

## TAX EVASION BETWEEN THEORY AND PRACTICE

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### Abstract

*Tax evasion is one of the economic and social phenomena of utmost importance for both the developed countries, and for the least developed countries. What can effectively be done in this field relates mainly to the limiting, as much as possible, the consequences of this phenomenon, its eradication being practically impossible. The effects of tax evasion are felt directly on the levels of the fiscal incomes, leading to distortions in the market's mechanism and, last, but not least, they may contribute to creating certain social inequities due to the "excess" and the taxpayers' various "inclinations" towards tax evasion. In all times, the multitude of the obligations imposed by the tax laws upon the taxpayers have stimulated their ingenuity in inventing various processes in circumventing the tax laws. The evasionist sometimes uses legal procedures, the loopholes left by the legislator. For promoting certain economic activities, the legislative provides, within the fiscal system, a certain strategy, and facilities, easements or even exemptions from the payment of some fiscal obligations, facilities of which- usually- tend to benefit certain taxpayers who are not entitled to receive them.*

**Key words:** evasion, tax authority, tax, law

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## 1. Introduction

### The notion and the forms of tax evasion

Tax evasion is one of the most studied topics in the field of taxation, both by the theoreticians and practitioners, both by the jurists and the

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economists. Nevertheless, the words designating this phenomenon are imprecise, and the field they explore is uncertain.

The previous regulation (Law 87/1994) defined tax evasions as being “the circumvention, through any means, in full or in part, the payment of taxes, duties and other amounts owed to the state budget, local budgets, the state social insurance budget and the special extra-budgetary funds to natural and legal persons, Romanian or foreign” (Law 87/1994).

The new regulation (Law 241/2005) no longer defines the concept of tax evasion, although the sense in which it is used, within the text of the law, leads to the fraudulent form of tax evasion, incriminated and sanctioned by the law. According to this law, the following acts of tax evasion are sanctioned:

- Hiding the goods or of the taxable source;
- The omission, in whole or in part, of registration within the accounting records or in other legal documents, of the commercial operations made or of the income realized.
- Registration, within the accounting records or the legal documents, of the expenses which are not based on real operations or registration of other fictitious operations;
- Altering, destroying or hiding accounting documents, memories of taxation devices or other means of storing data;
- The execution of double accounting records, using documents and other means of storing data;
- Avoidance to perform the customs, fiscal and financial checks, by way of non-declaration, the fictitious or inaccurate declaration concerning the main and secondary seats of the persons checked;
- The substitution, degradation or alienation the seized goods by the debtors or by third parties.

The specialised literature gives various interpretations to the concept of tax evasion, which, in essence, represents the non-fulfillment of the fiscal obligations by the taxpayer.

One of these defines tax evasion as being “the totality of the licit or illicit procedures with the help of which the interested parties hide their taxable matter, fully or partially, from the obligations established by way of the fiscal laws” (Șaguna, 1995).

Another definition: “Tax evasion represents a *de facto* state of the economy, as a result of the socio-economic behaviours of the individuals, and the genesis of which lies also within the principles of social co-habitation. Since

it is located beyond the frontiers of legality, from the point of view of the tax rules, tax evasion causes high risks, but, at the same time, it ensures a superior compensation for exposure to these risks (as compared with the official economy).” (Pătroi, 2007).

Illegal tax evasion comprises, beyond doubt, the deeds committed by infringement and by omission by the taxable subjects, which represent punishable and void violations of the fiscal legislation due to their negative financial consequences.

The circumvention of the taxable matter and the violation of equality before the tax can be not only illegal, but also legal, therefore, there is an illegal (illicit) tax evasion, as well as a legal (licit) tax evasion.

***The legal tax evasion*** allows the circumvention of a part of the taxable matter without this being considered an irregularity or an offense. This is possible because the legislation in different states of the world allows the elimination from under the category of taxes of certain income, parts of income, components of wealths or of certain acts and deeds that, under the conditions of the rigorous compliance with the law in force and of the principles of enforcement, should not escape taxation.

