

## Underevaluation of the Taxable Base as a Result of Policies Aggressive Accountants Source Generator of Tax Fraud

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### Abstract

*All economists, regardless of doctrinal orientation, agree that information in general and accounting information in particular play a key role in economic action. The objectives of this paper were to present and clarify issues related to the underestimation of the tax base as a result of aggressive accounting policies generating tax fraud, concepts, evolution and trends in tax fraud in Romania. In order to identify the phenomena of fraud or tax evasion, based on the risk analysis, it was decided to use the econometric analysis. Accounting information is a topic frequently debated and analyzed in both academia and business, having a special relevance for its users, including for institutions authorized by the state that have the obligation to identify and combat the underground economy, especially evasion and of tax fraud.*

**Key words:** accounting information, accounting policies, tax base, tax fraud, evasion

**J.E.L. classification:** M21, M41, E62, E63

### 1. Introduction

Both from the evaluations of national and international bodies, and from public sources available, it turns out that tax fraud and evasion has spread in Romania, in particular in recent years.

The constant expansion of markets, the diversity and versatility of trade, the development of rapid methods of communication, in accordance with national legislation and imperfect or non-harmonized international, have favored the proliferation of fraud and tax evasion, with its consequences on the national economy.

In the first forms of manifestation, cases of fraud and tax evasion were generated especially from the misunderstanding of the specific legislation and its functioning mechanism, on the merits stimulating exports and imports, improving financial discipline, etc. But later, the phenomena of fraud and tax evasion escalated precisely as a result a good understanding of the specific legislation and the mechanism of operation, context in which subjects prone to this phenomenon have speculated on legal opportunities and imperfections VAT operating mechanism.

After the introduction of VAT in the national legislation, there were several important moments that they have marked an increase in fraud or tax evasion, but the moment was important 01.01.2007 Romania's accession to the European Union, moment from which the exchanges the country's trade prices have increased substantially, along with increasing population mobility.

But at the same time, the phenomenon of tax fraud and evasion has increased and expanded, amid diversification of possibilities to circumvent national and European tax legislation.

Looking back on the recent 30-year history of Romania's economy, we can say that the phenomenon of fraud and tax evasion manifested itself in both trivial forms (eg: double accounting

records, non-declaration of taxes / fees, forgery of documents supporting documents, etc.) as well as in complex forms (eg non-declaration of taxable activities, decapitalization of state-owned companies, simulation of export operations, etc.).

## **2. Literature review**

Groșanu A. (2013) concludes that -creative accounting- is the result the flexibility that exists between accounting regulations, and if they are applied correctly, allow/provide a accurate and complete picture of the financial position and performance of the entities economic.

A. Laffer (2004) on the relationship between the level of tax evasion and the rate taxation enunciated the theory that bears his name, according to which the increase of tax levies incites a little work (discourages certain activities) or, determines the masking of a part of the submitted activity and its transfer to the unofficial sphere.

Panayi (2007) highlights the high costs of running different businesses and implicitly a reducing the scope of profits associated with cross-border transactions.

Pestieau P. (1993), concludes that the volume of receipts should be higher, a higher mass of taxable income, even during the reduction of the tax rate.

Rust (2011) suggests that existing double taxation conventions at at the moment they cannot solve all the legal problems of international double taxation.

## **3. Research methodology**

In order to identify the phenomena of fraud or tax evasion, based on the risk analysis, it was decided to use the econometric analysis.

To carry out this study, the accounting information suggested as relevant according to the following scientific research models was selected:

- Modelul Beneish M-Score (scorul M);
- Modelul Piotroski F-Score (scorul F);
- Modelul Dechow-Dichev – Accumulation quality;
- Modelul Lev-Thiagarajan – the theory of the 12 signals.

We consider these analysis models to be feasible compared to the accounting information reported in the Financial Statements by Romanian taxpayers, so that starting from the accounting information and indicators suggested by these models we can identify anomalies in the periodic accounting reports.

## **4. Materials and methods**

### **4.1. Methods for determining tax fraud**

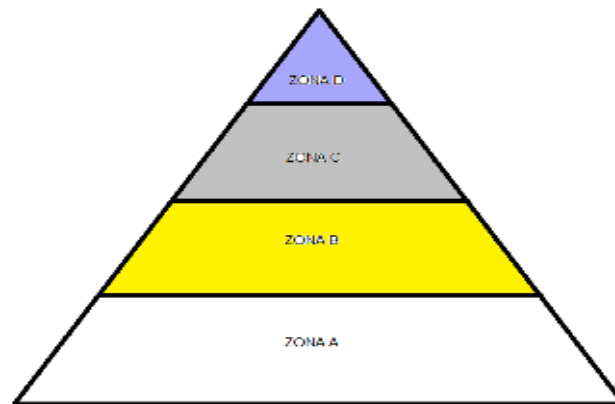
The most used methods of determination are:

- approximate methods, using economic and sociological tools through which wants to estimate the underground economy;
- the statistical methods that are elaborated starting from the statistics of the institutions empowered in combating the phenomenon of tax fraud or in the form of private investigations among certain professions.

