



IMPACT OF FISCALIZATION ON THE BEHAVIOUR OF THE ECONOMIC AGENT

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Rezumat

Multitudinea obligațiilor pe care legile fiscale le impun contribuabililor, ca și povara acestor obligații, au stimulat dintotdeauna ingeniozitatea contribuabililor de a inventa diverse soluții de eludare a obligațiilor fiscale.

Evaziunea fiscală este rezultanta logică a defectelor și inadvertențelor unei legislații imperfecte, a metodelor uneori defectuoase de aplicare, precum și a gradului de fiscalitate excesivă care-i provoacă, prin aceasta, pe contribuabili la evaziune.

Abstract

The multitude of duties which the fiscal regulations impose on the tax payers, as well as the burden of these duties have always stimulated tax payer's ingeniousness to invent solutions to elude the fiscal duties.

Tax evasion is the logic result of the faults and inadvertencies of an imperfect legislation, of enforcement methods that are sometimes deficient, and of the excessive level of fiscality which often challenges the tax payers to commit evasion.

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1. Tax evasion, form of manifestation of the economic agent's behaviour

Tax evasion means dodging the payment of legal duties to the state, being the way in which the economic subjects respond to the fiscal pressure on their income, wealth, sales etc. It is not only the fiscal pressure that generates dodging behaviours, but also any pressure from the state of levying taxes and dues when it exceeds a level regarded as necessary in order to initiate, maintain and develop a business or any lucrative activity, or when it affects their wealth or current incomes. Although tax evasion has connotations pertaining to the semantic sphere of the underground economy, it is not a component of the underground economy; rather it is at the inherent intersection of the underground economy with the formal economy.

The dodging behaviour is generated by two essential factors: a) the natural factor, derived from the *free rider*¹ instinct,

b) the institutional factor, derived from the implementation of the fiscal pressure.

Legally, tax evasion is defined by Law 87/1994 as: “*dodging, by any means, totally or partially, from the payment of dues, taxes or any other amounts of money due to the state budget, local budgets, budget of the state social insurances and to the special extra budgetary funds, by Romanian and foreign natural or legal persons, termed as tax payers.*”

One of the most delicate matters related to tax evasion refers to the delimitation between the legal (licit) tax evasion and illegal (illicit) tax evasion. The *legal tax evasion* should be considered as the tax evasion which manages to dodge the payment of duties to the budget (totally or partially) making use of some “escape gates” of the law. This will decrease the revenue to the state but it doesn't infringe the law. This means that we have a case of tax evasion, but it was not done by breaking the law.

¹ *The free rider behaviour is that behaviour by which an economic subject attempts to benefit of the advantages that it can extract from the economic environment, without paying the cost of getting these advantages. Tax evasion is a species of the wider concept of evasion from the social norm, a species of the free rider behaviour in relation with any regulation external to the specific individual. That is why the tax dodging behaviour must be understood as belonging to the psychological and cultural structure of the environment in which a specific individual lives and works.*

The legal² tax evasion is due to the conjunction between competence (the competence of the taxpayer to choose the most advantageous solution from the law) and incompetence (the incompetence of the law-maker who missed the “gates”). The situation in which it can be documented that the law-maker designed the tax evasion “gates” in the text of the law upon pressure of groups of economic interests (lobby), to the detriment of state’s interests, is not automatically classified as illegal tax evasion, because the taxpayer used a legal text which he didn’t infringe, but it may lead to other classifications, such as corruption.

The *illegal tax evasion* is any infringement of the fiscal norms that prejudices the interests of the state.

Briefly, the following can be said about the concept of tax evasion:

a) the *legal tax evasion* doesn’t cause prejudices to the interests of the state, but creates the possibility for such prejudices; if tax evasion is produced without breaking the law, it results that the planning of the revenues to the budget didn’t take into consideration the revenue to the budget that might be cashed according to the stipulations of the fiscal law. Therefore, the financial interests of the state were not, apparently, prejudiced; however, actually they were prejudiced. In other words, we consider that there is no legal tax evasion, in the proper meaning of the term. We therefore propose, within this context, that the so-called *legal tax evasion* be regarded as undervaluation or under-cashing of the possible revenue to the budget.

Therefore, there are two types of *legal tax evasion*:

- undervaluation of the revenue to the budget by the law-maker, by leaving “gates” to dodge the payment of possible revenue to the budget due to incompetence or neglect in office (when corruption can not be documented);
- under-cashing of the revenue to the budget by the collector / manager due to incompetence or neglect in office (also, when corruption can not be documented).

b) the *illegal tax evasion* is the only type of actual tax evasion, because it infringes the fiscal law. With this meaning, the phrase “illegal tax evasion” is a pleonasm, because tax evasion is illegal by definition.

