

## TAX EVASION AND FRAUD TECHNIQUES

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**Abstract:** *Tax evasion is, from a semantic point of view, an evasion from the payment of legal obligations due to the state. Therefore tax evasion is an actual or potential behavior of the economic subject (individually or collectively, as the case may be) likely to lead to the avoidance of payment of legal obligations due to the state. Therefore, not any evasion from the payment of legal obligations represents tax evasion, but only the evasion from the payment of legal obligations due to the state. This is logical, given that the tax obligations are set by the state for its benefit. If the tax evasion is defined as a legal reorganization of a business so as to minimize the tax liability, tax fraud is seen as an illegal rearrangement of a business for the same purpose. Tax evasion refers to minimizing taxation by using acceptable, real alternatives. On the other hand, tax fraud is caused by those taxpayers intended to disregard the tax law. We must understand that the tax evasion decision has a variety of factors and a clear demarcation is difficult. This paper aims at identifying and highlighting as clearly as possible these factors, clarifying the differences between legal and the fraudulent ones. We want to establish the imperfections, the legislative “leaks”, which would prevent the phenomenon of tax evasion, contributing to a correct collection of tax liabilities from taxpayers, according to their contributory power.*

**Key words:** tax fraud, tax evasion, evasion of tax liability, minimization of tax liability

**JEL Classification Codes:** H20, H30, G28.

### 1. CONSIDERATIONS ON TAX EVASION AND TAX FRAUD

The phenomenon of "tax evasion" is as old as taxes themselves, as taxpayers perceive the tax as a "necessary evil" that they try to avoid if they have the economic, social and often the favorable legislative framework. This is why tax evasion and tax fraud are widespread in the world, both in the developed countries, but especially in the developing or even poor ones. The phenomenon of tax avoidance is practiced from individuals to large multinational corporations, always performed with new methods, improved and increasingly difficult to detect by the tax system.

“The phenomenon of tax evasion has always been condemned, but its perspectives have not been changed by any social order. It continues to exist, to be perceived, to be felt, to be subject of analysis and even of electoral propaganda in the stages of evolution of human societies”( Gliga, Constantin Ioan,,2017). In other words, tax evasion is the logical result of the defects and inaccuracies of the tax system as well as of the imperfect legislation, of the faulty application methods, as well as of the lack of vision of the legislator on the inventiveness of the taxpayer.

Whether it is an economic boom or an economic crisis, the phenomenon of tax evasion produces an erosion of tax revenues, making it difficult for governments to find financing sources for the public sector. We are witnessing the current situation when Romania and other European countries are facing an unprecedented economic crisis, a context in which the



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indebtedness of individuals and companies has reached impressive levels, but also the national budget deficits have reached alarming levels. Many states find themselves in the imminent danger of being insolvent, determining the national authorities to find solutions to overcome these difficulties of financing the public sector. In this context, more and more countries recognize a problem, which has been quite ignored so far and which they have not boasted much about, the problem of tax evasion. But the current situation has made this issue the focus of debate as it is a major cause of the dramatic decline of the public revenues. Tax evasion is a current phenomenon as long as the governments do not find solutions to eradicate it. Moreover, the economic crisis has led to the intensification of the evasionist phenomena, the budget revenues have decreased considerably and the public debt crisis has intensified. In fact, the economic crisis has set aside the "curtain" behind which the tax evasion was hidden and intense concerns have begun to combat this phenomenon. Some probably expect the tax evasion to be reduced overnight and the money to come to the budget, but they are deceiving themselves in vain.

We consider that the approach of tax evasion in this new context of the economic crisis allows a more complex analysis and at the same time it represents a new element of this research compared to the already existing approaches in the economic literature. The problem of avoiding tax obligations through tax evasion and fraud is much more complex than it seems in a brief analysis, which is why this study approaches this issue from several perspectives. First we try to find the causes of these phenomena. Therefore, this paper reviews the main causes approached both in the national and international literature and identifies those factors specific to the Romanian economy, because the tax evasion, as well as the tax system specific to each state, has certain peculiarities in each country.