Licit tax evasion represents the underestimation of the taxable matter through the promotion of certain exemptions of fiscal facilities (generically called favorable tax regime) which enable “running from taxation” without directly breaking the law, these practices being somewhat tolerated by the permissiveness of the fiscal regulations. It can also be said that the “tolerated” tax evasion is the natural consequence of the legislative inadvertences and, sometimes, imperfectly assimilated in practice. The base of its existence is represented by the equivocalness of the law and the principles of the fiscal law, according to which the manner of assessment and charging of taxes and duties cannot be construed by way of their extension. (Pătroi, 2007).

An example of tax evasion sheltered by the law is the assessment of the income realized by certain categories of natural persons based on certain average income brackets, a taxation which creates in conditions by which the taxpayers realizing higher than average income do not pay tax for the difference in question.

Another example of legal tax evasion which allows for a part of the income to avoid taxation are the fiscal facilities granted to the economic operators from certain economic branches, upon incorporation or over the

course of their activity, in the shape of exemptions from VAT payment at import or export, excise duties etc, or reductions in the tax on profit.

The accelerated depreciation, when permitted by law for certain categories of fixed funds, leads to the reduction of taxable profit in favor of the establishment of a fund of depreciation greater than the one required by the value of the wear and tear and obsolescence, recorded by the respective fixed assets during the period taken into account.

**The fraudulent tax evasion:** is found on a much larger scale than the licit evasion and it is committed by breaching the legal provisions, being based on fraud and bad faith.

The fraudulent tax evasion can be found in various forms, such as: keeping untrue accounting records; the willful destruction of certain documents that may help in learning the truth concerning the deliveries of goods, the prices practiced, the commissions received or paid, etc.; the preparation of fictitious payment documents; unjustified modification of the supply prices and of the expenses with transportation, handling and storage; preparation of certain false customs declarations upon the importation or exportation of the goods; the preparation of false tax returns, when, knowingly, only a part of the realized income is mentioned etc.

In relation to these forms of manifestation, a distinction is made between:

- A. Traditional evasion** (through concealment), which consists in the partial or total failure to pay the fiscal obligations, either by drawing-up and submitting incorrect documents, or by not drawing-up the documents required by law. This form requires a series of processes, including:
- Preparation of false fiscal statements or lack of preparation thereof;
  - Intentional reduction of collections, with the aim of reducing V.A.T. (19%) and of the taxable profit, through cash receipts without receipts and sales without invoice;
  - Intentional increase of expenditure in order to reduce the taxable profit;
  - The production and trading of goods or services in a clandestine manner;
  - Carrying out certain professional activities compensated in a clandestine manner (black market);

- Decreasing the value of the inheritance received and of the transactions with the immovable goods, etc.
- B. Judicial evasion** consists in hiding the true nature of an organism or a contract in order to escape from certain fiscal consequences.
- C. Evasion of the accounts**, difficult to identify in practice, consists of creating an impression of a correct accounting record, using false documents, for the purpose of increasing expenses, reducing the profits, reducing the taxable profit and, as a consequence, the fiscal obligations owed to the state.
- D. Evasion by assessment** consists of reducing the stocks, over-estimation of the depreciations and provisions for the purpose of driving profit in the future.(Toader, 2007).

The analysis of the phenomenon of tax evasion on a cross-border basis indicates a continuous tendency for the extension of the fictitious entities, practically, of certain obscure business groups, whose purpose is to make huge profits through tax fraud, a fact eased by certain legislative gaps and which is based on skilfully exploited operational maneuvers.

In the specialised language, all these entities are generically called “**shell companies**” for defining the commercial activities carried out by the organised criminal structures, with the flagrant violation of tax and commercial legislation, by grouping a series of transactions under the responsibility of an entity, which subsequently cannot be identified for the justification of its activity. Practically, these commercial companies- with a strong “ghost”-type behavior- do not represent anything else than the most widespread way of association of certain groups, for the purpose of circumventing the payment of the fiscal obligations owed to the state budget. The most visible consequence of these companies’ activity is the avoidance of the taxation of certain considerable revenues, a fact that generates significant fiscal prejudices and deprives the state budget from important financial resources. In this manner, a pressure on the domestic currency is created, information and statistics are distorted, and the operations carried out through these companies lead to the vitiation of the competitive business environment, with obvious unfavourable effects upon the commercial companies that pay their fiscal obligations correctly.

