

Ghost Companies, Fiction or Reality?

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Abstract

In Romania the so called "ghost companies" are more often accused of tax evasion. Some of the "ghost companies" do exist but others don't really exist. The existing "ghost companies" and their shareholders are nowhere to be found and don't have employees. Companies that buy from "ghost companies" are accused that they do "fictitious operations" and account "fictitious expenses". Fictitious operations don't correspond to factual or legal reality and refer to imaginary operations, which in fact don't exist. Fictitious expenses aren't based on real operations and aren't based on totally or partially valid documents. "Ghost companies" are discovered applying the Law 656/2002 on money laundering, when reporting transactions higher than 15,000 EURO. Romanian and EU authorities find „ghost companies" when discovering differences between invoices accounted by suppliers and invoices accounted by buyers. Authorities should hold responsible only those who willingly are involved in tax evasion together with the "ghost companies".

Key words: ghost company, fictitious operation, fictitious expenses, tax evasion

J.E.L. classification: H25, H26, K40

1. Introduction

The researching of tax evasion cases in Romania shows that the concept of "ghost company" is more often used by Romanian authorities and appears on media. "Ghost companies" are accused of tax evasion together with the companies they do business with.

There are companies that purchase goods and services from other companies called "ghost companies" by authorities. Some of these companies are honest but others do business with "ghost companies" to pay less taxes or not to pay taxes at all. When knowingly buying from the so called "ghost companies" in order not to pay taxes is the most common form of tax evasion, that is through fictitious operations (Constantin, 2016, p.26).

Companies who buy from "ghost companies" are accused of tax evasion because authorities say they did „fictitious operations" and accounted „fictitious expenses" thus deducting VAT and expenses illegally. More often authorities try to recover prejudices from those who purchase from "ghost companies" without proving that they were involved in tax evasion.

The research directions that will follow will be about "ghost companies", "fictitious operations" and "fictitious expenses". These concepts are to be analyzed considering considering the Law 241/2005 on the prevention and fighting of tax evasion.

This work is to reveal the „ghost company" phenomenon, but also meanings for "fictitious operations" and "fictitious expenses". Ways of investigating and discovering „ghost companies" were researched also.

The results were obtained by researching several tax evasion cases investigated by Tax Authorities, police and prosecutors and came before a court of law. The main accusations of the studied cases were based on the fact that the accused companies were doing business with "ghost companies". Press articles on "ghost company" tax evasion were studied also.

2. Theoretical background. The “ghost company” phenomenon

As shown before, some of so called “ghost companies” do exist and are registered with the Trade Register but others do not really exist and are not registered with any authority.

The non-existing “ghost companies” are not registered with any Romanian Authority. These companies use forged documents, don’t pay any tax and don’t account anything. These “ghost companies” names are very close to existing ones who work legally and have legit businesses (Constantin, 2016, p.26).

The most common “ghost companies” are the existing ones. These companies apparently work legally, meaning that their shareholders are real persons and they really take part in the company’s foundation and registration with the Romanian authorities. They rent spaces for the official headquarter, they have bank accounts, issue invoices and have authorizations (Florescu *et al*, 2013, p.120). At first, some of these “ghost companies” work legally but in time they accumulate debts to the state budget.

These companies work in the underground economy. The high level of illegal economy is the result of the pure existence of this kind of companies (Florescu *et al*, 2013, p.119).

After a research of the Romanian legislation it was determined that a definition of the “ghost company” does not exist in any law, the term is not used by any law. However, the concept of “ghost company” is used by the Tax Authorities, police and prosecutors when investigating suspicious cases of tax evasion. The lack of any legislation regarding “ghost companies” and the lack of cooperation between state authorities have made these companies flourish. Romanian authorities accuse companies and people of tax evasion by using “ghost company” even though the term is not defined by any law. If we search for the term “ghost company” on the internet we find that press releases of the authorities in which the term is used are taken over by the press.

