

THE TAX EVASION AND THE UNDERGROUND ECONOMY IN ROMANIA- EMPIRICAL ANALYSIS

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Abstract

Tax evasion is a complex social and economic phenomenon, typical of all social and political systems. From ancient times, people who paid taxes knowingly acted to limit or avoid the payments.

This study traces the evolution of these phenomena during 2008 - 2012, starting from the official data issued by the Romanian or international specialized institutions.

The first part of the study is a theoretical one, watching how the two concepts, namely tax evasion and underground economy are defined and presented in the economic literature. The second part is an empirical study of the evolution of tax evasion and the underground economy in Romania over a period of 5 years and their influences on budget revenues and GDP.

Keywords: Tax evasion, underground economy, VAT, excise duties.

JEL Classification: H26

1. Introduction

The tax evasion accompanied taxes together throughout history. States have created their own tax systems, determined by their economic and military power held in various stages of history. The taxpayer's tendency towards tax evasion determines, at macroeconomic level, a decrease in tax revenue collected by the state.

Tax evasion and undeclared work are thus two economic and financial phenomena acting together to obtain illicit revenues. In this context we can talk about the influence of factors that contribute to the manifestation of tax evasion and underground economy: legislative gaps, frequent legislative changes that lead to ignorance or misinterpretation of the laws, administrative bureaucracy of public authorities, reduced in number and poorly trained staff in control structures.

2. The tax evasion and underground economy- literature review.

Over time many Romanian and foreign scholars have attempted to define the concept of tax evasion. A complex definition of tax evasion is given by Iulian Văcărel, which presents the tax evasion as "the theft by any means from the taxation or payment of taxes, contributions and other amounts owed to the state budget, local budgets, social security budget and special funds budget by Romanian or foreign individuals and legal persons".

The Communist power regulated the tax evasion by issuing the Law no. 344/1947 and the Decree No. 202/1953 who amending the Criminal Code by introducing the Title III bis - "Crimes against the economic system", and also by the famous law no. 18/1968 regarding the control of assets of individuals who were illegally acquired.

After December 1989, the main law that sanctioned the tax evasion was Law no.87/1994, amended by Law 241/2005 on preventing and combating tax evasion. These acts are not unique, they are in concordance with other legal and fiscal instruments (the Criminal Code, The Fiscal Code, The Tax Procedure Code, Customs Code, etc.). The article 1 of the law defines the tax evasion as "theft by any means, in whole or in part, from payment of taxes and other amounts owed to the state budget, local budgets, state social insurance budget and special funds extra budgetary by Romanian and foreign individuals and legal persons".

Tax evasion can be:

- Lawful tax avoidance (legal) also called tax avoidance, definitions corresponding to Romanian and Anglo-Saxon literature;
- Illegal tax evasion (fraudulent tax evasion) or tax evasion;

The tax evasion (tax fraud) is an offense to law, a willful violation of tax laws, while the tax avoidance (lawful) is tax minimization using methods provided by law.

The literature uses a number of synonyms for underground economy: parallel economy, unofficial, informal, cash, shadow, etc.

The complete definition of the underground economy belongs to Professor Pierre Pestieau from the University of Liege, who defines underground economy as "all economic activities that are carried out outside the criminal, social and fiscal laws or escaping from the inventory of national accounts"(Rădulescu, 2007).

3. The analysis of tax evasion and of underground economy in Romania during 2008-2012.

In this period, the National Agency for Fiscal Administration's budgetary revenues had the following evolution:

Table no.1 NAFA revenues

Year	Budgetary revenues– mil.RON	Budgetary revenues– mil.Euro ¹	Yearly increase %
2008	144105	31130,25	----
2009	135029	31866,75	-6,3 %
2010	142323	33806,74	105,4 %
2011	157503	37165,3	110,66 %
2012	167803,2	37657,8	106,53 %