But in choosing and selecting entities that may present a fiscal risk, it is important their fiscal history, as well as their behavior towards this phenomenon.

Thus, starting from the psychological behavior of the persons subject to taxation, to the fiscal risks of total or partial non-declaration of the fiscal activity/obligations or non-payment, in the following graph we can identify the following relevant areas:

Figure no. 1. Areas of action of fiscal risk depending on the behavior the taxable subject



Source: author processing

Starting from the hypothesis of an economic system that is not affected by economic crisis situations, according to the graphic presentation above, the psychological behavior of the people who do the object of taxation may be detailed as follows:

■ **area A:** where the majority of taxable persons are located, which determines and declares honestly the taxes and duties due to a state budget, and pays them with regularity at due dates. It is the area in which you want to locate any subject of taxation, and the associated tax risks - usually - are reduced:

■ **area B:** where taxable persons - usually - determine and declare honestly taxes and fees due to a state budget, but there are delays in payment within the due dates.

It is the area where you want to have an honest fiscal behavior from all points of view and - in my opinion - its support is needed to overcome the difficult moment (s), so as to be maintained on the market. Usually the associated tax risks - usually - are small or reduced;

■ **area C:** where the persons subject to taxation either determine and declare taxes and taxes due more or less undervalued, or often deliberately delay to pay them.

It is the area where the subject of taxation does not want a correct fiscal behavior and in in my opinion, it is necessary to -correct- or -correct- his attitude.

They usually create turbulence and distortion in the market, exemplifying with its fiscal behavior. In this area, subjects with associated fiscal risks are identified medium or large;

■ **area D:** where the persons subject to taxation do not determine, declare or pay taxes and fees due.

It is the area where the subject of taxation, intentionally, has an unfair tax behavior and in my opinion, it is necessary either to -correct- or -correct- his attitude, or to eliminate them from the economic system.

They create turbulence and distortions in the market, exemplifying with its behavior fiscal.

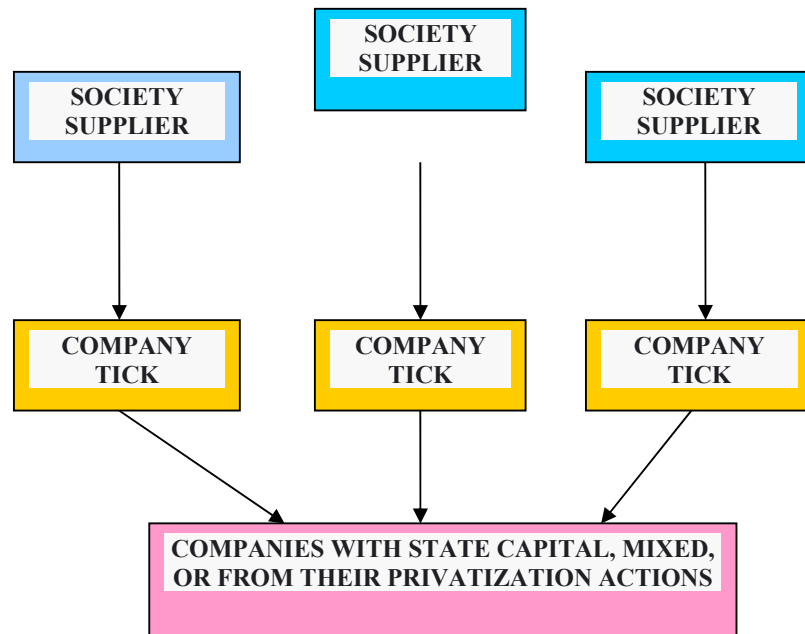
In this area, subjects with high associated fiscal risks are identified, who -activate- with security in the underground economy, generating cases of fraud and tax evasion.

Are subjects that significantly disrupt both the economic and the social system.

The main circumvention schemes involved intercalation in established economic circuits, traditional, of some companies with a dubious fiscal behavior, more precisely of some companies of type - phantom- or tick companies that have had or have the role of accumulating debts to the in return for the granting of unfair tax facilities to certain companies, usually beneficiaries of the goods or services that are the object of the transactions.

The insertion of some companies of type -phantom- or -tick- is presented schematically as follows:

Figure no. 2. The introduction of a tick company in the supply of a company



Source: author processing

Initially, the economic transactions were/are carried out directly on the supplier - beneficiary relationship, and the entities involved correctly and honestly reflect the transactions.

Then, out of a desire for immediate and untaxed gain, the people involved in these transactions have filed companies named in the literature as companies -phantom- or companies named – canteen.

#### 4.2. Underestimation of the tax base as a result of aggressive source accounting policies generating tax fraud

The manifestation of fraud and tax evasion, by underestimating the tax base consists, in mainly, in the intentional alteration of the supporting documents or the concealment of the records, financial and accounting purposes, with the aim of either overestimating expenditure or underestimating it income, all this to reduce the taxable amount, implicitly the tax obligations to the state budget.