Practice has shown the existence of two main categories of shell companies:

- *Companies that are not registered with the Trade Register*- these companies do not exist in fact, but they hold documents for their establishment and false stamps and they use financial-fiscal documents that are, as well, forged and illegally acquired. Usually, their name is close to that of a company that already exists, precisely in order to create confusion amongst the potential business partners and to give a note of apparent legality of the economic operations that they carry out. Evidently, they do not submit to the territorial fiscal body the periodic financial statements set forth by the Ministry of Public Finances, they do not conduct and they do not organise any financial-accounting records.
- *The companies registered with the Trade Register* -these commercial companies have an appearance of legality, in the sense that their shareholders exist as natural persons and they take part effectively in the company's incorporation and registration with the Trade Registry, they rent a space, they open bank accounts, they legally acquire fiscal documents with a special regime of recording and numbering, they obtain the authorizations necessary for operation. Many of these companies operate legally in the period immediately following the establishment, in the sense that they submit their tax returns, they conduct the financial-accounting records, they declare the company's initial places of business to the territorial fiscal bodies etc. Subsequently, after undertaking such approaches, the shareholders-natural persons- either disappear, and other persons handle the company's actual management, who are specifically empowered for that purpose, or they operate for a period of time in which they submit periodically the statements required by the legislation in force to the fiscal body, but with false data and uncorrelated information in order to aggravate a potential financial-accounting verification, they accumulate huge debts to the budget, and subsequently, they assign the company to foreign citizens who cannot be identified or held liable or who are no longer in the country.

## 2. The causes of tax evasion

In order to understand the phenomenon of tax evasion and to be able to elaborate and apply effective measures to combat, we must first identify the causes of this phenomenon.

There are multiple causes of tax evasion. What should be mentioned, first of all, is the excessiveness of the tax burdens, especially for certain categories of taxpayers, an excessiveness that has, however, as reasons precisely the ampleness of tax evasion.

**The factors favouring the tax evasion phenomenon** can be grouped in:

- A. **Psycho-social factors**, relating both to the inner drives and convictions of the taxpayer, as well as to the general conduct and the social environment of which the said taxpayer is a part of.
  - *The taxpayer's inclination towards tax evasion*- a factor that exists in any individual from whom a part of his income, that rightfully belongs to him, is taken away by way of authority, and this is because he/she perceives this measures as an attempt on his/her welfare. The dimension of this inclination seems to differ depending on the geographical areas (the inclination is greater in Southern countries rather than in Northern countries) and by the genetic fund of the peoples (the inclination is less in Anglo-Saxons as opposed to Latins, for instance). Characteristics such as a more tolerant attitude of the population towards the breach of regulations and a somewhat reticence towards discipline make out of the Latin peoples the main candidates in practicing tax evasion.
  - *The deficiencies of fiscal education*- referring to this aspect, in the '40s, C.N. Tăutu wrote about the fiscal education of the Romanian person from that period: "Nowadays, the education of our taxpayer is so weakly formed, that he has only one preoccupation: to pay as little as possible, or if could be, not at all. (Toader 2007). Unfortunately, things are pretty much the same at present, as well.
  - *The profession*-this fraud can be committed successfully by the persons occupying a higher social status and have specialized

knowledge that gives them the possibility to commit acts of tax evasion.

- *The religion and marital status* may also be of relevance for the decision to commit tax evasion.
- *Corruption* is another factor enabling tax evasion. The phenomenon of corruption has always been considered as one of the most severe behavioral deviations, which distorts the administration of public affairs towards private goals. From a sociological perspective, corruption, as a social pathology, concerns an ensemble of immoral and illegal activities, realized only by individuals with management positions or who exercise a public role, but also by various groups and organizations (public or private), to the purpose of obtaining certain material or moral advantages or of a superior social status, by using certain forms of coercion, blackmail, deceit, bribery, purchase, intimidation.
- *The social norm* constitutes another factor within the framework of tax evasion. When the collective conduct is that of circumventing the payment of taxes, the number of those who resort to tax evasion is likely to increase.

**B. Economic factors** related to the perception of the taxpayers with regard to the level of income remaining after the payment of tax and its ability to meet the taxpayer's individual needs. There are opinions according to which the inclination toward tax evasion is inversely proportional to the *level of taxable income* and directly proportion to *the rate of taxation*.