The first major review of the tax evasion literature was conducted by Jackson and Milliron (1986) who identified 14 key determinants of tax evasion: age, gender, education and occupation (demographic factors), income level, source of income, marginal tax rate, sanctions and probability of detection (economic factors), complexity, fairness, control by the authorities, fiscal ethics (behavioral factors). Based on data from five countries, the results of the OLS regression analysis in this study showed that the non-economic factors had the highest impact on tax evasion, especially gender, age, education, source of income and unemployment.

“The multitude of obligations that tax laws impose on taxpayers and especially the burden of these obligations have stimulated, at all times, the ingenuity of taxpayers of inventing various procedures to evade tax obligations” (Hoanță N., 2010). Tax evasion has always been especially active and ingenious for the reason that, the tax office hitting individuals in their wealth, it affects them in the most sensitive interest: the money interest.

The problem of tax evasion is a matter of morality and a man abandons when having to pay obligations towards the state. There are enough cases in which some people no longer recognize, do not want or forget to pay certain obligations due to the very high fiscal pressure that the state puts on their income and wealth.

The most conscientious taxpayers feel the tax levy as an unfair, or at least inappropriate amputation of their personal wealth. In most cases, the tax is perceived as a sacrifice, the question being whether, in addition to the material sacrifice, the taxpayer does not consent to a psychological sacrifice.

Even in its least contentious form, the tax is always felt as a constraint. A first proof of this constraint is indisputably that of the declaration, the more formidable burden, as taxpayers owe direct and indirect taxes and fees on their income and wealth (this is the case of the taxpayers with a large number of tax obligations, that they pay due to the number of these obligations and the large tax rates the state imposes).

”Therefore, tax evasion can be: illegal, sometimes fraudulent in nature, and legal, or rather tolerated”( David, Mihail,2008). The legal evasion refers to the action of taxpayers to circumvent the law, resorting to a combination, unforeseen by the legislator and therefore tolerated by escape from sight. It can only be possible due to an inadvertence or gap in the law and it is especially common in times when new forms of business or new taxes appear. The illegal tax evasion refers to the action of the taxpayer who violates the legal prescription in order not to pay the due tax. The illegal tax evasion is fraudulent when the taxpayer obliged to provide in support of his statement some justifications and established them irregularly, in order to deceive the tax office or when the undeclared income by their nature are materially justified, their insufficiency reaches a to such an extent that the fraudster's will becomes evident.

Tax evasion may be inserted between the abnormal act and the accounting error, it involves an incorrect management decision, a process by which the accountants act contrary to the tax rules, for example constituting tax deductible provisions to reduce taxable profit. Therefore, the taxpayer alleges an accounting error in order to obtain a less severe tax correction.

The most commonly used meaning of tax evasion is: the art of avoiding falling into the field of tax law. Tax avoidance may occur in three ways:

1) The tax law itself ensures evasion through a favorable tax regime (this is especially the case of the flat-rate taxation regimes, but also of the tax havens);

2) The abstention of the taxpayer to perform (carry out) the taxable activity, operation or act; this method is common in case of excessive taxation because the marginal tax rate becomes very high and the taxpayer prefers to refrain from providing an additional unit of work, evasion occurring in this case by substituting exempt free time for taxed work;

3) By using the shortcomings of the tax system (tax evasion is limited to tax ability or choosing ways to pay as little tax as possible).

Another principle that comes to clarify the field of tax evasion is that of management freedom. According to the other principle, that of legality, in tax matters, the taxpayer has a freedom to choose the most favorable situation from a tax point of view, especially when the tax law has gaps or inaccuracies. This principle also has economic sources, such as the freedom of the economic management of a company, which also involves taxation management.

The concrete processes of producing this phenomenon, in one state or another, only nuance the gravity and seriousness of this phenomenon, in no way to define it. The definition is only one: the space from the obligation to impose the taxable matter without expressly contravening the laws in force, or, on the contrary, contravening them.

