

CREATIVE ACCOUNTING IN THE ECONOMIC-FINANCIAL SYSTEM – CONVENTIONS FOR THE AVOIDANCE OF DOUBLE TAXATION

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Abstract

In time, the legislation changes in the accounting domain, taxation areas and not only led to the appearance of some representation methods of the business information that reflect more or less transparent the actual fact of a business entity. Most of the times is impacted the result of the financial year of a company, this being subject to taxation. In the endeavor of some entities to diminish their profit to avoid tax by masking results a significant role also has the existence of the conventions for the avoidance of double taxation, they being a refuge for companies' profits. The idea to comprehend in detail the reality transposed in the financial standings of an entity is a subject of interest both for the business entity itself and for its partners and the institutions they come into contact with, this is an idea from which we started from in making this paper with the purpose of making known the various aspects of using creative accounting. At the same time, we want to point out the fact that the limits of creative accounting are almost inexistent and that the legislation on global level facilitates in certain conditions the hiding of actual legality of the companies.

Keywords: creative accounting, convention, double taxation, fiscal benefits

J.E.L. classification: M41, M48, H30, H87

1. Goal and importance of the theme

The goal of this paper consists in the study, presentation, analysis and development of the concept of convention for the avoidance of double taxation, fiscal paradise, off-shore entity, the identification of the states with which Romania signed conventions to avoid double taxation, the identification manner of the taxable basis for non-residents, the fiscal paradises of the world and the benefits they provide to the people interested in taking their incomes on friendlier territories from fiscal point of view, the identification of some assessment criteria of a society other than the increase of profit so the economic decisions of the users should be better founded and based on data as close as possible to the actual reality.

In this paper we will approach an important subject – legal instruments of creative accounting and their impact upon the business environment with implications from fiscal point of view; it is about the conventions for the avoidance of double taxation with pragmatic approach of risks and benefits involved, with the morality and legality characteristic to a certain extent. In this subject we will present the concept, the criteria that underlie the taxation, a classification of the rules that establish the taxation manner for incomes and capital and in the end we will make a presentation of a few practical examples of applying the conventions to avoid double taxation signed by Romania with other states.

The scientific accounting research activity in the creative accounting field is in a stage of development, the subject being a sensitive one through the concept of professional ethics. Our paper does not defend or condemn the creative accounting or the conventions for the avoidance of double taxation; it is an ample research which intends to develop the connections of the conventions to avoid double taxation with the creative accounting, to present and debate the directions in which it develops and to identify their impact upon global and national economy.

The research project analyses aspects that influence the decisions of business operators and especially of the institutions from the banking system, aspects that concern the maximization of the

society's result – when is intended attraction of new investors, or on the contrary – its stultification if the target is the payment of lower taxes.

The approach from the point of view of users of accounting information from the banking accounting and the impact of the creative accounting techniques upon the financing decision of a business operator is in an unexplored stage at the time being, the bibliography available in this meaning is relatively scarce.

In a world governed by risks and uncertainties, the adequate control of risks is a stringent problem which concerns at the same time the managers, the auditors, the capital holders, the banking institutions, the investors, the governments, tax payers and the public.

2. Motivation of research

The purpose of this paper consists in the presentation, analysis and development of the concepts to avoid double taxation, fiscal paradise, tax evasion, but also the identification of the connections between the two concepts and the creative accounting, the main subject of our paper. We will approach these subjects that continue and develop on macroeconomic level the theory related to the theme's thesis; if so far we have presented at large the concept of creative accounting, loyal image, fraud, the relations between these creative accounting concepts and techniques on a society's level, in this paper we develop the idea of creative accounting in the economic environment with implications from fiscal point of view on entity level and afterwards as implications on national level and in the end on global level.

The conventions to avoid double taxation – in this subject we will present the concept of convention for the avoidance of double taxation, the criteria that underlie the taxation, we will make a classification of the taxation rules for incomes and capital and in the end of the presentation we will bring a few practical examples of the application of the conventions for the avoidance of double taxation signed with countries like Great Britain, Morocco, USA. Thus, the chapter has both a theoretical and a practical character.

A second goal of the paper is the delimitation of the concepts for the avoidance of double taxation, tax evasion and creative accounting, as well as the extrapolation of the last subject on global level.

3. Methodology

This approach is mostly qualitative, opinion-based and overall descriptive. This paper uses as a method of research both descriptive and exploratory, was followed the deductive nature and used the presentation and explanation of the cause-effect relationships; it has also an inductive nature and various interconnection relations with direct and indirect involvement factors were followed.

For data collection we used studies and reports published by various specialists and organizations to obtain a comprehensive description of the issues addressed.

