

TAX EVASION THROUGH FICTITIOUS ECONOMIC OPERATIONS, OBSTACLE TO SUSTAINABLE DEVELOPMENT

SERGIU-BOGDAN CONSTANTIN

UNIVERSITY LECTURER PHD, BUCHAREST UNIVERSITY OF ECONOMIC STUDIES,
e-mail: c.sergiu.b@gmail.com

Abstract

Tax evasion means the avoidance of declaring and paying taxes. The purpose of the research is to identify ways and mechanisms of tax evasion through fictitious economic operations and how this kind of tax evasion can influence sustainable development. The principal methods are researching tax evasion cases investigated by the Romanian authorities responsible for combating this phenomenon, court trials on tax evasion and using the bibliographic references in the field. The data used are obtained through open sources of the authorities specialized in combating tax evasion for the cases made public, the media and also from specialised literature. The principal results are that this type of tax evasion is manifested through transactions with “ghost companies”, with offshore companies and transactions between associated enterprises. The main causes of this problem are: high taxation, corruption, inefficient government and tax authorities, no fiscal education and very hard tax legislation. The consequences are that the state budget is affected, the companies that do business legally are affected and also the final consumers, so Romania will not have economic growth and the quality of life will not improve. The main conclusion is that in order to have sustainable development, tax evasion in general and this kind of tax evasion in particular must be eradicated. The measures that have to be taken are to prevent tax evasion and to tighten controls but without violating taxpayers rights and without making abuses.

Keywords: tax evasion, fictitious economic operations, ghost companies, offshore companies, associated enterprises, sustainable development

Clasificare JEL: H26, O11

1. Introduction

Taxation is critical for fiscal policy; it lies at the heart of the society and constitutes a powerful instrument for sustainable development. Incomes are taxed to generate revenues for the state to provide essential services for the citizenry [4]. Through taxation the state gets revenues for health care, social care, environment protection, education, research, infrastructure, investments all these necessary for development. Economically some sectors of the economy are developed with tax revenue from more developed sectors.

Taxation can be also an inopportunity for the Romanian taxpayer, however honest they prove to be. Moreover, it becomes a burden and the cause of public discontent when the state does not administer money properly, pushing the taxpayer not to pay taxes [1].

Tax evasion means the avoidance by any means, whether fully or partially, of declaring and paying taxes to the state budget. Tax evasion is committed by infringing the tax law, taking advantage of the specific way in which taxation is applied, and it is one of the social and economic phenomena of greatest importance [2]. The main causes of the phenomenon are: high taxation, corruption, inefficient government, inefficient tax authorities, no fiscal education and very hard tax legislation.

The most common form of tax evasion is through fictitious economic operations. Law 241/2005 for the prevention and fight against tax evasion defines the fictitious economic operations as being the dissimulation of the economic reality by creating the apparent existence of an operation which, in fact, does not exist. The accounting of documents of acquisitions that are not real, or the accounting of any fictitious operations, their essential purpose being to manipulate the accounting and fiscal information, therefore, to distort reality in order to avoid taxation or to obtain fiscal advantages that, otherwise could not be granted [5].

The specialty literature describes the tax evasion phenomenon both on national and international level, the Romanian authors performing researches and surveys in the field [1] – [8]. The problematic of the fictitious economic operations is also presented but without thorough dedicated research.

The purpose of the research is to identify ways and mechanisms of tax evasion through fictitious economic operations and how can they influence sustainable development.

There were studied tax evasion cases investigated by the Romanian authorities responsible for combating the phenomenon, court trials on tax evasion [9] – [13] and using the specific literature [1] – [8]. The information and data

used were obtained through open sources from the authorities for the cases made public, the media and also from specialized literature. First were identified the ways of making tax evasion through fictitious economic operations and then the consequences that affect sustainable development, were determined.

The most frequent fictitious economic operations are through “ghost companies”, offshore companies and associated enterprises.

2. Economic operations of the ghost companies

The analysis of the tax evasion phenomenon indicates a continuous tendency of fictive entities extension, practically of some obscure business groups, whose non dissimulated purpose is to achieve huge profits through tax evasion. This fact is facilitated by certain legislative deficiencies and is based on operational maneuvers cleverly exploited. All these entities are known as “ghost companies”.

Practice has proved the existence of two main categories of ghost companies, some that are registered with the Trade Register and others that are not registered at all.

The non registered ghost companies in fact do not exist, not being registered with the Trade Register. These companies have articles of association and forgery made stamps; they use accounting and fiscal documents that are false, counterfeit or illegally procured. Usually, the company name is close to the one of an existing one, just for creating confusion among the eventual “business partners” and give a note of apparent legality of the economic operations they carry out. Obviously, they do not submit tax statements, do not lead and do not organize accounting evidence.

