing; non-repatriation of income earned abroad by implementing reward support systems. Techniques are supported by different organizational schemes such as holding companies, mother companies and fictitious companies. Located in countries such as Lichtenstein, Luxembourg or Bermuda, holdings boast a multitude of functions. They are specialized in portfolio management, identification and use of financial resources, investment resources and are generally recognized by the phrase “Offshore Financial Centers".

What is characteristic for these protected areas the tax is the high degree of confidentiality of information relating to the managers of such companies? Generally, these companies are located in countries with low political and currency risk, taxation benefiting from the absence of income taxation, which provides connection to developed countries. In literature, the reference to tax havens is the opposite of “tax hells" which includes developed countries, the latter being recognized as practicing excessive tax rates.

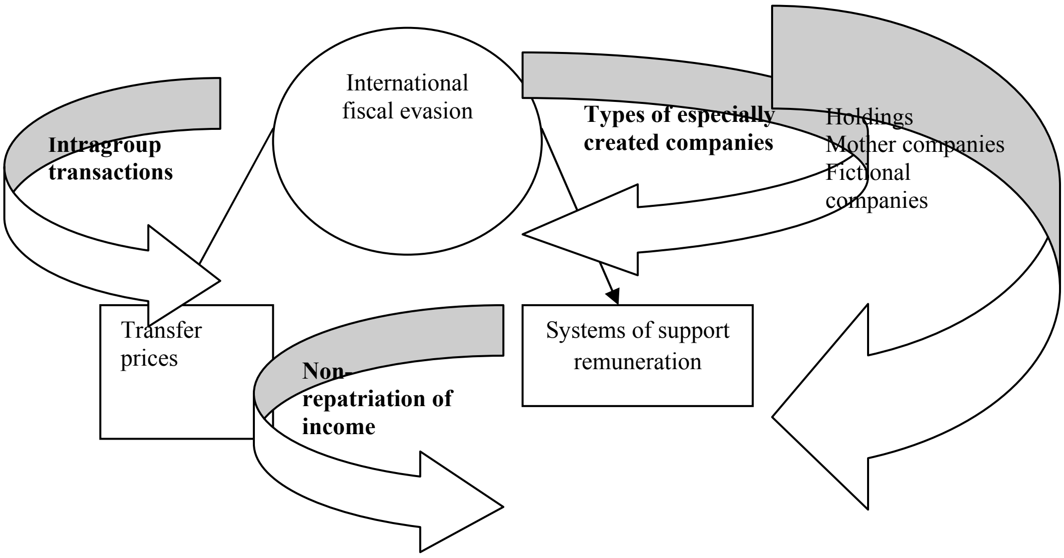

Figure 1. International fiscal evasion

However, the latest trend in the related literature is to highlight the fact that developed countries show both a high tax rate and the tendency to offer special tax regimes and laws of certain categories of investors that offers many amenities. Financial engineers are implemented by companies holding a high degree of creativity. A financial transaction subject to frequent engineering is the issuance of bonds. Thus, a company wanting to avoid high taxes imposed on income from capital in its country of origin will launch a bond loan through a holding company established in Cyprus. The holding company created for this purpose will issue securities in the country with a low tax burden and will transfer the amount obtained towards the origin country in exchange for an interest rate equal to that of bonds issued. Interests directed to investors by the company in Cyprus will not involve withholding that, normally, the company located in the country of origin would have borne it.

In this manner, the cost of funding is reduced for the company located in a country with a high level of taxation. In case of mother companies, they are distinguished by their own activity. These companies are implemented in order to manage the financial benefits achieved in other countries by group entities. Mother companies are concerned mainly with the company treasury and are located especially in Switzerland.

Fictitious companies (sham companies) have no material existence in itself, being frequently limited to a point of correspondence associated with a bank, law firm or accounting service. These companies are created focusing on two objectives: to locate in countries of refuge the profits made by various financial engineering schemes; to render difficult the fiscal control oriented towards the accounts of companies in the group.