There is a taxpayer psychology of never paying only what he cannot but pay. The human nature always tends to put the general interest behind the particular interest; it is inclined to regard taxes more as a prejudice than as a legitimate contribution to public spending and to always look down on the one who wants to reduce its assets. Not all socio-professional categories are equal when facing the possibilities of tax evasion, there is a sociology of tax evasion (fraud). The possibilities of tax evasion differ from one social category to another, depending on the nature and origin of the income or wealth subject to taxation, the concrete way of establishing the taxable matter, the way of organizing the fiscal control and other specific factors. In addition, the acceptance of the tax depends on multiple factors: the level of taxation, the effectiveness of the state, the social cohesion.

The small businesses resort to fraud more than the large ones because of both facilities and necessity. (Proudhon P.J.,pp259,2000). The facility is often provided by the family nature of the business, which profits from a management secret that the large companies do not benefit from.

Often many small businesses resort to fraud as a necessity. Due to the rate of return often at the limit, in order to maintain their fragile balance, tax evasion becomes a lifeline. This is all the more true in times of economic recession when, if a company is faced with detailed tax

controls, it can go bankrupt. Tax fraud is almost an asset of small businesses or a major component of their treasury survival.

The fraud techniques can be classified according to different criteria. A first criterion is the fiscal one, separating the fraud based on tax imposition and the fraud at the stage of tax payment. The first one is frequently the most common and consists in reducing the tax base either by minimizing income, benefits or turnover, or by increasing the tax deductible expenses. The fraud at the stage of tax payment mainly refers to customs duties and VAT. The existence of several tax rates encourages the transition of a commodity from a more strictly imposed heading to a less imposed heading. Thus, a false customs declaration on the characteristics and use of imported products can lead to a reduction in taxation by applying a lower rate than due.

Another classification criterion is the material one that distinguishes the fraud by concealing (hiding) the taxable matter and the fraud by increasing the deductible expenses. Depending on the material criterion, one can also distinguish between the frauds by action (involving active behavior, for example the use of a fictitious document) and those by omission (limited to abstinence, such as an undeclared income).

Depending on the authors of the fraud, a distinction is made between the frauds committed by individuals and those committed by legal entities, the distinction being interesting especially in terms of sanctions.

Finally, there is a quantitative criterion that opposes the artisanal fraud, very widespread, to the industrial fraud that may be the subject of bandit, mafia structures.

Fraud can also be seen geographically, when it comes to the national or the international tax fraud.

There are many examples of artisanal tax fraud. They range from a trivial decrease in the real sale price of a property or the import of goods without declaring them, to the omission of income registration in accounting or the increase of deductible expenses.

Another form of tax fraud is the undeclared work, which is symptomatic for tax resistance. It allows the person who exercises it to obtain undeclared (main or complementary) income. When it is performed within a salary activity, it exempts the employer from social expenses (contributions or social contributions). The higher the difference between the actual net salary received by the worker and the overall cost of the job (gross salary plus contributions due to the employer), the more interested the employer may be in using undeclared labor. As a result, the losses in income tax and the social security contributions can be considerable.

The industrial tax fraud is achieved by dividing the act of fraud within an underground network that aims to support and cover fictitious operations. So, in this case, several individuals and / or legal entities are involved in making profits, usually very important, by fraudulently evading the payment of taxes.

The most common ways of avoiding taxes internationally are abstinence and concealment. Abstinence is the simplest and most radical form of tax evasion. Discouraged by a too high tax burden, the taxpayer refrains from producing, working or investing and goes to countries with lower taxation. In the same vein, the parent company established in a country with a high tax burden will advise its foreign subsidiaries not to distribute dividends and thus the group's profits will accumulate outside the power of the national tax authorities.

Another issue to discuss is whether to encourage wealthy citizens to stop raising their wealth as a result of high fiscal pressure. On the contrary, those whose primary goal is to continually increase their wealth are unlikely to abandon this inclination. They will always look for new ways to earn even more, while pursuing the refuge of income in fiscally protected areas.

The concealment of the taxable matter implies the non-declaration of the incomes earned abroad or of the wealth located there, the taxpayer giving inaccurate information to the tax office about everything that passes outside the national borders.