Source: Ministry of Public Finances - NAFA – Performance reports 2008 – 2012

The NAFA's budgetary revenues had an increase of 23698, 20 mil. RON in 5 years, meaning an increase of 16,44 %. In 2009 the revenues had a 6,3 % decrease from the previous year, followed by yearly increases during 2010-2012, the trend being more emphasized in 2011 (+ 15180 mil. RON towards 2010). Similarly is the situation when the revenues are presented in euro, provided that the values were calculated using the average annual exchange rate. Analyzing the NAFA revenues in relation with GDP the collected revenues by NAFA in GDP increased with 0,7 pp from 28 % in 2008 to 28,7 % in 2012, with a decrease in 2009 (27,4 %). We noticed that the state budget's revenues had the main share in all revenues collected yearly by the fiscal administration, with a steady percentage increase from 63 % in 2008 to 68 % in 2012, in the same time with the decrease of the social security budget's revenues from 26 % to 21 % during this period. Also we noticed that the percentage of the unemployment budget's revenues and health fund's revenues remain unchanged during 2008-2012.

Given the essential role of the state budget in the annual budgetary execution, we analyzed the revenues regarding the main taxes of the state budget, according to the below figures:

Table no.2 Revenues of the main taxes of the state budget

UM: mil.RON

Taxes	2008	2009	2010	2011	2012
Profit tax	13040	10617	10091	10289	10825
Income tax+payroll tax	18414	18551	17858	18849	20732
VAT	40874	34322	39246	47917	50516
Excise duties	12383	14272	17247	19026	20172
Customs duties	971	679	592	669	708

Source: Ministry of Public Finances - NAFA – Performance reports 2008 – 2012

VAT has the most significant contribution to state budget's revenues in the period under review, with an 9642 mil. RON increase in 5 years. It is noted that the income tax and excise duties registered significant values: +12,59 % income tax, +62,9 % for excise duties. In contrast we noticed that the tax profit has an downward trend : from 13040 mil. RON in 2008 to 10825 mil. RON in 2012, while the customs duties were lower with 27, 08 pp in the same period.

¹ Calculated using the average annual exchange rate: 2008 -3,6827 lei/euro, 2009 - 4,2373 lei/euro, 2010- 4,2099 lei/euro, 2011 – 4,2379 lei/euro, 2012 – 4,4560 lei/euro (source: National Bank of Romania – www.bnro.ro/cursul-de-schimb-3544.aspx).

An important role in fighting tax evasion has the specialized bodies of Ministry of Public Finances: fiscal inspection, fiscal audit, the Financial Guard, the Customs National Agency(CNA). The yearly performance reports of NAFA revealed that all control structures have taken strong actions to fight tax evasion, reflected in the increasing number of inspections in the five years period. The inspections carried out by NAFA have been doubled in this period.

As a vector of the fight against tax evasion, Financial Guard increased the number of controls related to criminal complaints , so an increase of revenues of 34.08 pp.

If the funds raised by the fiscal inspection structures increased by 161.78%, a less favorable situation presents the results of the Customs National Agency, whose incomes in this segment decreased by 43.6%.

The results of the fight against tax evasion are quantified at NAFA 's level by value indicators such as additional obligations, precautionary measures and confiscations. The additional obligations increased with 81,55 pp in 5 years, with a sharp increase in 2011 (15573,1 mil. RON). In fact, 2011 was the peak year in the agency's activity, as the number of controls and the amounts representing precautionary measures and confiscations. The precautionary measures increased by 2,7 times while the confiscations increased almost ten times (from 36 mil. RON in 2008 to 350 mil. RON in 2012).

Although the government 's fiscal strategy between 2012-2015 foresaw measures against tax evasion (increasing the tax collection , reducing the non-fiscal taxes, increasing the tax base, checking taxpayers with high fiscal risk) tax evasion has yet important values in our country. "If Romania would collect the taxes at its maximum, would have budgetary revenues as a percentage of GDP, above the European average"

The estimated value of tax evasion is 102113 billion RON in 2013, representing 16.23% of GDP. This value is higher by 80% compared to 2008.