The registered ones have an apparent legal aspect, meaning that their associates exist as natural persons and effectively take part in the firm’s foundation and registration with the Trade Register, lease a premise, open bank accounts, issue invoices, obtain the necessary authorizations for being able to function (obviously where the fiscal legislation provided this obligation) [5].

Some of these “ghost type” companies cannot be controlled, as they do not function at the declared premises, being used sometimes only for collecting the reimbursable VAT from the state budget. Most times, these companies act, in a first stage, in the transparent area of the economy and only subsequently prove a “ghost type” behavior, as they accumulate debts at the state budget; they frequently use the bank accounts to collect money from clients and to make the payments towards the suppliers just for creating a note of apparent legality over the activity they carry out. The said companies are used both for defrauding the state budget (usually functioning by organizing and leading double accounting activities that are based on a whole technique regarding documents forgery), and the commercial partners (initially, these companies attentively build an image of respectable and correct company for winning the business partners’ trust, and subsequently, will issue checks with no cover for the purchased goods, simultaneously with the disappearance from the registered office and from the declared working points).

The ghost companies are frequently used by the owners and/or administrators of some companies in order not to pay to the state budget the profit tax, the VAT, the tax on dividends and the salary contributions. After they deduct profit tax and VAT then they withdraw vast amounts of money – thus obtaining “black money”. The said acquisitions decrease the accounting profit of the company, and the dividends which would have been taxed on payment. Further on “under table” salaries are paid.

Ghost companies are also used in the contracts for public works of infrastructure - roads, bridges, water sewerage, and blocks’ rehabilitation. The contracts in cause are carried out with the state institutions after the Tenders are counterfeit. The owners of the companies that concluded such contracts with the state institutions use the ghost companies for having the necessary money to bribe the civil servants. In this case, fiscal evasion is joined to corruption.

The most visible consequence of the “ghost companies” activity is represented by the avoidance of taxation of some important incomes and VAT unreal deductions, deeds that generate significant fiscal prejudices and deprives the state budget of important financial resources. This is how a pressure over the national currency is created, information and statistics are distorted, and the operations carried out through these companies lead to the vitiation of the competitive business environment, with unfavorable effects over the companies that correctly fulfill their fiscal obligations. We should not lose sight of the fact that these illicit commercial practices encourage the introduction on the market of some expired or qualitatively inadequate products, with severe effects, on long term, over the population health status. Hence, the activity of these companies impairs the national economy, slows down the economic development and life’s quality decreases.

3. Economic operations through offshore companies

This is a method of international tax evasion that consists in the transfer of profits to states with reduced taxation by taking revenues out of the country. The companies are paying services provided by offshore companies registered in tax havens but these services are not real [2]. Tax havens are tax free jurisdictions which have a legal status of state entities. These states entities offer an escape from tax but do not have anything illegal because everything is provided in the local law. They also provide secrecy, escape from financial regulation and are indifferent to the laws

of other jurisdictions. A tax haven is a place that attracts business by offering facilities to help tax payers escape the laws of their countries.

The services provided by offshore companies registered in tax havens are of consultancy, management, marketing, and they cannot be quantified because they are fictitious services. Such services are not concretely or practically provided, and only a circuit of documents is created, but such documents do not reflect real economic operations. These services, although not real and not based on actual economic operations, are regulated based on commercial contracts concluded between parties, which contain a series of advantages in order to favour the transfer of profits to a country with much more favourable tax regulations. Many of these contracts stipulate the confidential character of the business precisely because it is desired to hide fictitious economic operations without a real base. In order for the services to look more real, written reports and estimates of works are made also. The fictitious services are used as instrument of transfer of an important part of the taxable profit to more favourable tax conditions, practically making a transfer of the right of taxation from Romania to countries with lighter taxation [2]. By accounting these services as deductible expenses, less profit tax is declared and paid to the Romanian state budget. More expenses mean less dividends and less dividend tax to pay.

The offshore companies are also used in the field of goods export. The indigenous goods are exported at modest prices to an offshore company, which carries a price adjustment. The price is raised up to the real value of the export, and, subsequently, the said products reach the final destination. The taxable profit is visibly diminished with the hidden price of the goods that are to be “exported” to other offshore companies from tax havens, and the effect is represented by the diminishing of the profit tax due in Romania. Goods may be also exported to offshore companies and then imported back in Romania, illegally requiring the VAT reimbursement in the Customs.

Thus offshore economic operations are a device to avoid taxes.

Because of the offshore companies, vast amounts financial resources are kept offshore and go untaxed. Romania cannot afford to lose these tax revenues. The more is done to eradicate tax evasion, the more resources Romania will have to finance growth-enhancing public investment, restore the health of public finances, and put the euro area economy back on a sustained and long-term recovery.