² We may speak here of law infringement by the law-maker who, by incompetence or interest, left the “gates” for dodging the payment of the generic duties to the budget.

Causes of the tax evasion

a. *Fiscal pressure*³

b. *Weakness of the fiscal administration*, effect of the corruption of the fiscal administration or of its professional incapacity (incompetence). Irrespective of the cause of fiscal administration weakness, when this becomes notorious, or even when it is only hinted by the taxpayer, tax evasion is “accessed”.

c. *Moral hazard (fiscal facilities)*: which is a change of behaviour generated by the existence or promises of facility of any kind. The fiscal facilities reduce the fiscal burden (by exempting or cancelling dues to the budget, by granting other forms of fiscal support). The tax payers being granted such fiscal facilities go on behaving in the same manner in expectation of further facilities; this generates a behaviour intended to dodge the fiscal burden, thus dodging the fiscal duties.

d. *Contagion (imitation)* is a tax evasion generating factor; it is difficult to control and can take mass proportions. The mechanism is as follows: a taxpayer, who notices that other, dodging, taxpayers paid little (or at all) for their dodging behaviour will decide to assume this behaviour hoping things will go the same for him/her. The force of contagion in generating and spreading the dodging behaviour is very strong, depending largely on cultural and institutional factors. The force of the fiscal administration and the force of contagion are inversely proportional in generating the effect of total tax evasion, which means that a strong fiscal state may have less dodging contagion.

The four fundamental causes which generate the dodging behaviour are directly proportional to the magnitude of tax evasion: the higher are these causes, the higher is the tax evasion. At the same time, relations of interconditioning exist between these causes:

- the weaker fiscal administration, the higher contagion;
- a higher fiscal pressure leads to the need for new fiscal facilities, to stop the Laffer curve effect, which increases the moral hazard;

³ *The fiscal pressure expresses the intensity of levying duties from natural and legal persons, or from the entire society. The fiscal pressure has a high economic relevance because it shows the measure in which the nominal income of the population is adjusted by taxation. It also is a measure of the state revenue earned by taxation.*

- a higher weakness of the fiscal administration may cause a higher fiscal pressure, to balance the decrease of the state revenue.

2. Underground economy

The underground economy is one of the most “complete” phenomena of tax evasion because in this case, practically the entire taxation basis is kept away from the fiscal administration.

We will use four concepts deriving from the (micro)economic behaviour, which will help us identify the concept of underground economy⁴:

- the underground economy influences significantly the main macroeconomic variables of the real and monetary economy (the demand and offer of goods and services, the monetary mass in circulation, the demand and offer of work, the foreign economic balance etc.);

- the underground economy has a considerable impact on the formation and dynamics of the economic behaviour of all the economic actors (natural persons, economic agents, institutions, government);

- the underground economy seems to play a complementary role and a substitute role in relation to the formal economy⁵;

- the underground economy seems to be, next to the orthodox institutional regulator (the government), a *sui-generis* regulator of the micro and macroeconomic balances and unbalances with means which, again, seem to be very efficient and uncostly.

We may say that a third actor, the *underground economy*, appeared within the economic system, besides the two acknowledged main actors – the free market and the government. This statement is grounded on the following facts:

- ▶ *first*, the underground economy “penetrates” the national economy, both from the perspective of the government, and from the perspective of the state, as instance of regulation and control.

- ▶ *second*, there are criteria which prove the existence of the underground economy:

⁴ Some authors name the underground economy, the “dual economy” and the formal economy, the “primal economy”.

⁵ Some authors use for the formal economy the phrase “global economy”, to show that it includes the totality of activities running in an area.

1. *institutionality*: refers to the degree in which the structures of economic activity are regulated by the state through normative papers or by other institutions. According to this criterion, the national economy can be: a) formal economy (commercial company); b) informal economy (household economy; sales in the streets);

2. *legality*: refers to the degree in which the economic activity observes the legal provisions concerning the object of activity, the form of organisation, the manner of drawing resources (financial, labour) etc. According to this criterion, the national economy can be: a) legal and b) illegal;

3. *transparency*: refers to the degree in which the economic activity is registered according to the legal regulations so it can be monitored and surveyed by the adequate public authorities. According to this criterion, the national economy can be: a) registered and b) unregistered;