According to the Fiscal Antifraud Directorate General these “ghost companies” are not to be found at their official headquarter or anywhere else; don’t have any secondary headquarter; don’t have any employee to coordinate and carry out the business. The administrators and shareholders of the companies don’t have any declared revenues. As the “ghost companies” cannot be found at their official headquarter or anywhere else, they cannot be inspected by the authorities.

“Ghost companies” are used both for dodging taxes and for cheating business partners. At first these companies build a business relationship with their partners and win their trust. In time they accumulate big debts and cheat on their honest partners (Constantin, 2016, p.27).

Some shareholders of the “ghost companies” are not to be found, they are not the real shareholders, they are only intermediaries. Other shareholders are real but after the companies accumulate debts to the state budget, they sell them to people who cannot be found by the authorities.

So called “ghost companies” are used by other companies and their administrators to dissimulate, to hide some transactions and to misrepresentation taxes. “Ghost companies” provide fictitious origin for smuggling goods, clandestine produced goods or goods that actually don’t exist. They assume the role of beneficiaries of goods that are consumed on other markets or are sold on black markets. They provide fictitious goods and services for real customers for which they receive a fee. Thus “ghost companies” are used by tax dodgers to illegally deduct VAT and expense and not to pay VAT and profit tax. After they “buy” from the “ghost companies”, they dodge profit tax and VAT and they withdraw “black money”.

Based on the cases encountered it was determined that companies and their administrators who buy from “ghost companies” are very often accused of tax evasion through fictitious operations according to Article 9 (1) letter c) of the Law 241/2005 on the prevention and fighting of tax evasion. These accusations are based only on the fact that the accused companies and persons have purchased goods and/or services from “ghost companies”. It must be said again that some of the companies and their administrator are very honest and have no idea that the so called “ghost companies” commit fraud.

3. Fictitious operations and fictitious expenses

According with Article 9 (1) letter c) Law 241/2005 on the prevention and fighting of tax evasion, it is an offense *"the recording, in accounting documents or other legal documents, expenses that are not based on real operations or recording of other fictitious operations"*.

According with Article 2 letter f) Law 241/2005 on the prevention and fighting of tax evasion, the fictitious operations are *"the dissimulation of reality by creating the appearance of an operation that does not actually exist"*. The accounting of acquisition documents 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 illegal fiscal advantages (Constantin, 2016, p.27).

Charges of tax evasion that have been made and are still made, are based on the fact that the accused have made fictitious acquisitions and/or fictitious expenses. Because of this, the accused companies and their administrators appealed to the Constitutional Court of Romania (CCR) the fact that the fictitious operations and fictitious expenses were not defined properly by the Law 241/2005 and the article should be unconstitutional. The Court considered that it was necessary to provide more explanation for fictitious operations and fictitious expenses.

The fictitious acquisitions and fictitious expenses are not defined in any dedicated research. The scientific literature in the field of accounting or taxation does not define the two terms.

The Constitutional Court ruled, at point 25 of the decision no. 673/2016, that (...) *"recording unrealistic (fictitious) operations or expenses in official accounting or financial-fiscal documents is the activity in which records are made in these documents which are not based on totally or partially valid supporting documents."*

The Court also ruled, at point 35 of the same decision, that (...) *"in the case of the offense provided by Law 241/2005 Article 9 (1), letter c), its material element is to record in the accounting documents or other legal documents the expenses that are not based on real operations or the recording of other fictitious operations. In this context, the Court considers that the phrase "not based on real operations" refers to those operations that do not correspond to factual or legal reality, and "fictitious operations" refer to those imaginary operations, which in fact do not exist."*

The so called "ghost companies" are being set up and operating, although there are the sanctions provided by the law on "fictitious operations", the constitutional court has clarified the "fictitious operations" and the authorities are making considerable efforts to fight them.

4. Ways of discovering „ghost companies"

"Ghost companies" work in the illicit economy, where cash predominates. With the entry into force of the Law 656/2002 on the prevention and sanctioning of money laundering, part of the cash transactions of ghost companies, higher than 15,000 EURO (or the equivalent in lei), have been discovered. Any transaction higher than 15,000 EURO (or the equivalent in lei) is considered suspect transaction and must be reported to THE NATIONAL OFFICE FOR PREVENTION AND CONTROL OF MONEY LAUNDERING (THE OFFICE).

