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# Fiscal Evasion – Principal Cause and Consequence of the Romanian Gradual Transition

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## Abstract

*Unknown or almost nonexistent till '90 years, the phenomenon of tax evasion had abundantly flourished in the Romania's transitional economy, covering all its fields with black spots, under many, various and harmful appearance. The first laws stipulating the profit and the salary taxes also had revealed the appetite of the contributors for the tax evasion, in a small measure at the beginning, of course, because of the economic spirit of those years.*

*After the regulations for the value added tax and the excise taxes, as well as due to the innumerable modifications of the fiscal legislation, the fiscal evasion knew a considerable development and diversification, greatly stimulated by the controversies between the fiscal and the bureaucratic pressure.*

**Keywords:** tax evasion, tax avoidance, fraud, fiscal ability, fiscal law, black economy

**JEL classification:** E 26, E 62; H22, H26, K34; P35, P37

## 1. The essential premises as deficiencies in the fiscal policy

While individuals' incomes were almost equal and constant before the nineties, with some very few differences (and, actually, illegal incomes, such as those earned by the physicians, trade workers, militia's officials and public clerks or simply managers of public restaurants), good premises were installed during the transitional process as to widen the area of such revenues gainers. But the human behaviour itself has an outstanding importance for the growing effects of the tax evasion, among other specific causes.

And to improve the manners of *fiscal evasion* as well! ...

Many deficiencies in the fiscal policy and regulations are to be blamed for the multitude of ways that the evasion pervaded in the whole economy:

- Generally high fiscal pressure;
- Incoherent or ambiguous regulations;
- Discrimination, protectionism or simply lack of rigour in applying the fiscal stipulations;
- Lack of proper instruments for a proper fiscal discipline;
- Lack of contributor's culture meaning the assumption to pay taxes a. s. o.

The growing trend of the investments in all the economic fields has also stimulated the *tax avoidance*, meaning a clever using of the fiscal laws stipulations in order to hide money from the public taxation.

The first years of the transition were characterized by an explosion of rapid and great revenues which were too quickly gathered by ever other and larger social categories than before. Not to forget the eighties, with their severe constraints for electricity, proper life-conditions and even the most essential food stuff....Suddenly and easily acquired and continuously growing, these amounts of money were primarily directed towards food, clothes and electrical home appliances. After a short time, they were spent for luxury personal purposes such as huge houses, very expensive cars, or trips and entertainment. There are (official) estimations that, due to these procedures, over 10 billion US dollars were transferred abroad between 1990 and 2004, when the first form for the regulation of the fiscal evasion was adopted.

**2. Constitutive elements and aspects of the fiscal fraud**

It is an old and well-known story that both *tax avoidance* and *tax evasion* have a very bad influence upon the public budget and this is the reason for the public authority’s deep interest and involvement to improve the methods and instruments meant to stop these phenomena. In the figure bellow one can see the (logical) efforts of all the contributors to find the most convenient position to avoid paying taxes. There are many ways, from the simplest error, to the most sophisticated use of the fiscal options, from the abstinence of paying, to the most cunning manifestation (or even abuse) of the fiscal regulations.

<b>Grey zone</b>	<b>Fiscal ability</b>
Legal zone	Abstinence Error Avoidance

Source: Government White Book [www.mfinante.ro](http://www.mfinante.ro)

The practice reveals a certain difficulty in distinguishing the voluntary accounting error, from the conscious decision of avoiding taxes, so that a limit between the fraud and the ability should be traced step by step to each case. There are three *constitutive elements* that determine the fraud and they are floating at the boundary between the *fiscal* and the *criminal law*:

- a. *The legal element* is an obvious condition; the principle of legally founded accusations is necessary and ensures the contributor a real and solid guarantee against the possible abuses the public bureaucratic might do; thus, the solution for a fraud is strictly conditioned by a very precise law stipulation;
- b. *The intending element* is the vulnerable and also conspicuous element of the fraud and there is not a common opinion in the law science or practicing yet; in order to prove the intention it is necessary that the contributor should have been acquainted with the terms of violating a fiscal regulation or he should have voluntarily acted, in perfect acknowledgement; it means that one should clearly demonstrate that the fraud is committed freely and under no constraint;

c. *The material intent* requires that the fraud should be considered in a latent estate, so that an outside factor is stimulating it; therefore, many fiscal stipulations in some developed economies sanction the intentions, not only the very action of not paying taxes. Apart from the consecrated division of *avoidance* and *evasion*, an important approach in the present exposure refers to the most frequent *aspects of the fiscal fraud*, especially those broadly prevalent in the Romanian transitional economy:

◆ *Traditional evasion* meaning simulation which causes partly or entirely subtracting from the fiscal duties, either by incorrect or by false documents:

- Inexactness in filling up the required fiscal papers;
- Intended reduction of the revenues, as to diminish the added value tax, excise or/and profit taxes;
- Cash - operations without invoice or receipt, correspondingly;
- Hypothetic deductions and expenses that can diminish the final base of taxation a. s. o.

◆ *judicial evasion* means hiding the real nature of an organism or of a contract, in order to avoid certain compulsory stipulation for paying taxes; for instance, transforming a partnership agreement into a labour contract, as for its beneficiary should gain certain advantages as a salaried worker;

◆ *Accounting evasion* is more difficult to identify because it creates the impression of a correct registration; the appearance of precise evidence relies on false documents eventually and contains huge or exaggerate expenses, for the same well known purpose, i.e. diminishing the taxable revenues;

◆ *Evasion through misevaluation* refers to the underestimation of stocks or to the over estimation of the amortization of intangible assets, in order to transfer the profit taxation in the following periods.

### **3. Measuring the dimension of the fiscal fraud**

Since political reasons are mostly involved in such actions, in our country, measuring the magnitude is a complex procedure based on approximate methods exclusively, and therefore, the results are often hazardous, consequently. There are still many and various imperfections in the fiscal regulations, as many as the strongest causes of the failures in this hard battle against such a devastating scourge.

However, there is much estimation about the real size of the fiscal evasion and for the period 2001-2006 they show a value over 40 per cent of GDP. International Reports, such as USA Treasury Report concerning Romania states that huge economic result, the equivalent of more than 42 cent from the real GDP, was successively achieved during these years by the so-called *black economy* and that it has simply escaped from the official statistics and taxation as well.

The figure bellow presents a complex structure of this phenomenon, including selected percentages of different categories of taxes in the above mentioned period:

<b>The Tax</b>	<b>2000 %</b>	<b>2005 %</b>
Added Value Tax	27.80	39.68
Profit Taxation	33.03	25.24
Wages Taxation	6.73	8.78
Excise	14.60	10.07
Local Taxes	3.30	3.21
Others	14.54	13.02
<b>TOTAL</b>	<b>100.00</b>	<b>100.00</b>

Source: Government White Book [www.guv.ro](http://www.guv.ro); [www.mfinante.ro](http://www.mfinante.ro)

Despite missing many necessary details concerning some sociological aspects of the matter, about 98.2 per cent from *these players* are companies in both small and big business, comparing to only 2.2 per cent that, are individuals. As one can see in the figure above, the value added tax is in an ascendant trend of evasion along these years, in spite of the unique rate of only 19 per cent for all kind of goods and services. However, the high mobility and diversity of trade and transactions are susceptible to a high rate of tax evasion, even if the official statistics do not precise that.

The outrageous growth of this scourge also *flamed* the reports provided by the secret services in our country, that appreciate that over 40 per cent from the public revenue is frauded by different ways of tax evasion or/and contributors. The following figures reveal the percentages of facts that generate evasion, as they were analyzed for 2005:

1. Errors in the base of taxation 38.50
2. Frauds in using fiscal papers 36.00
3. Overestimation of the expenses 25.50

Yearly diminishing of the fiscal revenues, the hardly controlled inflation because of the unpredictability of utilities costs, as well as the statistics and reports provided by the public finance administration reveal a continuous growing rate of the fiscal evasion.

#### **4. Conclusions**

The transition of the Romanian economy to the capitalism was gradual, incoherent and harmful, and among the causes that determined such a hard period both for the individuals and for the companies, the fiscal fraud or the evasion is on an outstanding position. Consistently supported by the corruption and the protectionism, this phenomenon hides the core of all the vicissitudes that our society inherited from the communism. Unfortunately, we all should struggle with it still long time from now on.

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