The main forms of manifestation of tax evasion by underestimating the tax base are:

- incorrect registration in the supporting documents and in the accounting of the operations economic;
- destruction of financial - accounting supporting documents;
- organization of double accounting records;
- preparation of accounting balances with altered data;
- partial or total non-declaration of commercial activities or sources of taxation;
- preparation or alteration of documents reflecting import-export operations, etc.

The techniques of fraud and tax evasion, by underestimating the tax base, are manifested in connection with all tax obligations.

Cases of underestimation of the tax base are frequently identified in repeated transactions between two or more companies, operations -usually- without economic substance, companies where goods or services move randomly between partners, operations that are not followed by their settlement.

Theoretically, the tax base consists of the difference between the price of its goods the services which are the subject of the transactions and all the expenses which may be allocated to them, to which is added a profit margin.

But repeated transactions between companies make it impossible to clearly identify revenue and exactly, or the expenses can not be identified or allocated judiciously, which leads to distortion of the taxable mass, implicitly to the distortion of the tax burden of the entities involved in these transactions.

**Example:**

**1). on the underestimation of corporate income tax:** transactions in the nature of service between two affiliated entities, namely Company A based in Romania and the Company B (parent company) based in Germany. The share capital of the first Company is held by the second. Both companies are taxpayers in their countries of residence. Company A produces large series devices according to the specifications of various customers. Into the selling price of the devices includes production and design, brand, costs indirect.

Company B (coordinating company) performs management, marketing, design, and owns the trademark of the group of companies.

Company B invoices to Company A management, marketing, design services, but also services called -royalties- with significant values.

Analyzing these last services, it results that they are not clear and determinable, and from from a fiscal point of view, they decrease the reported profit in Romania of company A, explicitly profit tax.

**2). on the overestimation of the income tax of micro-enterprises:** Company A is affiliated with company B. Company A is a profit tax payer, company B is the payer of the micro-enterprise income tax.

Company A produces unique devices for various customers, according to their specifications.

Into the selling price of the devices includes both the design and execution of the products, Company B deals exclusively with design.

As a result of the tax optimization policy of the group of companies, company B invoices company A design the devices at increased prices so that company A obtains a low or diminished profit from the sale of devices.

As a consequence, company A is a small tax base for calculation profit tax, while company B constitutes a higher taxable income, but a whose tax rate is much lower.

**3). on undervaluation / undertaxing - value added tax:** Company A is owned by company B, the two companies having tax residence in countries different.

Company B transfers sums of money to Company A on the basis of loan agreements.

Company A provides building design services for various beneficiaries, and with the money received from company B, it carries out the project of a building in country A (its country of residence), for future own use by the Parent Company, but does not charge for the services of design to company B.

Thus, in the case of affiliates, the ability to conceal the provision of services between affiliates increases, in this case the absence of billing of services between affiliates producing a VAT damage to State A.

## **5. Discussion**

The cost efficiency of a multiple taxation can be severe, since the rates of nationally imposed taxes are sufficiently high or actually discourage the sea majority of international business, if applicable at the same time, for the same type of income.

By the presentation and the methods of avoidance by underestimating the taxable base, to which they appealed and appeals to people prone to these phenomena for non-payment of taxes or fees to the budget, or to justify the origin of goods from illicit sources, or from smuggling, or from clandestine domestic production, fraud has been highlighted.

The main schemes for evading the state budget involved interleaving in the circuits established, traditional economic conditions of some companies with a dubious fiscal behavior, May exactly of some companies of type -phantom- or companies -tick- that had or have the role of accumulating

debts to the state budget, in return for the granting of unfair fiscal facilities companies, usually beneficiaries of the goods or services that are the subject of transactions.

## 6. Conclusions

Summarizing what is described in this chapter, the main negative elements that favors tax fraud, are:

- unstable legislation, due to frequent changes, sometimes contradictory to the rules of work and even the basic principles that come to regulate a certain field of activity;
- the absence of specific regulations for certain activities or, on the contrary, the abundance regulations, having the same object;
- difficult procedures, with room for variable interpretations, at-handly -/- understanding- the operator or representatives of the authority;
- the existence of an arbitrary, exaggerated or, on the contrary, devoid of sanctioning system authority, etc.

Economic and psycho-social factors generating the phenomena of fraud and evasion fiscal are amplified, always by:

- confusing tax legislation, which creates imbalances between various areas of activity or which contains many legislative inaccuracies;
- excessive taxation, which always leads to the growth of the underground economy, implicitly to increasing the phenomenon of tax evasion and fraud;
- a burdensome and inefficient tax system, difficult for taxpayers to understand, leads by often to an indifferent attitude of the taxpayers, implicitly to the non-declaration by them a taxes or fees due, etc.

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