

# APPROACHES REGARDING THE TAX EVASION IN ROMANIA

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*In any economy, the main purpose of the tax system is to provide a solid and stable source of government revenue. On the other hand, a tax system should aim to enable the country's economic development and support disadvantaged groups. Achieving these objectives should be accompanied by a continuous preoccupation of the tax administration to increase its efficiency. In this process, a particularly important factor consists in reducing the tax evasion, given that it contributes to a diminution in terms of efficiency within the state structures, while being a factor of corruption. Over the past 20 years, in Romania, the presence of tax evasion has reached relatively large dimensions in both the economic area and the underground economy, where the phenomenon is widespread. Taking the road from the particular to the general, distinguishing the legal tax evasion from the fraudulent one, this paper aims to answer the question: Why is it necessary to control the tax evasion phenomenon and how to do this? This question aims at achieving the following objectives: distinguishing between the legal and the fraudulent tax evasion and the methods used by taxpayers to circumvent the tax obligations.*

*First of all, reaching the objectives was assured by consulting a significant amount of work, that is to say publications of scientific claim, while making use of analysis, induction and deduction, significant volume of quantitative information was examined and submitted to professional reasoning. In literature, there are many Romanian and foreign authors reporting on the tax evasion issue while as far as specialised magazines are concerned, there are just a few discussing about the social protection issues or about the European experience in the tax adjustment whereby the states have gone over the years, such as: the Romanian Economic Journal, the Annals of the American Academy of Political and Social Review of Social Innovation and other authors such as Saguna & Tutungiu (1995), M. Duverger (1965), Carmen Corduneanu (1998), Hoanță (2000). Research results and general conclusions on the issue of tax evasion in Romania are listed at the end of the paper.*

*Keywords : fiscality , tax evasion, blak labor, romanian taxpayer, the State*

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## **1.Introduction:**

Taxation has been and is still an objective necessity, despite being inappropriate for taxpayers. Holding backwards a millennial history, accompanying, in time, the birth and development of the state, the tax is one of the most controversial public institutions. Even though it was deemed to be established by the citizens' general consent, the taxpayers opposed the tax burden of the payment, through legal and less legal means in an effort to protect the most important part of their personal income. The literature offers a multiple of interpretations on the concept of tax evasion. One of them defines tax evasion as "all legal and illegal procedures whereby, all those interested peculate, in whole or in part, their taxable material obligations established under the tax laws." (Saguna & Tutungiu, 1995: 45). Another meaning of the concept of tax evasion was given by M. Duverger (1965:77), who considered that this phenomenon "refers to all manifestations of fleeing from tax" in this sense, tax evasion taking place when "the one who is supposed to pay the tax,

doesn't do it, without its obligation to be passed on to a third party." The tax evasion consists in the theft of taxpayers to pay their respective tax liabilities, partially or wholly, using legal loopholes or using clever maneuvers, in order to conceal taxable material. But regardless of how this phenomenon is defined, tax evasion is, ultimately, failure of the taxpayer to assume their tax liability.

The means of concealment employed for avoiding tax obligations can be divided in two categories: extrapolation of legislative failure or even the possibilities left by the legislature in certain illicit intentions and processes. In terms of how it can be accomplished, the relationship that exists between this phenomenon and the current legislation, tax evasion, there are two forms of manifestation: licit tax evasion (shelter built at law) and illegal tax evasion (fraudulent) or fraud tax. In terms of space, it can be identified the national tax evasion (tax lawful and unlawful tax) and the international tax evasion. (Hoanță, 2000: 52).

## **2. Research Methodology**

The demarcation line between the unlawful tax avoidance and the lawful one is necessary and useful, because it gives the possibility, at least theoretically, to estimate the size of the phenomenon, in the two forms of manifestation.

Moreover, this distinction helps to sensitize policy makers and the administrative search and determine appropriate means to limit and control the phenomenon.