4. How we define the conventions for the avoidance of double taxation

The conventions to avoid double taxation are the result of states' desire to clear out and to standardize the fiscal standing of tax payers involved in any type of activities from other countries – commercial, industrial, financial, etc. by the implementation by all countries of a unitary solution in identical situations of double taxation.

For example B. Spitz thinks that *„the international double taxation occurs when the fiscal authorities of two or more states collect simultaneously taxes having the same basis or the same incidence to such an extent that an individual bears a tax liability which is bigger*

than if it was subject to a single tax authority”(Spitz, 1972).

Legally speaking, the international double taxation appears if an income obtained by a tax payer, natural or legal person is subject to taxation in two states. In order to remove the undesired effects of international double taxation upon the free exchange of goods and services, countries worldwide signed bilateral or multilateral conventions that mark the settlement of problems and cases appeared most frequently in the international double taxation aspect.

Double taxation can be defined as taxation twice or several times of the same taxable base for the same timeframe, but by two fiscal authorities from different states. This phenomenon can appear only in case of direct taxes like the income tax or wealth tax. In case of indirect tax it is not about international taxation. In order to remove obstacles in carrying out economic relations between states, was necessary the creation of a legal framework on national level through the legislation of each country related to the taxation and internationally by the conventions for the avoidance of double taxation so as to avoid the negative consequences of double taxation.

At present Romania has 82 conventions for the avoidance of double taxation signed with countries throughout the world. Germany was the first country with which it signed such a convention and it came into force on 01 January 1972; Saudi Arabia is the country with which Romania signed the last convention. 8 of the conventions signed – conventions with Austria, Belgium, Canada, Finland, Germany, Morocco, The Netherlands, Pakistan- were renegotiated in time.

The creative accounting assumes the use of flexibility that exists on the level of accounting or fiscal regulations to reach some goals of the people from management. An advanced form of manifestation of the creative accounting techniques are the fiscal paradises as the activity of companies is transferred to a geographical location in which fiscal pressure is minimized.

Through the conventions for the avoidance of double taxation are also established other taxation quotas applicable to the incomes obtained from dividends or from other categories of incomes obtained by natural or legal persons without residency or with residency abroad.

5. Criteria underlying taxation

World Tax Practice admits that there are three criteria underlying taxation:

1. the residence - fiscal domicile

According to this criteria, income tax is levied by the tax authority in the country where the person or entity is resident. This criteria does not take into account the place where the income or wealth that is subject to taxation is obtained or located.

2. citizenship - nationality

According to this criteria, a country taxes its residents who own property or earn income in that country without taking into account the fact that they live or not in the given country.

3. criteria of territoriality

This criteria is based on the idea that a foreign citizen is a taxpayer in the given country because he has to contribute to the normal functioning and prosperity of the country so that the country can contribute to the welfare of the taxpayer, namely the state offers the taxpayer the opportunity to earn income, to subsequently invest the gained income or use it through consumption

From our point of view, this latter criteria is the most equitable and, together with the criteria of "citizenship", leads to fair taxation. Starting from the weighting of these criteria taken into consideration by various states, we can make a group of them as follows:

Table 1 International tax practices in applying the criteria underlying taxation.

Source: own projection

Examples of states	Criteria applied in taxation	
	Residence	Territoriality
USA, Russia, England, Germany, Romania	>50%	<50%
France, Japan, Switzerland, Denmark, Sweden	<50%	>50%

Conventions for avoiding double taxation were designed on the same structure. They include:

- the presentation of the purpose with which the convention was concluded, the definition of the terms used with a greater frequency than an article in the convention;
- drawing up the method of taxing income and capital gains as well as defining the methods for eliminating double taxation;
- special provisions against discrimination related to information exchanges, friendly procedures, cash assistance, diplomatic missions and consular posts, specifications on territorial extension

6. Classification of income and capital taxation

A classification of the taxation rules for income and capital can be made as follows:

1. *Income and capital gains taxed without limitation in the source country and the country of residence has no right to tax;*

This category includes: income from real estate, income from artists and athletes, income from a permanent establishment, remuneration received by members of the boards of directors, remuneration received by a resident with a residence in a country for work carried out in a another country.

2. *Income or earnings that may be subject to limited taxation in the source country and the country of residence must make a tax reduction;*

This category includes income from dividends, interest, commissions or royalties.

3. *Income or capital gains which can not be taxed in the source country but are taxed exclusively in the country of residence*

This category includes business profits such as international transport, capital gains, or student earnings.

Country Source is the country in whose territory the income or capital gains originated. More specifically, in the case of income generated by business, the source country is the one in whose territory the business is made, and in the investment return situation, the source country may be the country in which the payer is resident or the country in which the asset generating the assets is physically resident income

In order to avoid obstacles in the development of economic relations between states, it was necessary to create a legislative framework at national level through each country's legislation on taxation and international double taxation conventions so as to avoid the negative consequences of double taxation.