**C. The factors of legislative order.** The possibilities for circumvention of the tax authority differ from one social category to the other, depending on the nature and origin of the income or wealth subject to taxation, on the concrete manner of establishing the taxable matter, on the manner of organization of fiscal inspection and by other specific factors.

Thus, the **legislative factors** having decisive impact on the phenomenon of evasion are:

- *The fiscal legislative system* that, along the fact that it is incomplete, presents huge gaps, imprecisions and even ambiguities, which allow the potential fraudulent taxpayer to have a large space of maneuver in his attempt to circumvent the



payment of his legal fiscal obligations. The lack of a clear, precise and uniform regulation to limit this phenomenon, and to prohibit it, represents one of the primordial causes of tax evasion.

- *The exaggerated taxation*, consisting in a large number of fiscal obligations, which the taxpayer is subjected to, but also the instability, throughout time, of the legislation that institutes taxes and duties. In the international practice, the efficiency of a tax system is not measured so much by the importance of the tax income, as it is by the degree of consenting to taxes which is inversely proportional with the degree of resistance to taxes, therefore to tax evasion.
- *The much too loose and unsubstantiated granting of fiscal facilities* is one of the most representative factors in our country. Thus, in Romania, since 1990 and up to the present, a significant number of legislative documents containing numerous fiscal facilities were issued to the purpose of developing the economic activity, especially by attracting foreign capital. The fiscal facilities were used as veritable instruments of “legal” tax evasion (Ungureanu 2007).

**D. The factors of administrative order.** The lack of a well-organised control and of an apparatus formed by skilled and correct personnel may lead to major forms of tax evasion. Here, we can mention the insufficient equipment with material means that are necessary to the administration for fulfilling its duties, insufficient personnel from a numerical and qualitative perspective, since the financial institutions do not have the possibility to efficiently control the totality of the natural and legal persons.

### 3. Concrete cases of tax evasion

Following certain inspections carried out, having as objective to verify the manner in which the provisions of the fiscal and accounting legislation are complied with by the **A. S.A., B S.R.L., C S.R.L., D S.R.L.**, the following were noted:

**A. Referring to the agreements concluded between A S.A., in its**

**capacity as buyer and the suppliers B S.R.L., C S.R.L., D S.R.L.,**

-In each agreement, it is provided that the object of the agreement is the “sale and purchase of the products listed under Annex 1 to the sale/purchase agreement”, but there are not any products listed under Annex no. 1 to the sale/purchase agreement.

-From the verification carried out, resulted the fact that *the persons who sign the agreements on behalf of B S.R.L. C S.R.L., do not hold any kind of capacity within these companies.*

**B. Referring to the invoices issued by B S.R.L., C S.R.L., D S.R.L. to A S.A.**

A) The invoices are prepared by the persons who do not hold any kind of capacity within these companies.

B) the identification data of the persons who prepared the invoices issued by B S.R.L. , C S/R.L. ,D S.R.L. To A S.A. Are erroneous or they belong to other persons.

C) The invoices issued by B S.R.L. and C S.R.L. to A S.A. are edited by the same accounting program.

D) *The legal representatives of B S.R.L., C S.R.L. and D S.R.L. do not appear on any document issued by these companies to A S.A.*

**C. Referring to the persons representing B S.R.L., C S.R.L., D S.R.L. In their relations with A S.A.**

-B S.R.L. has as administrator the legal person E LTD, Great Britain, represented by the named *P.D. who has the same capacity within D S.R.L., as well.*

-D S.R.L. has as administrator the legal person E LTD, represented by the so-called P.D.

-C S.R.L. has as administrator has the legal person F LTD, Hong-Kong, represented by E.G.

-B S.R.L.’s declared registered seat is the same as that of C S.R.L.

-B S.R.L., C S.R.L., and D S.R.L. have never operated at the declared registered seat and they did not declare any secondary seats.

**D. Referring to the operations of acquisitions and supplies of goods registered by A S.A.**

-No documents were presented showing the way in which the transport of goods has been carried out from the B S.R.L., C S.R.L., D S.R.L. to A S.A.