**The licit tax evasion** is the theft of a lawful part from the taxable matter, without this being considered offense or crime. It involves the exploitation of the existing regulatory framework in the sense of a smart capitalization of the inconsistencies, contradictions or equivocations of some legal proceedings in order to avoid legal obligations to the state. In some cases, the intentionality of action, coupled with the fact that it seeks to avoid paying tax obligations, leads to the conclusion that this form of tax evasion attracts the fault of the involved economic subject.

However, it is not the system of punishment that comes with the tax fraud, given that the accused one has not violated any laws, but basically took advantage of the existing legislation (or a lack thereof), "using a combination unforeseen by the legislature and, therefore, which was tolerated to escape from view." The "guilty" one of producing legal tax avoidance is therefore only the legislature. (Saguna & Tutungiu, 1995: 34). The frequency of this type of fraud is higher in the periods when new laws are introduced or changed and when the state uses intentionally tax incentives to promote policies towards certain socio-professional categories or in certain fields. In practice, lawful acts of tax evasion, based on a favourable interpretation of the law, are very diverse, depending on the inventiveness of the taxpayer and the largeness of the law. In Romania, tax evasion was done lawfully, being often based on tax incentives granted by government (rescheduling, postponement or exemption from taxes, increases and penalties relating thereto) and the omissions in the regulation of taxes and fees. Of course, this form of tax evasion can be avoided by correcting and improving the legal framework which has become possible, but often the existence of political, economic and social circumstances determines a tacit tolerance of evasion.

**The fraudulent tax evasion (tax evasion)** is a form of aggravated circumvention being studied, analyzed, and sanctioned by monetary and custodial measures, whenever it is discovered. This consists in a total or partial illegal concealment of taxable material with the purpose of eliminating or reducing the tax obligations which are incumbent on them. It was considered that this is a "cancer" that affects society and politics and, in some opinions, it would be about 25% of the budget of developed countries, reaching impressive percentages in emerging countries (Clocotici & Gheorghiu, 1996: 56).

This type of evasion is outlined in two forms: the traditional evasion (avoiding partial or total payment of tax obligations, or by completing and submitting incorrect documents, or by failure to produce the required documents by applicable law, failure to produce employment contracts

generate the black employment, declaring the minimum wage to a salary achieved much higher), legal evasion (hiding the true nature of an organism or a contract, although signed, the contract work is not declared at ITM), accounting evasion (creating the impression of accurate accounting records, using false documents in order to increase spending, reduce revenues, reduce taxable income and therefore tax liabilities due the state, per diem expenses, related to fuel the journey within the documents) and the evasion of the assessment (reducing the inventory value, increasing amortization and provisions in the overstatement of profits with the purpose of an increasing future profit). (Gliga, 2007: 45)

In relation to tax regulations, in the case of the taxpayers various tendencies and motivations are manifested in order to evade tax obligations. The extent to which tax evasion arrived in our country makes this phenomenon to be so real that its presence became daily in all lucrative spheres. It can be stated without exaggeration that in the period after 1989, a social norm of tax evasion was gradually but surely established, the Romanian taxpayer, regardless of his financial or social status, trying and succeeding, most of the time, to evade tax payment.

The proliferation of tax evasion in Romania was supported by a number of factors, including a tax law characterized by the presence of gaps, inconsistencies, vagueness and lack of stability over time as well as the late appearance of a law to combat tax evasion (Law no. 87 / 1994 came into force in the late 1994). Until 2004, there was no tax code or a tax procedural code which would have been essential to the tax legislation, as it has as purpose to limit the effect on tax evasion. At that time, there were too high incumbent taxes compared to the Romanian taxpayer's real capacity to pay, the revenue to GDP in 2008 being the lowest (32.8%) of all EU member countries in the context of an increasing corruption in society. In Romania, the most used tax fraud techniques established afterwards the carried out control actions, grouped by categories of tax duty are (Gliga, 2007: 48):