The methods of performing the international tax fraud consist mainly of two techniques:

- a) the transfer of profits to a country with reduced taxes, by manipulating the transaction prices;
- b) the non-repatriation of incomes collected abroad, by manipulating the remunerations.

The first technique of profit transfers raises one of the most classic problems of the international tax law. The issue of transfer pricing manipulation arises in the relationship between the parent companies and its subsidiaries. The members of a group have, in reality, only a very limited autonomy in relation to the parent company that leads them. The commercial transactions between the different group companies consequently are performed at fixed prices, not so much according to the economic truth (the market prices) as to a fiscal stratagem, using the loopholes and breaches offered by the different fiscal legislations.

The method is the transfer price. A transfer means, in a broad sense, any outflow of value found in the accounts of a company which corresponds to an entry of the same value in the accounts of another company. As the tax administration has to establish the presumption of indirect transfer of benefits abroad, two conditions must be met:

- the simultaneous existence of dependency links between companies;
- the existence of an abnormal advantage.

Specifically, tax fraud occurs by increasing the purchase prices or by decreasing the selling prices. The increase of the purchase prices works at import, while the decrease of the sale prices operates at export.

## **2. TAX EVASION AND FRAUD TECHNIQUES**

The tax evasion techniques depend on a multitude of factors: the nature of the company's activity, its size, the government's ability to perform effective tax controls, the size of the tax burden, the organizational culture, and so on. The main categories of tax evasion techniques (methods) may be summarized as follows:

2.1. In the case of tax evasion regarding the profit tax, the following tax evasion techniques may be used:

“Reducing the tax base by including some expenses as costs, without supporting documents or legal basis (fines, penalties, etc.)” ( Legea 241/2005 [Combating tax evasion]):

- ✓ recording some oversized expenses or above the limit allowed by law (depreciations, socio-cultural expenses, travel expenses, protocol expenses, etc.);
- ✓ deducting some personal expenses of the associates or the interests on loans granted by the employers to their own organization;
- ✓ partial registration of incomes, either by not drawing up the accounting documents of primary evidence, or by registering some delivery prices below the effective ones;
- ✓ the transfer of taxable income to some newly created organizations (companies) within the same group (holding company), which are in the period of exemption from the payment of the profit tax, simultaneously with the registration of some losses by the parent company;
- ✓ determining the profit tax by an improper application of the legal provisions (eg, if the reinvested profit is non-taxable);
- ✓ the non-profit organizations may not calculate the tax related to the economic activities performed according to the law;
- ✓ the accounting may not register the differences established by the fiscal control acts;
- ✓ the accounting may not register the budgetary obligations regarding the profit tax.

2.2. In the case of value added tax (VAT) tax evasion, the evasion techniques may be:

- ✓ applying erroneously the deduction regime (VAT deduction based on documents that have not entered the value of VAT or even deductions without documents or with illegal documents, double deductions due to repeated entry of invoices in the purchase journal, deductions based

on documents belonging to other organizations, VAT deduction related to registered operations without the right to deduct);

- ✓ not including some VAT operations, or not including the VAT related to all the invoices, in the calculation base;
- ✓ not registering and not transferring the VAT related to advances from customers 137;
- ✓ not registering, as a VAT payer, at the moment of exceeding the minimum ceiling that was the basis for non-registration as a VAT payer;
- ✓ evading the VAT payment related to the imports of goods, by presenting in customs some fictitious acts of donation, from external partners, instead of the purchase documents;
- ✓ not including the VAT to be paid in the customs in the returns;
- ✓ issuing fiscal receipts and invoices with VAT for a company which is not a VAT payer, without registering in the accounting and transferring the respective VAT;
- ✓ not using or using faulty the standardized forms, with incomplete records in the purchase journal or with repeated records in these journals;
- ✓ the "loss" of invoices, the postponement fiscal invoices in order to postpone VAT payment, the non-inclusion in the VAT calculation base of all elements of the invoice (packaging, transport costs, etc.);
- ✓ falsely declaring imports as temporary (therefore not subject to VAT) though they represent purchases. Obviously, this is an important issue still debated by specialists, that of VAT exigibility, but we do not insist on it now;
- ✓ various deliberate "calculation errors", aimed at reducing the budgetary obligations related to VAT.