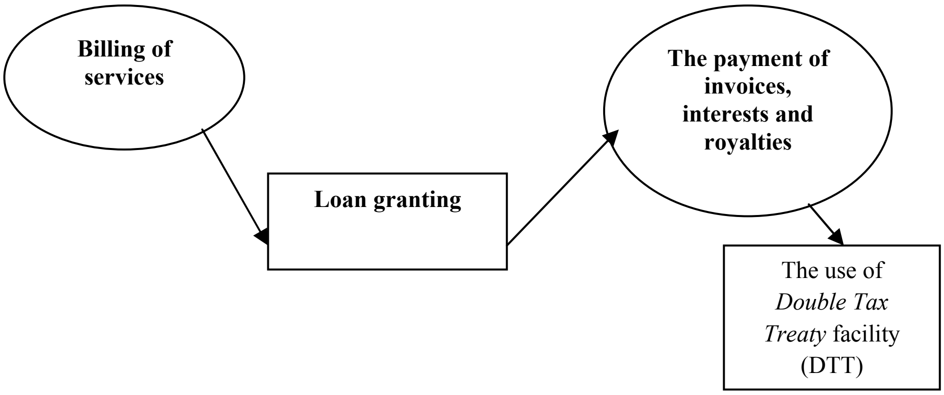

Figure 2. International fiscal evasion flows

Among sham companies, there can be found patents companies, on whose behalf it is possible to obtain patents which are then leased, or auxiliary services companies which have the habit of services over-billing. In general, in case of sham companies, billing is done on services like advertising, financial or legal. Concerning the mother companies, they are distinguished by their own activity. These companies are implemented to manage the financial benefits achieved in other countries by group entities. Mother companies are predominantly concerned with the company treasury and are located mainly in Switzerland.

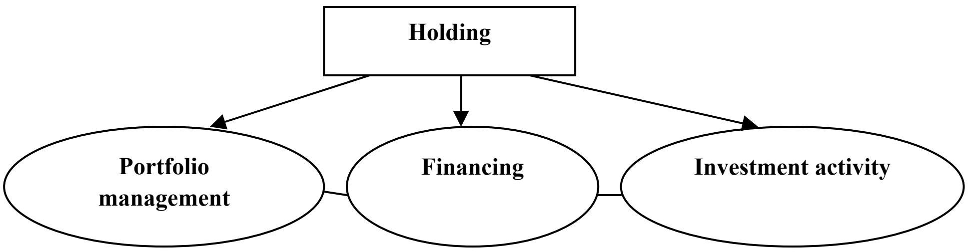

Figure 3. The activity of the holding

3. LEGAL FISCAL EVASION

Legal tax avoidance involves reducing the tax base under the protection of tax legislation. In essence, in case of the legal tax evasion, tax avoidance is not considered a contravention or crime. Cases of legal tax evasion are more numerous in the context of legislative changes as well as in the context of providing support by fiscal policies in order to encourage certain economic sectors.

Tax evasion can meet legal form as such:

- permanent fiscal facilities (exemptions, reductions, deductions);
- temporary fiscal facilities (for example, newly created companies taking advantage of this status for avoiding to pay income tax. Another example of this kind is the lax legislation in some countries that allow companies to opt for either income tax for individuals or as capital for companies.
- if the state is facing a high level of debt or an alarming trade deficit, then it resorts to exempting from tax income revenues deriving from bank deposits or investments;
- if there are precise rules on company expenses, then there is the tendency to overestimate them for deduction purposes. An example is the depreciation expenses that firms tend to overstate in comparison with the wear degree in order to reduce the tax base. For the same purpose there can be manipulated the hospitality expenses as well.
- taxation made by certain socio-professional categories based on average income rules that encourage taxpayers who have an income above average to not pay tax on that difference;
- tax havens that are created in order to escape the tax authorities. Offshore companies are supportive to avoiding the payment of taxes, in order to increase profitability in a favorable macroeconomic environment, characterized by political stability, currency flexibility and absolute privacy.

Tax haven is usually valorized in order to distort transparency of the income and to give rise to apparently reliable documents attesting to the long existence of the company. Although the existence and the proper functioning of the company is essentially informal, being used only for tax purposes, apparently authentic documents are used to certify the credibility of the company, its solvency or value of property in relation to its business environment.

Tax havens ground on: transactions apparently legal in accordance with the laws known as tax planning. In general, tax planning involves channeling profits from home company to the parent company implemented in the tax haven. These returns require services or export-import operations whose content is manipulated favorably; transactions that hide under the protection of legal unintended inaccuracies are considered circumstances of tax evasion. In this category there are integrated captive insurance companies, investment companies and some companies providing various services done through tax havens.

In both cases, reality is distorted in order to obtain considerable tax advantages. Fraud is done under the protection of geographical relocation, increased fiscal risk resulting in invaluable tax losses.

3.1. The implementation of an off-shore company in the business circuit

A commercial transaction involves the initial delivery of goods or services – the real flow that are subsequently charged, which generates cash flow. Tax base is the acquisition cost plus other expenses. In general, the offshore company is integrated in the median transaction and the profit is recorded in its own documents. In this way, profit is oriented from a high fiscal burden area to one with very lax taxation. The offshore company will receive further orders from customers and goods will follow the same circuit. The interesting thing is that the advantages are for both the seller and the buyer.