4. *administrative reporting*: refers to the degree in which the economic activity is reported to the qualified public bodies. According to this criterion, the national economy can be: a) fully reported; b) under-reported;

5. *observability*: refers to the degree in which the economic activity is accessible informationally to the qualified public structures. According to this criterion, the national economy can be: a) observed; b) unobserved;

One of the main adverse consequences of the *underground economy* refers to the manner in which it can affect the fiscal "health" of a country. There are theories saying that if the governments would be able to control the forms of manifestation of the underground economy, many fiscal problems of the public sector, such as the public debt, could be alleviated. However, numerous experts and critics consider that this argument is just blaming ("putting the finger on") the citizens for the budgetary failure of the governance. For these critics, the underground economy is an unavoidable companion of the system of economic-social taxes and regulations.

The underground economy has a strong impact at the social level too. It is closely related to several phenomena such as corruption, crime, drug addiction, mob-type organisations, labour exploitation via the black market, money laundering, infringing human rights, environmental pollution, etc.

Despite these shortcomings, the underground economy seems to have spill-over effects too into the formal sector. The characteristics of stability of the “black economy” have been synthesised as follows by D. Cassel⁶:

- *economic lubricator* – the black economy has a strong potential to absorb the economic and political shocks being a reserve of flexibility when some activities shift from the formal to the informal sector;

- *social appeasement* – in the presence of the black economy, the social costs of some policies of stabilization are easier to bear (for instance, the case of anti-inflationist policies). The impact of a period of recession is thus dampened increasing thus the odds of returning to price stability;

- *built in stabilizer* – acting as short-term buffer for the political mistakes and for mistakes during the reform. The induced stability doesn't function, however, from the economic systems at order or in transition, to which it brings elements of instability.

The favourable critiques say that the underground activities provide flexibility and adaptability to the formal economy which it lacks, filling in the gaps left open by the formal economy, giving jobs to the unemployed and acting as a remedy during the recession periods. According to Milton Friedman, the underground economy is a “valve” for the formal economy in crisis.

The perception of the population on the underground economy is quite different. The public opinion doesn't condemn as much the underground activities, while the people studying is (specialists, political people) stress, according to their own perceptions and interests, specific aspects, implications or special issues with which they can easily manipulate the official statistics and thus influence the electorate. For instance, in France, an analysis on the attitude of the population regarding the immorality of some informal practices shows that, while 99% of the interviewed people consider drug selling condemnable, 66% condemn travelling in public transportation without buying tickets, only 52% condemn tax fraud and just 36% disapprove black labour.

⁶ Andreea Vass, „Has the underground economy positive consequences?” „Tribuna Economică”, no. 51-52, December 2000.

3. Fiscal fraud

Fiscal fraud is the illegal (illicit) tax evasion and it is tightly connected to the underground economy, to corruption and to fiscal immorality. A distinction might be done, nevertheless, between tax evasion and fiscal fraud in terms of the intentional/subjective character of the phenomenon. Two distinct situations may exist, situations which, although don't eliminate tax evasion, give some hints on its "sustainability", on its scale, on its impact on the fiscal behaviour in general, or on the budget equilibrium.

1. *first*, it is possible, for instance, that a taxpayer makes accounting records that may lead to dodging fiscal duties, by negligence or incompetence. This is the *subjective incapacity* – the taxpayer can be charged of tax evasion (law infringement and monetary prejudices to the state in relation to the planned revenue to the budget). However, if the records have been made willingly, on purpose, than we have fiscal fraud.

2. *second*, there is a second situation, *objective incapacity*. We suppose the existence of monetary arrears between two companies. The company which has outstanding overdue credits on another company can not fulfil its budgetary duties. This capacity, however, is not its, it is not deliberate, either; it is not the result of neglect or incompetence. We have here a case of tax evasion (the debtor company prejudiced the financial interests of the state by infringing the fiscal law), but not fiscal fraud. However, if a situation can be documented which shows that the company confronted with arrears is in relation with the debtor company, then we have fiscal fraud.

Creative accounting and fiscal fraud

The fiscal evasion generated by the subjective incapacity, together with a certain tolerance displayed in relation to the dodging behaviour of the taxpayer, lead to the concept of *creative accounting*.

The creative accounting presumes a set of accounting techniques and methods (recording, synthesis, consolidation and communication to the stakeholders) which aims to maximize the results of the company from the perspective of the managers of the particular economic organisation. It exploits the imprecision, incompleteness and inconsistencies of the fiscal legislation so as to minimise the impact of the levies on the final results of the company.