According to the law, all companies have the obligation to report to THE OFFICE cash transactions higher than 15,000 EURO (or the equivalent in lei). Banks have also the obligation to report to THE OFFICE transactions exceeding EUR 15,000 (or the equivalent in lei), cashing or payments, cash deposits or withdrawals. THE OFFICE must investigate and report to Tax Authorities, police or prosecutors if any illegal transaction is discovered.

In this way, the mystery of the banking secrecy being lifted, the illegal business of these "ghost companies" began to appear on the surface.

Another way to discover „ghost companies" is through differences on „394 Statements". In accordance with Article 59 (2) of Law no. 207/2015 on the Tax Procedure Code, companies must periodically provide tax authorities with information about their business. According with the Order no. 3769/2015 and Order no. 2328/2016, "394 Statement" is the "Information Statement on deliveries/services provided and acquisitions within the national territory". All companies that are VAT registered must fill in the "394 Statement" and submit it to the Tax Authorities.

The role of this informative statement is for the authorities to make a direct correspondence at national level between invoices issued and accounted by suppliers and the same invoices received and accounted by buyers. The scope of "394 Statement" is to prevent and fight tax evasion. The differences discovered by the authorities are firstly notified directly to the companies for rectification, and if the differences are maintained, a tax investigation is carried out. If there is a difference between what the supplier registered and what the buyer registered, investigations are initiated to determine the causes. Most of the time, "ghost companies" do not record anything in the 394 statement and so are discovered.

According to the European Commission, VAT registered companies making the intra-Community supplies must report the total supplies (of good and/or services) to each company (that also is VAT registered) in another Member State on a VIES recapitulative statement which is submitted to the tax authorities of the company making the supply. The VAT Information Exchange System (VIES) is an electronic mean of validating VAT numbers of companies in the EU Member States for cross border transactions on goods or services.

In Romania the VIES recapitulative statement is governed by Article 325 of the Tax Code. According with the Order no. 591/2016 and Order no. 592/2017, "VIES Statement" is the "390 Recapitulative statement on intra-Community supplies / acquisitions / provided services".

The role of this recapitulative statement is for the EU authorities to make a direct correspondence at EU level between invoices issued and accounted by suppliers and the same invoices received and accounted by buyers. The scope of "VIES Statement" is to prevent and fight tax evasion. The differences discovered by the EU authorities, tax investigations are carried out. If there is a difference between what the supplier registered and what the buyer registered, investigations are initiated to determine the causes. Most of the time, "ghost companies" in Romania do not record anything in the VIES statement and so are discovered.

As seen authorities have ways and means to investigating and discovering „ghost companies”. All they need is will and cooperation.

5. Conclusions

Because of "ghost companies", vast amounts of money go untaxed and to the underground economy, so the state doesn't get the financial resources to fulfil its obligations.

When authorities discover that a company does not declare and pay its taxes, that a company is involved in a tax evasion case and is considered to be a "ghost company", then they must recover the tax debt from that „ghost company". Authorities cannot hold any company responsible because it's business partner is considered to be a "ghost company" is involved in tax evasion. Any tax damage must be recovered from those proven to be guilty of tax evasion and not from those they did business with.

The applicability of the research is in the accounting and fiscal practice for better understanding the concepts of "ghost companies", "fictitious operations", "fictitious expenses". This work could be used both by honest companies to protect themselves from the abuses of the authorities and from "ghost companies", and by the Romanian authorities for better understanding of the "ghost companies" and to protect the honest ones. Authorities may take measures for informing honest companies about the so called "ghost companies" and for eradicating them. Authorities may learn about investigating and discovering "ghost companies". A better cooperation between authorities is needed.

Nobody can be accused of tax evasion based on the concept of "ghost company", the concept that don't exist in any law, so the authorities must make changes in the law to define the concept or stop using it.

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