-The entry-reception notices associated with these invoices are inscribed with, usually, the mention of “liv dir” or the mention “liv directă”

(direct delivery), a mention that signified the fact that the goods have not been unloaded at the warehouses belonging to A S.A., but they have left directly from the initial suppliers to the final beneficiary;

-Certain extensions have been added to the name of the goods inscribed within the entry-reception notices, so that these goods that appear to be supplied from these suppliers can be identified at any time;

-Discrepancies have been noted between the information contained in the invoices and those from the entry-reception notices, as well as the differences between the data for invoicing and data relating to the shipment of goods

- D S.R.L., B S.R.L. AND C S.R.L. do not bring proof concerning the origin of goods.

- B S.R.L., C S.R.L. AND D S.R.L. did not declared all deliveries to A S.A.;

- D S.R.L. has never been registered for VAT purposes.

- The goods purchased from A S.A. From B S.R.L., C S.R.L., D S.R.L. appears to be delivered through intra-community trade to economic operators from Cyprus:

From the verifications made in view of establishing the realities of the intra-community deliveries resulted the following:

-Part of the recipient companies are entered as carriers within the CMRs submitted by A S.A., but they never carry their own goods.

The international transport documents (CMR) are drawn-up by the A S.A. Employees.

-from the verifications made by survey concerning the CMRs, the following have been noted:

■ goods appear to be delivered at the A S.A.'s places of business, although the entry-reception notices contain the expressions "liv dir" or "liv directă" (direct delivery).

■ the means of transport, driven by the same drivers, who appear to travel from Romania to Cyprus with an average duration of 2-5 days, but the second trip starts before the end of the first trip, and the third before the end of the second etc.

■ the same means of transport appears to have been carrying out, during the same time frame, several trips on the course of Romania-Cyprus lead by different drivers;

■ the same driver appears to have performed within the same

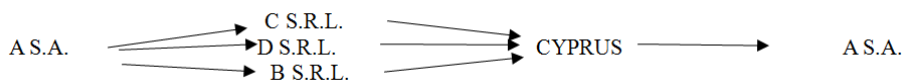
time-frame more trips on the Romania-Cyprus route, driving different means of transport;

■ in the case of certain CMRs, the duration of the transportation on the Romania-Cyprus route is of 1-2 days, including the loading-unloading operations, although the route has a minimum length of 1.760 km and it involves at least one maritime crossing by embarking on naval means of transportation for a distance of 121 km. Having in view the legal maximum speed for travel, the mandatory times for stationing provided by the traffic legislation and the time of waiting upon embarking and disembarking to/from the means of naval transport results that *the transport could not have been made within the time frame inscribed in the CMR.*

From the above results the fact that the operations inscribed within the international transport documents CMR are fictitious.

**E. Referring to the operations of collection and payment carried out between the companies A S.A., B S.R.L., C S.R.L., D S.R.L. and the beneficiaries from Cyprus:**

-According to the statement of accounts received from the banking companies, results that the circuit of the amounts of money between the companies presented above was the following:



- The operations of collection and payment made between these companies bank is carried out through bank accounts opened in Romania.

-The payments performed by B S.R.L., D. S.R.L., C S.R.L. To the companies from Cyprus are not based on commercial operations.

Based on the protocol concluded at the A S.A. Company, the control bodies considered that the transactions carried out between the above-mentioned companies do not have an economic purpose, being carried out with the purpose to create fiscal and financial advantages for the A S.A. Company.

With regard to the matters set forth above, the Anti-Fraud inspectors have the following opinion:

The aspects presented shall give rise to the reasonable suspicion that in the period 2011-2014, the constitution of an organised criminal group was initiated, together with the legal representatives of the A S.A. B S.R.L., D S.R.L. și C S.R.L companies, with the simultaneous existence of the reasonable

suspicion that the members of the organised criminal group registered in the accounting of their company fiscal invoices that do not reflect the reality of the economic operations and they do not constitute supporting documents relating to the origin of the goods that appear to have been traded, and the financial circuit was a fictional one, create for the purpose of hiding or to dissimulate the real nature of the origin, of the circulation or of the right upon the amounts of money transferred, knowing that they originate from committing crimes of tax evasion, being susceptible to reunite the elements of the facts provided and punished by C. 9 par. 1, lett. C) and f) of Law no. 241/2005 for preventing and combating tax evasion, reported to C. 367 paragraphs 1 and 6 of NCP and C 29, par.1, lett. b) of Law no. 656/2002, republished for preventing and sanctioning money laundering, reason for which precautionary measures have been ordered and a document for the intimation of the criminal prosecution bodies.