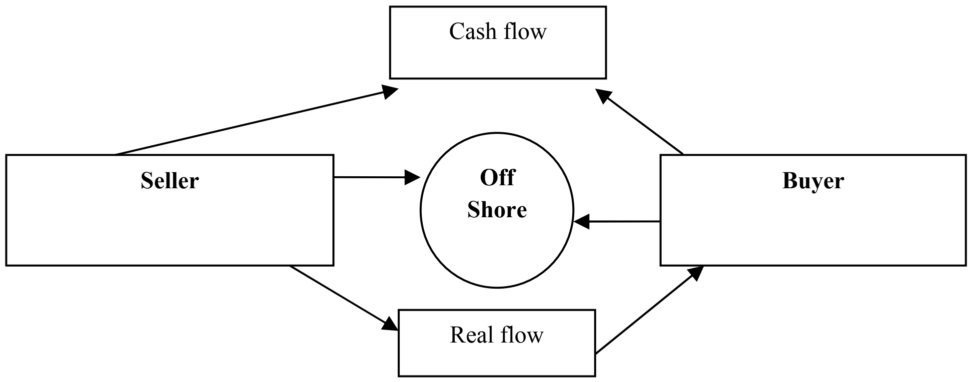

Figure 4. The implementation of an off-shore company within a commercial transaction

The seller will transfer the profit arising from the differential between the cost of goods sold and the selling price and the buyer will not pay tax on the difference between the purchase price of goods and the selling price of goods in his country. A holding company may be incorporated in a fiscally advantageous jurisdiction to finance the group entities located in tax disadvantaged areas. There can be remarked the following positive aspects: by exploiting the double taxation agreements, entities within the group obtain funding at a reduced cost; deductibility will apply to profits generated by sub-entities within the group by virtue of the interest rate, and tax due on interest is reduced up to elimination; a share issue becomes possible within the entities in the group without incurring tax imposed on profits from the capital; there can be directed fees towards the off-shore company as well.

3.2. Illegal fiscal evasion

Illegal tax evasion involves the deliberate avoidance of payment of taxes, being subject to punitive action. Generally, tax evasion involves unlawful clouding of part of taxable materials in order to reduce the tax burden. The following forms can be distinguished:

- ✓ traditional fiscal evasion in virtue of avoiding tax liability payment by making false related documents or non-creation of these documents; In this case, there can be used the following procedures: the elaboration of false VAT documents; intentionally reducing the tax base by not including income. In general, sales are made without billing and cash receipts without receipts; intentional cost reduction in order to reduce the tax base; production of illegal goods and services; carrying out clandestine activities; reducing the value of real estate to reduce the transactions tax base;

- ✓ legal evasion lies in hiding the true substance of the contract for avoiding tax payment;
- ✓ accounting evasion is to achieve certain accounting tricks by using false documents in order to increase spending, reduce revenues and, consequently, taxable income and state tax liabilities;
- ✓ evasion through assessment derives from the reduction in value stocks, supra-valuating and provisions for handling taxable income;
- ✓ evasion through assessment derives from the reducing inventories value, amortization and provisions overestimation in order to manipulate the taxable net income.

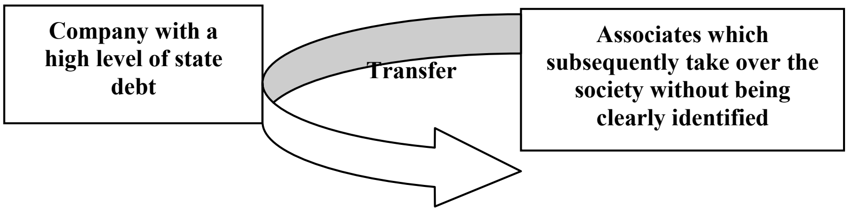

Figure 5. The transfer of an indebted company to the state

There are many companies that seemingly operate legally, but can not be clearly identified according to their official head office. In general, the establishment of such companies is done in order to avoid payment of tax obligations. Such traders may appear gradually as well, by transforming a real company which accumulates debt over a certain period of time in a phantom company.

This transformation takes place through the initial company's assignment to associates hard to identify in terms of fiscal residence. Such companies issue bills which generally reflect sales prices equal to the purchase prices, inputs of fixed assets or fictitious services, which causes real fiscal frauds such as circumvention of tax payment or illegal tax refunds. In general, to carry out this scheme, import operations are made at underestimated prices in comparison with the real prices and the related payments are mostly in cash.

