Fiscal Risk in the Activity of a Company

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Abstract

Fiscal risk can arise in countries where the government applies a tax system that has only one purpose, to bring revenue to the budget. If a country wants to attract investors from other countries, it must apply a proper tax system, without high taxes, because those investors will be tempted to migrate to other countries with a more permissive tax system, perhaps even to those countries considered tax havens. In addition to all this, an important role in implementing a tax risk-free tax system is also globalisation. Nor should we forget inflation, which can occur and lead to a high tax risk, which can result in an erosion of the income of enterprises and a decrease in profitability. The objective of the paper is to highlight the tax risk to which an enterprise is subject in various situations (inflation, globalisation) and their effects.

Key words: fiscal risk, inflation, globalisation, revenue, expenses
J.E.L. classification: D24, G32, M41

1. Introduction

Fiscal risk represents the likelihood that a company could be disrupted by changes in tax legislation or adjustments to a government's fiscal approach. These changes may include variations in tax rates, the introduction of new taxes or the removal of specific tax incentives. In addition, fiscal risk can affect financial planning and business strategies. Companies need to remain vigilant to potential changes in tax laws and, in response, adjust their strategies to mitigate any adverse impact on profitability.

Investors and individuals must consider tax risk when making investment decisions and managing their investment portfolios. Changes in tax legislation can affect investment returns and may influence investment decisions.

It is therefore necessary to pay close attention to the fiscal environment and to the regulations that may have an impact on financial planning and decision-making, both in investment and in corporate management. Seeking advice from tax and financial experts is critical to gaining a clearer understanding of tax risks and potential strategies (Aivaz et *al*., 2023, 2070).

2. Theoretical background

2.1. Reasons for the emergence of fiscal risk

Tax risks may arise from a number of factors, which may vary depending on changes in tax laws, government policies and economic changes. Some of these factors include:

a) *legislative changes* – Changes in tax legislation can have a significant impact on companies. Governments may introduce new taxes, remove, or reduce tax incentives, adjust tax rates or change the rules on tax deductions. All of these changes can create uncertainty and affect existing tax strategies;

b) *economic instability* – The emergence of economic instability or financial crises may prompt governments to take fiscal measures to address these economic problems. Therefore, these measures may result in increased taxes or the implementation of other fiscal measures to raise additional revenue or to encourage certain economic behaviours;

c) *globalisation* – In a globalised economy, the fiscal policies of governments can be influenced by the fiscal policies of other countries, and thus the fiscal competition created by globalisation may lead governments to adjust their fiscal policies in order to remain competitive and attract foreign investment;

d) *unexpected economic developments* Periods of recession or faster-than-forecast economic growth can also lead to changes in the fiscal policy, and governments may respond by adjusting taxes or spending to manage the economic impact of these two factors;

e) *tax fraud and tax evasion* – An increase in tax fraud and evasion may lead governments to take a number of measures to counter these practices. These measures may include tax audits, the introduction of new economic and legal regulations, in particular a tightening of tax sanctions.

All these aspects only add to the complexity of the tax environment and create tax risks for taxpayers, especially companies (Brasoveanu, 2023, 88).

2.2. Fiscal risk generated by inflation

In addition to the previously mentioned elements that can create fiscal risk, inflation can also be a source of such risk. Thus, inflation can have a significant impact on fiscal risk, and the consequences can vary depending on how it affects the economy and fiscal policy. Below are some of the ways in which inflation can contribute to the fiscal risk:

1) *consumption power erosion* – Inflation leads to a general increase in the prices of goods and services, and this can implicitly erode the purchasing power of the currency, which can affect fiscal revenues. If inflation is not taken into account in the fiscal policy, budget revenues will be high in monetary terms but lower in real terms.;

2*) increase of fiscal costs* – The possibility previously mentioned arises because fixed costs, such as salaries, are included in the budget structure and these can increase due to inflation. The increase in expenditure can lead to budget deficits;

3) *the impact on public debt* – To cover deficits, governments borrow or issue bonds, and inflation can reduce the real value of the debt as the amounts owed remain constant even as the purchasing power of the currency declines. This is nothing more than a form of debt adjustment, which can also create risks related to confidence in government debt;

4) *fiscal policy adjustments* – As inflation rises, governments face the need to take measures to counter its effects on the economy and public finances, including changes in taxes and spending to maintain economic stability;

5) *tax revenue adjustment* – Inflation can lead to an increase in tax revenues, but this does not always translate into a real increase in purchasing power. Governments therefore need to manage this aspect carefully, as fiscal revenues are a consequence of raising taxes without actually achieving real income growth;

6) *the impact on the economic stabilisation policy* – It is well known that in times of high inflation, governments may take measures to reduce inflation, which may have fiscal consequences.

It is clear from these illustrations that inflation has the potential to create significant uncertainty and fiscal risks. In order to manage this situation effectively, it is crucial to implement fiscal policies that can respond flexibly to economic changes. Appropriate adjustments in fiscal policy play a crucial role in mitigating the fiscal risks associated with inflation (Brasoveanu, 2023, 55; Munteanu, 2021, 72).