#### **A case with interposed companies:**

As a result of the check performed, having as objective the verification of the manner in which the provisions of the fiscal and accounting legislation have been complied with by the **T SRL** company, that the economic operator recorded within the accounting records a fictional trading circuit to obtain the benefits of a fiscal nature (VAT deductible).

Within the commercial relations with the **H SRL** company, a transactional relation has been distinguished, that had the purpose of decreasing the fiscal obligations related to the payment owed by the **T SRL** company to the consolidated state budget, as such:

**A. Plateau 1:** the company has an inadequate fiscal behavior, having the role of creating artificial fiscal advantages for the company from plateau 2. (**A SRL**)

**B. Plateau 2:** the company which was *interposed* within the fictional trade circuit for the creation of an appearance of the existence of an operation which, in fact, did not exist (**H SRL**);

**C. Plateau 3:** the *beneficiary* company, respectively those that obtained fiscal advantages consisting of the deductible VAT (**T SRL**).

The **T SRL** company registered within its accounting records 25 invoices for the purchase of goods (means of transportation), paid in full by the **T SRL** company, through bank transfer, the operations being declared through the VAT settlement and statement 394.

Subsequently, those goods purchased were sold by the **T SRL** company

**to the LEASING FIN company and then taken back as user within a financial leasing agreement.**

As a result of the inspection performed at the H SRL company by the control body, resulted the following:

-The H SRL company purchased, based on 25 invoices, 25 means of transportation from the intra-community partner DE, the goods were delivered immediately to the T SRL company;

-The H SRL company registered within the accounting records and declared through the VAT settlements submitted to the fiscal body, VAT collected associated with the deliveries made to the T SRL company, yet it did not pay the fiscal obligation to the general consolidated state budget, since it appeared with reimbursable VAT, for which the company did not submit an option for the reimbursement of the balance of the negative balance.

-Reimbursable VAT recorded by the H SRL company originates from the VAT deducted for the purchases of goods and services from the A SRL company (also controlled by the Ministry of Finances), purchases that represent operations that do not have an economic purpose, having the sole role of creating fiscal advantages).

Pursuant to the SCAC type of request, *The EU fiscal administration*, the following were communicated:

-The goods were delivered in ROMANIA;

-The T SRL company negotiated, ordered and prepared the documents for taking over the traded goods;

- after the conclusion of the negotiations, the T SRL company requested that the invoices be issued on behalf of the H SRL company;

The source of the funds for the payment of the goods originated from the delivery or advance payment invoices paid by the T SRL company to the H SRL company, before this company made the external payment to the company from the community space.

Based on the protocol concluded by the H SRL company, the control bodies considered that the transactions carried out between the H SRL and T SRL companies do not have an economic purpose, resulting that the H SRL company was interposed, artificially, into the trade chain, with the purpose of creating fiscal advantages for the final beneficiary, respectively for the T SRL company.

Through these operations, VAT receivable was artificially transferred from the H SRL company to the T SRL company, being used for extinguishing

the VAT payable generated from the sale of goods to the leasing company. **Having in view that the circumstances described above are susceptible to meeting the constitutive elements of the act provided by C. 9, par. (1), letter c) of Law no. 241/2005 for preventing and combating tax evasion, with subsequent amendments and completions, precautionary measures were ordered and a document for the intimation of the criminal prosecution bodies was prepared.**

#### **4. Conclusions**

The fiscal burden, imposed upon the taxpayer by the multitude of fiscal obligations has always stimulated their ingenuity in inventing new procedures for bypassing the fiscal duties. Shirking from the fiscal duty has always been present, both among the persons with modest income, and especially in the case of those with high and even fabulous earnings. The psychology of each taxpayer, from the hedonistic nature of each of us, is to never pay tax, and in cases of coercion, to pay as little as possible.

Therefore, increasing the degree of fiscal pressure brings about the increase of tax evasion. For combating the negative effect of tax evasion on the long run, even reducing the degree of fiscal pressure has been proposed, a matter that leads to increasing economies and, implicitly, to the growth of investments, by attracting these economies to the economic sphere.

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