2.3. In the case of tax evasion on payroll tax, the following tax evasion techniques may be used:

- ✓ not taxing the amounts paid to the employees as salary incomes (aids in cash or in kind other rights granted in kind, premiums, amounts representing the employees' participation in profit, various incentives, etc.);
- ✓ the incorrect application of salary rights taxation tables;
- ✓ not withholding and not transferring the salary tax for the persons employed on the basis of civil conventions or for day laborers;
- ✓ not accumulating all salary incomes for taxation;
- ✓ not registering in the accounting the obligations to pay the salary tax;
- ✓ not complying with the legislation regarding the establishment of the tax base of the salary rights (cumulation of functions, exemptions or tax deductions, etc.);
- ✓ generating fictitious expenses with the salary of some persons (payments in the nature of dividends camouflaged in the form of salary rights);
- ✓ creating facilities for employees, which do not fall within the sphere of taxation of salary rights;
- ✓ the use of micro-enterprises to camouflage the budgetary obligations regarding the salary tax (consulting contracts, etc.);
- ✓ some documents obtained by the employees attesting their right to be exempted from paying the salary tax: certificates of revolutionaries, disability certificates, etc.

2.4. In the case of excise tax evasion, the following tax evasion techniques may be used:

- ✓ failure to include all taxable amounts with excise duties in the tax base;
- ✓ reducing the tax base by underestimating the imported products, in customs, by using double (parallel) documents;
- ✓ not calculating and not registering the excises related to the change of the alcoholic concentration in the accounting;

- ✓ not including the excise duties in the selling price of the products for which excise duties are due;
- ✓ failure to highlight in the accounting the obligation to pay the excise duties;
- ✓ evading the payment of excise duties by changing the name of the excised products and passing them to the category of non-excised or excised products with reduced quotas (mineral oils, alcohol, etc.).

2.5. In the case of tax evasion regarding other budgetary obligations, the registration in the accounting of some buildings at values lower than the real (effective) ones, the following techniques of tax evasion may be used:

- ✓ failure to submit, to the fiscal bodies, the declarations regarding the buildings in the patrimony, the means of transport in possession and the lands owned or under the administration of the company;
- ✓ declaring erroneous, outdated or insincere data regarding the tax on buildings, the tax on means of transport, the tax for the use of state-owned lands, etc.;
- ✓ not establishing and not transferring the dividend tax or its erroneous calculation;
- ✓ not withholding the dividend tax related to the advances granted during the year, which, after profit making and balance sheet approval, had the final destination of dividends;
- ✓ individuals that do not declare the incomes from various activities (meditations, incomes from rents, sale of products through consignments, sale of products “from the yard”, etc.).

### 3. CONCLUSIONS

Tax evasion committed according to the techniques briefly presented above (and, of course, of many other such techniques) is somewhat benign, in the sense that it can be ascertained by the competent fiscal control bodies. The problem is aggravated when the evaded amounts are laundered, which causes the fraudulent origin of the amounts in question to be lost and they become "honorable".

The fight against tax evasion is often without a long-term result, even if the evasion taxpayer is checked and punished, it does not mean that he will not try to evade again in the future. In the current situation of Romania, it is difficult to isolate tax evasion from corruption and especially from the underground economy, since there is an undesirable combination of these phenomena that potentiate each other.

This paper aims to identify the links between these phenomena and the plans and means by which the evasionist phenomenon can be combated. Unfortunately, the financial apparatus is too little computerized and controls and checks are made by officials who are often accomplices of evasionists, which is why the magnitude of the evasion phenomenon is far from actually diminished.

As the evasion action succeeds, the taxpayer's fortune will be greater than it would have been if the legal obligations to the state had been paid, exactly with the amount that was stolen. The evasion action can succeed on the background of various circumstances: the special ability of evaders, the imperfections and loopholes of the law, the lack of organization of the tax in pursuing the tax burdens of taxpayers and achieving fiscal control, the lack of firmness in law enforcement, the corruption of persons from fiscal or judicial structures, etc.

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