Following are some of the techniques of creative accounting used by the organisations are:

1. *increase the expenditure and/or diminish the income*. For instance, if one wants to diminish the expenditure, one can adopt the method of the linear amortization of the fixed assets. If one wants to increase the income, then future incomes can be included (income form rents charted upon signing the renting contract) or sales of an asset at overevaluated price.

2. *manipulation of the net value of the assets*, via the volume of provisions and via the system of amortization that is used;

3. *„reconsideration” of company debts*, with the purpose to influence the true image of company indebtedness;

4. *elusion from using the consolidation operation*, when transactions are made between the mother-companies and its daughter-companies.

The taxpayers use various procedures in order to dodge their fiscal duties, procedures which they adapt to the evolution of the fiscal legislation, to the evolution of the economic relations and to the evolution of the accounting software.

In Romania, the fiscal legislation generates tax evasion because of the changes and completions of the fiscal legislation⁷, because of the lack of correlation between the regulations for taxes and dues, because of the imprecisions in the laws which lead to interpretations and disagreement between the normative papers.

The struggle against tax evasion is a goal for the authorities worldwide. To have success it is more efficient to prevent the phenomenon than to charge the culprits after the event took place.

Tax evasion can be prevented using several measures:

► **fix the fiscal legislation**, by eliminating the ambiguities which leave room for interpretations that can be speculated by the tax dodgers. The legislation must be clear, without hidden taxes and without tax raises which can not be explained. The taxation system must be easy to understand both by the organisations and by the individuals and the volume of the legislation should be as small as possible, to come to the support of the small business and entrepreneurs. Globally, the companies use almost two months in order to conform to the fiscal regulations – 15 days for the taxes on

⁷ Only in 2008, before the financial crisis broke out, the Romanian fiscal code has been modified at least five times by Emergency Ordinances.

corporative incomes, 21 days for the taxes and contributions related to work and 21 days for the consumer dues;

▶ **collaboration between the Romanian and the foreign enforcement authorities** (particularly the neighbouring ones), knowing that foreignness elements appear usually in the acts of tax evasion (forged import and export invoices, foreign personal accounts or companies abroad, often using fictitious names, internalization of the mob-type relations etc.);

▶ **elaboration of analyses and prognoses** to determine the directions of “movement” of the tax evasion;

▶ **increase the efficiency of the fiscal control** (efficient planning and use of the time);

▶ **improve the techniques of fiscal control** (stressing on the documentation of tax evasion, use the acquired data, apply sanctions);

▶ **remove the political factor from the fiscal activity** – appoint the managers from the fiscal system strictly on professional grounds, with no political interference;

▶ **reduce the corruption within the fiscal administration and justice;**

▶ **establish fiscal courts of law**, with the role of judging the matters of fiscal legislation infringement. The fiscal area is very complex and the practical situations support the specialisation of judges on such causes. Romania lacks a Fiscal Court of justice which to rule on the reports of fiscal inspection of the control bodies. The existence of specialists for fiscal causes within the courts of justice would result in rulings much closer to the conclusions of the control bodies.

Special studies⁸ show that Romania ranks second (42.7%) within the EU as tax evasion, second to Italy (51%), followed by Bulgaria (39.2%), Estonia (37.6%), and Slovakia (34.1%). At the opposite end are the United Kingdom (6%) and Sweden (3%).

In detail, the tax evasion phenomenon in Romania looks as follows:

⁸ Report by Associazione Contribuenti Italiani and Klrs Network of Business Ethics.

- The proportion of the underground economy within the GDP increased over the past four years from 14.5% to 21%;
- The taxation of the underground economy would have brought in 2008 in excess of 58 billion RON in revenue to the state budget;
- Black labour accounts for the largest share of the underground economy;
- The potential revenue to the budget by levying the black labour was estimated to 29.5 billion RON, in 2008;
- Tax evasion to VAT payment reached in 2008 to almost 24 billion RON, overt here times more than in 2004;
- The total revenue obtained in 2008 was of 164.5 billion RON, 20 billion RON lower than the planned revenue⁹.

Among the most used methods of tax evasion and fiscal fraud are:

- Buying merchandise from a member state through a ghost-company which doesn't pay its duties;
- Record unreal, fictitious operations which do not occur in reality;
- Non registration (correctly) as reverse taxation of the VAT for intracommunity purchases, with the purpose to reduce the VAT duties to the state budget;
- Improper excises set for goods purchased by local companies from EU member states;
- Establishment of companies which become bankrupt rapidly. They trade (particularly in energetic goods) using prices much lower than the market prices with firms which disappear and don't pay the VAT due for the transaction.

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