VAT generates the largest tax evasion, its share in total increased from 67.24% in 2008 to 75.23% in 2013. In 2010, the new rate of 24 % is applied, leading to an increase with 25, 37% of VAT evasion in one year. This fact is reflected in the increasing share of VAT evasion total of 1.58 percentage points in 2010 compared to 2009, but also in increasing the share of GDP, both of the evasion of VAT (+1.6 pp) and of total evasion, reaching in 2010 to 15.09% of GDP, compared to 12.89% in the previous year. Social security tax evasion has significant rates: in 2008 was equal to the aggregate evasion of profit tax, income tax and excise duties, and in 2012 and 2013 represent over 15% of total tax evasion of Romania. Social security tax evasion is interrelated with the number of people working in the informal economy (see table no. 7).

If profit tax evasion decreased steadily from 3993 mil. RON to 3126 mil. RON between 2008- 2013, excise duties evasion recorded an increase of 11 pp, largely due to higher excise duties on alcohol from 51.08 euro / hl in 2009 to 165 euro / hl in 2011 and the increase in excise duties on cigarettes (from 31.5 EUR / 1000 cigarettes to 64 EUR / 1000 cigarettes in 2008-2010).

Income tax evasion recorded an absolute increase of 1740 mil. RON in the analyzed period, especially due to the informal sector (family businesses, freelancers, small craftsmen).

The evasion related to the underground economy is estimated by specialists in 2013 at 16414 mil. RON, or 2, 61% of GDP. In the period under review, the underground economy has registered an upward trend until 2011, when it reached a maximum of 17.51 billion lei, then declined over the next two years to 1096 million (- 6.25 pp).

Tax evasion expressed as gross value added has steadily increased from 100741 mil. RON in 2008 to 143906 mil. RON, sharing 24.53% of GDP in 2012.

The most important factor in the growth of the underground economy is the number of people working illegally, without legal documents. Their number has increased from 1.05 million persons (2008) to 1.57 mil. persons in 2012, leading to an increase of nearly 50%, representing about 28% of all employees in the economy.

According to some authors [Stănică Cristian Nicolae, 2014], the number of employees in the underground economy is 1.79 mil. persons (2012) and 1.75 million persons in 2013.

Table no.3 The structure of employees –main sectors of the underground economy 2008-2013

Economic sector	2008	2009	2010	2011	2012
TOTAL EMPLOYEES which	1050191	1533038	1590716	1611096	1568624
Industry	632543	695889	644818	554606	548360
Trade	128345	315514	259190	355253	358934
Transport & telecommunications	94803	142333	178837	176135	163324
Construction	107552	234461	301206	322693	335564
Other sectors	86948	144841	206665	202409	162442

The industry has the largest share of undeclared work in 2012 (34.96%), followed by trade (22.88%), construction (21.29%), transport and telecommunications by over 10%.

If the number of people in the informal economy grew by 0.51 million people in the analyzed period (49.36%), the figures revealed that 2009 recorded the highest yearly growth both in absolute terms of the number of people (+ 0 48 mil.persons) and relative value (45, 97%).

The European comparisons on underground economy are clearly unfavorable to Romania. The study prepared by dr. Friedrich Schneider (Kepler University Linz, Austria) and AT KEARNEY in 2013 on the underground economy (shadow economy) shows a decrease in its share in GDP of the EU-27 (plus Croatia, Norway, Switzerland and Turkey) from 19.9% in 2009 to 18.5% in 2013 .In an comparative view Romania increased from 1.74% to 2.61% in the same period for the share of shadow economy in GDP.

According to the authors of the study, the Romanian shadow economy is estimated at 40 million Euros, or 28% of GDP, which puts us on the second lowest place in Europe, ahead of Bulgaria (31%), far away from the European average (18.5%).

4. Conclusions.

In the current period, combating tax evasion is for NAFA an absolute priority. Tax evasion damaging society as a whole by reducing budget revenues, leading to insufficient financing of social and economic policy of the state, but also by practicing unfair competition and business distortion. The control actions will focus primarily on large evaders and areas with major non-compliance risks, improving and extending the risk analysis of taxpayers.

The control methods will improve, controlled areas will be expanded. The quality of the control will be improved by actions that will cover areas ranging from improving methodologies to better training of NAFA employees.

Improved measures will be taken for better borders security, protecting national interests in this field and to strengthen customs controls to combat smuggling.

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