- **The income tax:** reducing the tax base by including expenses on cost categories without supporting documents or legal basis (fines, penalties, etc.) , the registration of oversized or over-permitted by law expenditure, the deduction of the shareholder's personal expenses or interest rates on loans from the companies of their employers, failure to record the total income, the transfer of the taxable income to the newly created company within the same group, in the period of their exemption from the tax payment, along with loss records by the parent company , calculating the tax on profit by the incorrect application of the law, no-calculation of the tax revenues from economic activities by certain nonprofit organizations, not recording differences or income tax obligations in the accounts established by the audit;

- **The value added tax:** the misapplication of the deduction system, not including certain operations which fall within the VAT tax base or not including all invoices in the tax base calculation, not highlighting and not transferring to state the VAT for the advances received from customers, failure to register as Payer once the minimum threshold was surpassed, the issuing of tax receipts and VAT invoices without the trader to be paying and without incurring and transferring VAT, "computation error", etc., are just some of the methods used to defraud the VAT;

- **The Wage tax:** tax exemption for all amounts paid to employees as wage income, not withholding and paying the taxes due on those wages on account of those workers employed on civil conventions or laborers, failure to pay the tax obligations on wages, non-compliance on the tax law, aggregation, tax exemptions and discounts, etc.

- **The Excise tax:** not including all taxable amounts in the tax base, reducing the tax base by undervaluation of imported goods, by using double customs documents, not calculating the excises for alcohol concentration changes, not including the excise tax in the sale price of the products which require excise, not highlighting the excise duty in accounting, avoiding excise duty by changing the names of the products demanding excise and transferring them to a product category which doesn't owe excise taxes, having reduced rates (for mineral oils, alcohol, etc.).

- *Other taxes and fees owed to the state or local budgets*: highlighting in accounting, buildings at lower values than the actual ones, failure to submit declarations regarding heritage buildings, means of transport in possession and owned terrains or under management operators, declaring erroneous data, Failure in constituting and paying the dividend tax and its wrong calculation, individuals not declaring their incomes for various activities, etc.

### 3. Research results:

Table number1 shows the data published by the National Tax Administration Agency on fiscal discipline at the national level (in Romania) but also the attitude of the competent bodies in the discovery and punishment of fraudulent tax evasion, data concerning the number of checks and their results for the period 2003- 2009. It may be noted that although the number of checks performed by the control decreased during the period 2003-2009, the frequency of cases of tax evasion has increased. Of course, fewer checks lead to a lower probability for a taxpayer's evasion to be discovered and more than that, it doesn't have a positive impact on the degree of tax compliance of the romanian taxpayer.

***Table number 1. The evolution of tax evasion in Romania over year 2003-2009***

| <b>Nr. Crt.</b> | <b>Indicator</b>   | <b>2003</b> | <b>2004</b> | <b>2005</b> | <b>2006</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> |
|-----------------|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1               | Number of checks   | 446.822     | 273.020     | 286.903     | 259.032     | 278.623     | 282.764     | 276.544     |
| 2.              | The number of identified cases of tax evasion                    | 195.425     | 120.077     | 115.158     | 181.630     | 195.982     | 198.603     | 212.559     |
| 3.              | The frequency of tax (%) (2/ 1*100)                              | 43,70       | 44,00       | 40,10       | 70,01       | 70,33       | 70,23       | 76,86       |
| 4.              | The total value of the identified tax evasion (thousands of Ron) | 798.900     | 982.350     | 1.746.304   | 1.552.673   | 1.774.060   | 6.728.000   | 9.910.000   |
| 5.              | The total number of applied penalties ( thousands of Ron)        | 1.804.700   | 1.984.522   | 1.137.326   | 1.044.421   | 1.257.745   | 1.036.000   | 2.418.000   |
| 6.              | The additional drawn amount of money (thousands of RON) (4+5)    | 2.603.600   | 2.966.872   | 2.883.630   | 2.597.094   | 3.031.805   | 7.764.000   | 12.328.000  |

Source: National Tax Administration Agency, and the author's own calculations

As far as Cluj County is concerned, the table number 2 and table number 3 are displayed below in accordance with the ITM Cluj activity reports for the 2007-2010. It is noted that since 2009, both the number of employers, including the contracts during the year and the number of employees have decreased. This leads, of course, to a decrease in the number of employers found to be practicing undeclared income, along with an increase number of people identified as working illegally. Analyzing national campaign for detecting and combating undeclared work in Cluj County, in various fields, there is an identification of a large number of unauthorized workers in the construction industry. Based on statistics, national campaigns in certain sectors, which didn't use black labor, did not even refer to this area in the coming years.