Tax evasion is materialized, in general, by the special relations between different business actors. For example, a company specializing in producing pastry specialties invoices a distributor who supplies a commercial chain. This distributor has developed various business lines, one of which being represented by financial and accounting services which ensure the bookkeeping and the control of the financial operations developed by the supplied commercial chain; this last aspect allows the issuance of false invoices for the purchase and sale of commercial chain partners thus providing a legal real flow. Pastries were actually following an underground flow under the protection of false import labels that allowed the practice of selling prices four times higher than the purchase prices. Another example is represented by the case of an offshore company specialized in medical equipment leasing. Invoices issued in order to record income derived from the equipment rental were drawn up in the country the equipment was rented and the income was taxed in a very lax manner in tax havens.

Creating a phantom company involves the following steps: setting up a company in good faith with observance of the official stages, in parallel with the inclusion of people with false identity as shareholders. In general, against such firms, the founding shareholders disappear, the company being taken over by other agents; manufacturing false incorporation documents, allowing the involvement of the company in a chain of commercial transactions that are intended to exploit various tax avoidance schemes; conversion of a company in good faith in ghost company, after accumulating a high level of tax debts to the state-by assigning it to third parties, which gives difficulty to the clear identification process of the initial company.

In many cases, tax evasion is supported by a predisposition to certain types of tax evasion phenomenon. For example, indirect taxes have a higher degree of fiscal risk in relation to the direct taxes from the perspective of the below aspects: high tax rates; extended segment of application; principle of reimbursement for certain types of commercial transactions; a time differential between the moment it is generated and chargeability, which allows for various operations involving phantom companies, and dispose of a certain level of funds for a while.

Tax evasion is done often through smuggling at the level of customs duties. In general, the customs are paid, except customs duties and other taxes - such as VAT, which gives serious evasion operations. Another method used for tax evasion is the presentation of under-valued prices as a basis for required customs documents, as the falsification of the origin of the traded sold goods' by their location in geographical regions that have a lax tax regime.

Also, applying a different tax treatment depending on the material characteristics of the product (technical structure, concentration) favored the emergence of the tendency to falsely register certain categories of products in categories that do not reflect in any way the fiscal material characteristics. Fiscal fraud has been registered in the VAT. The complexity involved in the process of calculating the tax evasion phenomenon allows variety. Frequently, before the financial year end, oversized acquisitions are made, allowing the increase of collected VAT because in the beginning of the next financial year the procurement operations are to be cancelled.

At the level of the transfer prices, various intra-group transactions are frequently made based on certain oversized goods in terms of value, but undersized in terms of practical use in order to influence financial results according to the group interests. These VAT evasion schemes applied at the level of direct taxes translate at the level of the direct taxes as well; it is noted that tax evasion is facilitated by accounting and financial instruments. Applying- linear, accelerated, decelerated-amortization principles, the methodology to determine the provisions, as well as the VAT payable or receivable in some cases provide the necessary support to tax evasion phenomenon.

4. CONCLUSIONS

Research has shown fiscal risk as a separate component of the tax evasion phenomenon, in essence, tax evasion is possible in terms of high fiscal risk elements valorization. Relevant approach to tax risk is not possible in terms of materialization in the absence of the fiscal evasion from the perspective of the forms of manifestations, causes and also effects at the microeconomic and macroeconomic level.

Globalization of the corporate sector has favored the emergence of the international dimension of the tax evasion through international double taxation, the high heterogeneity manifested in the national tax regimes and thus different levels of fiscal pressure, which led to multiple opportunities for arbitrage. To evade tax, the taxpayer is guided by protected areas in terms of fiscal burden. Gradually, tax and financial engineering schemes have been drafted that embodying various combinations whose substrate lies in fraudulent behaviors.

Research approach emphasized the main mechanisms of tax fraud at national and international level as well as the intensity of national tax evasion phenomenon. They showed characteristics of the Romanian economy during the transition; the abrupt transition from a centralized economy to a capital market economy was favorable in the context of the fiscal evasion phenomenon in Romania. The emergence of non-performing sectors supported by excessive tax arrears has been a proliferation framework for acts of tax evasion.

The absence of a precise regulatory framework and accounting sphere has allowed export-import operations, predominantly in cash, to be performed in an incoherent, chaotic manner, which generated the excessively avoiding tax payment. In this way, we can appreciate that the period immediately following the year '89 was marked by the existence of a high fiscal risk. By crass corruption actions materialized by tick companies, profitable activities have been directed from state enterprises to the private sector, thus maintaining non-profitable activities within state enterprises.

The research presented various schemes of legal and illegal tax evasion in order to highlight the fundamental dimensions of this phenomenon. In this context, it was revealed the need to strengthen fiscal control actions mainly at the level of by the indirect taxes in order to develop a more efficient system of tax revenues collection.

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