Creative accounting implies the use of the flexibility that exists in accounting rules or tax regulations to achieve some management goals. An other evolved form of manifestation of creative accounting techniques is represented by the tax havens because these involves that

companies' activity is transferred to a geographical location where tax pressure is minimized. states that are considered to be tax havens have very low taxes. Another example of creative accounting technique is the transfer of benefits to the company's headquarters in a low-tax country because it influences the outcome of the company in the country where the transfer was made, and so the financial statements of that company do not reflect the reality, do not show the productivity and the profitability. This is a reason why the profit margin should not be considered relevant. We conclude that there is a strong link between the existence of tax havens, the blurring of double taxation avoidance conventions and the application of creative accounting techniques.

Conventions for the avoidance of double taxation establish other tax rates applicable to income derived from dividends or other income categories obtained by individuals or companies with or without overseas residence.

The tax rate applied to paid dividends for non-residents is established by the conventions for the avoidance of double taxation which require or not a certificate of fiscal residence attesting to the category of beneficiary – individual or company.

Romania currently has 92 conventions to avoid double taxation with countries around the world. Germany was the first country with which such an agreement was signed and it entered into force on January 1, 1972. Of the conventions concluded - conventions with Austria, Belgium, Bosnia-Herzegovina, Bulgaria, Canada, China, United Arab Emirates, Finland, India, Italy, Germany, Morocco, the Netherlands, Pakistan, Syria - have been renegotiated over time.

7. Preliminary conclusions and perspectives

Besides the beneficial aspects generated by the globalization process also appeared negative aspects like internationalization of crime activities from the field of organized crimes. Under this context has grown the number of entities established in the fiscal paradises that had as purpose the facilitation of delocalization of taxable material, placing in a certain legality significant amounts of money whose origin was in essence a fraudulent one.

The continuous development and very ingenious of the mechanisms related to the operation of companies from off-shore territories offer a structured and organized character to the criminal activities from the area of «dirty business» and which have a very serious impact upon the «health condition» of the business environment.

The fiscal paradises are a “fertile land” for the handling of the tax base of the profit, by the use of intermediary transfer prices, having as supporting basis business transactions, that are, most of the time, simulated. The legality and morality of the techniques used in this meaning are debatable.

The business people involved in such actions named these procedures «modern methods of fiscal planning or management» in order to provide a higher standard of legitimacy to the fiscal paradises and to the off-shore companies.

These instruments like fiscal paradises are some creative accounting techniques, on global level, the final purpose being that of avoiding the payment of taxes and fees or to diminish their quantum.

As the other creative accounting techniques, the set-up of off-shore companies in a fiscal paradise observes the legal provisions, but the morality and correctness of this fact is debatable.

The terms “creative accounting, fiscal paradise, convention for the avoidance of double taxation, tax evasion” are closely related, one involving the other. More precisely, the fiscal paradise is creative accounting and with the conventions for the avoidance of double taxation they facilitate the legal tax evasion, on international level.

Their appearance are a consequence of the multitude of fiscal obligations imposed to tax payers who, burdened by the payment of these obligations resort to techniques to avoid them within the legitimacy limits.

The evolution of these methods of withdrawal from the payment of taxes and fees was continuously developed, they being the permanent result of the ingenuity of tax payers and accounting specialists. The impact of these phenomena lies on several environments, the fiscal fraud subject being analyzed by specialists in the legal, economic, journalism fields. It is often difficult to detect an escapist, even by the specialized control bodies.

The consequences of not finding them may have a negative impact upon the financiers of the assumed escapist and tax payer and therefore upon the bank providing the financing. The latter is exposed to a credit risk when it invests its money in a company less transparent from the point of view of the financial standing and from a reputation risk when its image is linked to that of a company found to be committing tax evasion.

Thus, the banks in general, and some in special, refuse to operate transactions with certain destinations and try to ensure the knowledge of the customers by introducing statutory declarations of the customers related to their tax evasion regardless if it is about a legal or natural person.

This way and by imposing the declaration of the source of funds and by producing supporting documents for transactions that exceed certain thresholds is intended the control of the money laundering phenomenon through banks.

The control measures are difficult, usually those who want to make money laundering start to know the procedural limits of the banks related to these inspections and also try to avoid them.

If up to a point there are numerous connections and implications between concepts, the delimitation of the creative accounting phenomena, the convention for the avoidance of double taxation, the tax evasion is a significant aspect, as well and sums up to the legitimacy which the first 2 notions involve and the lack of legitimacy in case of the latter.

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