4. Transactions between associated enterprises

Commercial and financial transactions between associated enterprises must be made as if they were independent enterprises and that is according to the principle of free market price [7]. The transfer pricing principles must be considered when determining the profits of the associated enterprises and the revenues or expenses should be adjusted in order to reflect the market price for the goods or services provided.

Transfer pricing abuse refers to various acts of manipulating transactions in associated enterprises with the view to reducing the amount of profit tax and/or value added tax (VAT) these companies should pay. When referred to transfer pricing abuse it can also be referred to making false profits or losses, false company performance [3].

Transfer pricing abuse makes access to real information impossible. Manipulating financial information makes financial statements difficult to access and assess. Such companies are irresponsible because they undermine the important contributions that government, banks, shareholders, trade unions, and stock exchange make to their success.

When some companies have to recover the VAT or have fiscal loss, they issue invoices for sales or for fictive services supply to friends companies or to associated enterprises. The companies making such acquisitions diminish the VAT or the profit tax to pay. Friends companies are third parties companies which have common interests and are in the same sphere of influence. They are clients companies from the “group” with the main goal of avoiding transfer prices rules. Each company among the ones mentioned above may act both as supplier, and as client towards the others, meaning that each company may be both supplier, and client for all others, exchanging invoices among each other. All these companies don't use real prices of the goods and services within the transactions. The profits of these companies are not real and do not observe the principles regarding the transfer prices. The total annual expenditures are artificially kept at certain percentages from the total annual revenues every year. The transactions among these companies do not have an economic purpose, do not have a real economic content, but have the role of achieving the fiscal optimization, of avoiding taxation, hence, of paying as less as possible at the state budget, the said transactions being artificial and fictive. The main purpose of the transactions among these companies is to diminish their taxes by fictively increasing the expenditures, decreasing incomes and the illegal deduction of VAT. They consider this a fiscal optimization, but, actually, this is tax evasion, prejudicing thus the state budget by this shuttle system.

Some of the associated enterprises that do business are offshore companies incorporated in tax havens. So, some enterprises do business with associated enterprises from tax havens. Because of the secrecy policy in the tax havens nobody really knows what companies that do business are associated enterprises. Even thou the business is real is very hard for the tax authorities to determine if the transfer pricing rules are respected.

As associated enterprises continue to report false financial statements, the business environment will not show its real potential and the potential investors will judge it wrong. Such investors will leave and relocate when they'll learn that they were cheated, resulting in a loss in employment and national income.

5. Conclusions

“Ghost companies”, offshore companies and transfer pricing abuses are the main forms of tax evasion that threaten sustainable development. Because of these, vast amounts of financial resources go to the shadow economy, go untaxed and a pressure is put to the national currency, so the state doesn't have the money to fulfil its role in society. Potential investors may consider the business environment as hostile and take their business to other countries.

These forms of tax evasion lead to the destruction of competition as those that pay all taxes and fees are obliged to practice smaller prices, to cover their costs. Or, each entrepreneur is free and independent to set up the price of its products based on its own production costs and the amount adherent to the estimated profit.

The evasion practices block the development efforts for those who want to function legally, as the others function in the underground economy. The manufacturers and traders that work under the table from the fiscal point of view, do this from other points of view too.

The applicability of the research is in the accounting and fiscal practice for understanding which are the most common forms of tax evasion through fictitious economic operations, but also their inferring over the sustainable development. This work could be used both by the taxpayers that work legally in order to protect themselves, to correct and direct them, and by the fiscal authorities for better understanding these practices and for finding them out easily. Starting from the results of the research, the fiscal authorities may take measures for informing the entrepreneurs about the risks and the negative implications inferred by the ghost companies, offshore companies and the transactions between associated enterprises.

In order to avoid tax evasion running out of control during the evolution of our society and to try to eradicate the phenomenon, further actions are required seeking for preventive measures as well as the improvement of the control system of economic subjects concerning the compliance with tax legislation. The evasion practices are an impediment for the sustainable development and, hence, the eradication or, at least, the diminishing of the tax evasion should be compulsory.

Sustainable development must remain a fundamental objective for Romania and it will not be brought about by eradicating tax evasion only. It must be taken up by society, as well as the big political and economic decisions that have to be taken. This requires profound changes in thinking, in economic and social structures and in consumption and production patterns.

The research directions that will follow will be about other forms tax evasion may manifest in Romania. Tax evasion is to be analyzed on each type of tax and fee regulated by the Tax Code, also considering the way tax evasion is presented in Law 241/2005 for tax evasion prevention and control.

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