**Table number 2 . The evolution of black labor in Cluj County**

| Nr. Crt. | Criteria   | 2007    | 2008    | 2009    | 2010    |
|----------|--|---------|---------|---------|---------|
|          | years  |         |         |         |         |
| 1        | Number of verified employers                                   | 3.200   | 3.066   | 3.509   | 2.504   |
| 2        | Number of employers discovered to practice black labor         | 523     | 567     | 551     | 176     |
| 3        | Number of employees discovered to practice black labor         | 1.430   | 1.212   | 1.891   | 576     |
| 4        | Applied penalties (thousands of lei)                           | 2.126   | 1.788   | 1.929   | 1.112   |
| 5        | Number of employers existent in records at the end of the year | 22.840  | 23.517  | 21.485  | 19.690  |
| 6        | Number of contracts recorded during the year                   | 106.113 | 104.011 | 69.011  | 53.701  |
| 7        | Number of contracts active at the end of the year              | 152.106 | 156.506 | 136.278 | 129.304 |

Source: A representation belonging to the authors and which was made in accordance with the ITM Cluj activity reports, 2007-2010

**Table number 3. Black labor as a result of the national campaign to identify and combat illegal work in Cluj County**

| Nr. Crt. | Fields identified                              | 2007  | 2008   | 2009    | 2010  |
|----------|--|-------|--------|---------|-------|
|          | years  |       |        |         |       |
|          | Number of units                                |       |        |         |       |
|          | Number of employees                            |       |        |         |       |
| 1        | Car wash                                       | NO    | 2.229  | 1940    | NO    |
| 2        | Constructions                                  | 3.791 | 60.117 | 136.278 | 1.129 |
| 3        | Forestry, logging, wood processing             | NO    | 66     | 1.629   | NO    |
| 4        | Mountain units                                 | NO    | NO     | 45      | NO    |
| 5        | Milling and baking                             | 1.420 | -      | NO      | NO    |
| 6        | Textiles                                       | 22    | -      | NO      | 22    |
| 7        | Manufacture of alcohol                         | NO    | -      | NO      | NO    |
| 8        | Ensuring a decent and healthy work environment | NO    | 57     | NO      | 11    |
| 9        | Commerce                                       | NO    | NO     | NO      | -     |

### **Conclusions:**

Tax evasion is not a phenomenon specific only to Romania, or to countries with emerging market economies. The phenomenon is as old as the very existence of tax itself is.

The tax evasion doesn't fit into time or space boundaries. However, the extent of this phenomenon represents significant differences from one country to another, generally considering that in countries with unstable and dysfunctional economies, where corruption is manifested in full economy and tax evasion are "at home".

Tax evasion has consequences, primarily at the macroeconomic level, consisting in state's deprivation of income and thereby the opportunities for maneuver are decreased in both the economic and social fields.

On the other hand, entities that avoid paying taxes, having lower costs, will compete unfairly with those who meet their tax obligations and the first ones will distort the smooth operation of free market mechanisms, undermining some industries. Accepting and generalizing this phenomenon would undoubtedly lead to the suppression of the state.

Despite this, in modern times, this is impossible, given the fact that the private initiative was never able to provide social and economic balance to a nation. Now, more than ever, it is universally acknowledge that, during the global economic crisis, the market economy is not a business model to ensure continuous prosperity to those who adopt it.

In conclusion, tax evasion is equal to a "cancer" and it affects the civil and political society which would be around 25% of the budget of a developed country, reaching an impressive percentage in developing countries. Hence, the state must maintain a fair level of taxation in order to keep away the tax evasion phenomenon and to provide diversified and sufficiently severe penalties, fighting for this cause.

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