2.3. Fiscal risk in the context of globalisation

Globalisation can lead to an intensification and amplification of fiscal risk, as companies operate in international markets and interact with different tax regimes. The following are some of the key aspects of tax risk in the context of globalisation:

a) *fiscal competition* – To attract foreign investment and capital, countries compete with each other by offering favourable tax regimes. This competition can lead to frequent changes in fiscal policy in order to maintain competitiveness. Companies wishing to enter different markets have to adapt firstly to the fiscal policies of these states and secondly to any subsequent fiscal changes that may occur;

b) *international tax planning* – Typically, multinational companies engage in multi-year budget planning to strategies their tax policies and maximise profits. This often results in the transfer of profits and activities to jurisdictions with more favourable tax regimes, posing challenges for the tax authorities in those jurisdictions to manage and regulate these practices, thereby creating tax risks;

c) *international tax treaty* – An increasing number of countries have entered into bilateral tax treaties to avoid double taxation and to establish rules for cross-border taxation. However, differing interpretations and legislative developments can lead to uncertainty and tax risks for companies and investors;

d) *transfer pricing regulations* – Transfer prices regulate transactions between the subsidiaries of a multinational company. Because of these transfer prices, tax authorities must monitor these transactions to ensure that they are conducted at market prices. If discrepancies are found, they can lead to tax disputes and even sanctions;

e) *changes in the international financial reporting* – International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Principles (US GAAP) may affect how tax liabilities are recognised and reported. These standards are subject to change and these changes may affect how investors perceive tax risk;

f) *anti-evasion rules* - At a global level, there are various initiatives aimed at combating tax evasion and aggressive tax planning. The emergence of regulations such as BEPS (Base Erosion and Profit Shifting) proposed by the OECD (Organisation for Economic Co-operation and Development) and others can have a significant impact on how companies manage their tax risk;

g) *complexity of compliance* – To meet the tax requirements of multiple jurisdictions, companies must devote significant resources to ensure compliance and successfully avoid the risks associated with non-compliance in multiple jurisdictions;

h) *monitoring legislative changes globally* – One of the effects of globalisation is that legislative changes in one country can have both direct and indirect effects on taxpayers and businesses in other countries. Continuous monitoring of legislative changes around the world is essential to anticipate and manage tax risks.

In the face of these challenges, strategic tax planning and collaboration with tax specialists are essential to manage tax risk in the context of globalisation and to ensure compliance with various tax regulations (Munteanu et *al*., 2023, 217).

3. Research methodology

In this scientific paper, the analytical research method was used.

The primary aim of the analytical method is to uncover relevant information about a particular topic. To achieve this, initially available data related to the subject were gathered. Once collected, this data was examined to test a hypothesis or support a particular idea.

The analytical method was used primarily to find supporting evidence for ongoing research, to make it more reliable or to form new ideas about the topic.

In the framework of this research, a review of the existing literature on the topic was used. Thus, in order to achieve this, data previously collected on the subject studied were reviewed.

One of the most important aspects of the analytical method of research is that its results are always subject to change as new data, or data on which new research is based, is obtained. This is true to a greater or lesser extent of all scientific methods, but it is particularly true of this one.

The problem is that while other tools, such as the experimental method, enable one to assert causality and thus obtain solid evidence about what causes a phenomenon, the analytical method does not. No matter how much data is available on the subject under investigation, it will always be incomplete (Rus, 2022, 1012).

4. Findings

Having presented the reasons for the emergence of fiscal risk and its manifestations in different situations, it is natural to outline some of the consequences of fiscal risk, consequences that can have a certain impact on companies and the economy:

- *reduction of profitability* – An increase in taxes or the introduction of new tax obligations can lead to a reduction in the profitability of companies due to a reduction in their revenues;
- *investment downturn*– Fiscal risk can lead to caution on the part of investors and companies regarding investments, and uncertainty about fiscal policy can discourage long-term investments and innovation;
- *reorientation of economic activities* – In the case of high tax risk, companies may be tempted to relocate their operations or headquarters to jurisdictions with more lenient tax regimes in order to find a more favourable tax environment;
- *affecting competitiveness* – Fiscal changes can play a crucial role in the competitiveness of a country or region, because if taxes become too high or the government's fiscal policy becomes uncompetitive for the business environment, companies may be inclined to move their activities to other countries or regions;
- *increase in tax evasion* – As noted above, high tax risk can lead companies to seek ways to avoid or reduce tax payments, which can lead to increased tax evasion. This can affect the overall tax collection rate;
- *fiscal litigation* – Changes in tax legislation can lead to disputes between taxpayers and government authorities. These disputes can result in significant costs and complicate the resolution of tax issues;
- *impact on financial markets* – Fiscal changes can have a significant impact on financial markets, as investors may react to these new regulations, causing significant fluctuations in the prices of stocks and other financial instruments;
- *decline in public confidence* – Frequent changes in fiscal policy, which may result in apparent fiscal injustice, can undermine taxpayers' confidence in government and the tax system it promotes, potentially leading to social and political discontent;
- *social and economic issues* – Fiscal risk can have social and economic consequences, such as increased poverty and inequality among individual or corporate taxpayers, if new fiscal policies adversely affect the more vulnerable segments of society;
- *the need for adaptation and compliance* – Businesses and individual taxpayers need to adapt to tax changes and ensure compliance with new rules, but this adaptation can be costly.

All of these consequences of tax risk indicate that it must be managed through careful planning and monitoring, which requires collaboration with tax and legal experts to minimise negative impacts and enable effective adaptation to any tax changes (Paraschiv & Stan, 2023, 176; Stan, 2019, 235).

5. Conclusions

Fiscal risk cannot be neglected, as it has implications and consequences ranging from changes in tax legislation to the adaptation of business activities in the face of globalisation, variable inflation and more.

For a business, it is crucial that tax rules do not create tax risk, as this can lead to the erosion of revenues and expenses, affecting the profitability of the business. Not all companies can relocate to countries with more permissive tax regimes.

At the same time, high fiscal risk can lead to tax fraud and evasion, which is undesirable for boh the company and the government.

Every government has the tools to implement a tax system that generates revenue for the budget through the tax system, but does not result in businesses paying new or higher taxes.

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