

Considerations Regarding Tax Evasion and Its Implications

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Abstract

The main objective of this research article is to provide a well-founded framework regarding the concept of tax exemption and its various implications. This research article includes both a complex theoretical part, but also an empirical part based on descriptive statistics regarding the member states of the European Union. Although there are various opinions and points of view in the literature, a generally accepted conceptual approach for tax evasion has not yet been established. The shadow or underground economy is an essential factor in perpetuating the tax evasion. Fiscal regulatory bodies and tax authorities represents levers of legal intervention in combating tax evasion.

Key words: tax evasion, tax avoidance, hidden economy, taxpayers, fiscal pressure

J.E.L. classification: E62, F43

1. Introduction

Tax evasion and fiscal fraud can be much easier to detect within a national tax system, but internationally this is much more difficult to identify. Also, the legal or illegal nature of the means used to carry out the transfer of taxable matter from one state to another implies the existence of both a reference system and a system of criteria in making this assessment. At the international level, no such reference system is recognized, which generates a convergent attitude between the negative phenomenon of tax evasion and international fraud. Moreover, international cooperation indeed plays a very important role in combating these illegal phenomena.

The specific activities of tax evasion are aimed at the deduction from the payment of taxes and fees by certain economic agents based on the non-declaration or false declaration of taxable income. Tax evasion is more difficult to obtain with regard to indirect taxes, as compared to the case of tax applied on profit (standard profit tax) or income tax. From an economic and social perspective, tax evasion has important consequences for society as a whole. Prejudice regarding tax compliance also counts for employment models, as they affect the difference between regular and irregular work, but are relevant only if tax evasion is quite widespread.

The hidden economy or underground economy represents an essential element in ensuring the propagation of the negative effects of tax evasion. However, with regard to risk management, it is obvious that tax evasion is an illicit activity that involves numerous risks. On the other hand, tax evasion must also be perceived as a negative behavior chosen by the regular taxpayer. Certainly, tax authorities have a major responsibility in combating tax evasion. Bejaković (2015) argued that hidden economy includes various activities such as that particular form of production of goods and services that has legal forms but is not declared, but also that production of not legal goods and services.

2. Literature review

Although there is a broad literature on tax evasion and its effects, there is still no generally accepted definition. Tax evasion is defined as representing the way in which economic subjects respond to fiscal pressure based on the related taxation, such as: income, wealth, sales, etc. (Dinga, 2008). Maji (2017) provided an elaborate definition of the phenomenon of tax evasion by using an

interdisciplinary approach referring to certain forms of misinterpretation or concealment of the real financial situation to the fiscal authorities and legal tax inspectors.

Păcurari (2013) formulated a definition of tax evasion considering the taxpayer's behaviour, such as : "intended total or partial lack of compliance with tax obligations based on evading tax obligations altogether or dealing with them fraudulently with the purpose of reducing the amounts payable to the state budget".

In most countries of the world, the implementation of fiscal policies to reduce tax evasion has not reached a satisfactory level in the last decades, so that this phenomenon can be reduced to a reasonable level. In the specialized literature, the issue of tax evasion has been debated over time, because it is a topic of great interest. There are many ways of combating this economic-social scourge but the actual implementation involves many aspects. Zai (2014) has identified certain causes that led to tax evasion such as the lacunarity, but also the inconsistent and permissive character of the law which negatively influences the tax payer's behavior. Tax evasion is a threat to the process of collecting budget revenues, and the application of this phenomenon becomes widespread, because, in the absence of measures to prevent and combat tax evasion, it negatively affects economic stability. It should also be mentioned that reducing tax evasion can be achieved by educating taxpayers on the importance of paying tax debts, but also by developing systems and procedures that can detect this phenomenon in time and eliminate tax fraud (Pătrașc and Șerban Boiceanu , 2012).

Ferrer-i-Carbonell and Gërkhani (2016) have conducted an empirical study using a subjective measure of satisfaction (individual well-being) in 14 countries in Central and Eastern Europe and have identified on average a negative relationship between tax evasion and life satisfaction. However, this relationship has shown a clear heterogeneity between individuals, which is distinguished by their experience in the social and institutional context. However, such an inconvenience is due to a particular social and institutional context in which the subjects are analyzed plays an important role in mediating this negative relationship. The focus on the role of the social and institutional context is particularly relevant in these countries of Central and Eastern Europe, as they have undergone profound changes at the social, economic and institutional level. The authors of the study also showed that this negative relationship becomes positive for the people who have access and financially support the associations of the "looking for tenants" type. However, with regard to institutional factors, the empirical results indicated that people who believe that the government does a good job in providing public services, have developed a negative relationship between tax evasion and life satisfaction.

Williams and Franic (2016) support the strong association between participation in undeclared work and fiscal morality, as well as the need to focus on a policy approach that aims to improve fiscal morality by creating greater symmetry between formal and informal institutions. This involves significant efforts to generate a culture of taxpayer compliance. This clearly requires a fundamental restructuring of the formal institutions of the society and, above all, the fact that the ruling classes are the main tax evasionists who use legal schemes to avoid taxes, but which are not considered legitimate in the eyes of the citizens.

On the contrary, Dell'Anno (2009) argued that in certain circumstances tax evasion is ethical like the case when the local government is corrupt or does not use the public financial resources for the benefit of the citizens of the country. Moreover, Lorenz and Diller (2015) mentioned that if tax avoidance represents a prerequisite for tax evasion phenomenon then a certain algorithm must be applied that aims considering that if the total percentage of tax evaders has the possibility to increase if a higher percentage of possible taxpayers avoid paying taxes due to the increase of another tax.

Slemrod (2007) have conducted an empirical research study on U.S. federal taxes and concluded that deterrence represents a significant factor in evasion decisions considering the behavioral dynamics with respect to dutifulness and honesty which determines the evasion heterogeneity across-individual and across-country.

Schneider, Raczkowski and Mróz (2015) investigated the linkage between shadow economy and tax evasion in the European Union (EU) and concluded that the most significant pillars of the shadow economy are indirect taxes, self-employment and unemployment, while excessive interference in budget policy of given member state can have very harmful effects in certain

conditions.

Murray (1997) have conducted an interesting research study now more than two decades but with the same practical applicability regarding the impact of state and local sales tax, considering that individuals have the following legal alternatives to reduce tax liabilities, ie : change spending patterns toward favorably taxed items, make purchases and pay sales tax in low-tax jurisdictions, choose one's location of residency in a low-tax region, and self-provide otherwise sales-taxable goods and services. On the other hand, Roberts, Hite and Bradley (1994) have highlighted the fact that ordinary citizens tend to have difficulties in properly understanding the concepts of flat and progressive tax systems. Hofmann, et. al (2008) highlighted essential aspects regarding certain effective measures such as audits and fines which are useful in reducing tax avoidance. On the other hand, Feige (1990) examined sensitive topics such as shadow, underground, gray or otherwise known economy and revealed the importance of transformation sets and transaction costs.

3. Research methodology

The research methodology is based on descriptive statistics techniques. Moreover, this research paper includes both qualitative and also quantitative methods in order to provide a comprehensive analysis regarding tax evasion and its various implications. However, this research article is primarily a literature survey on tax evasion.

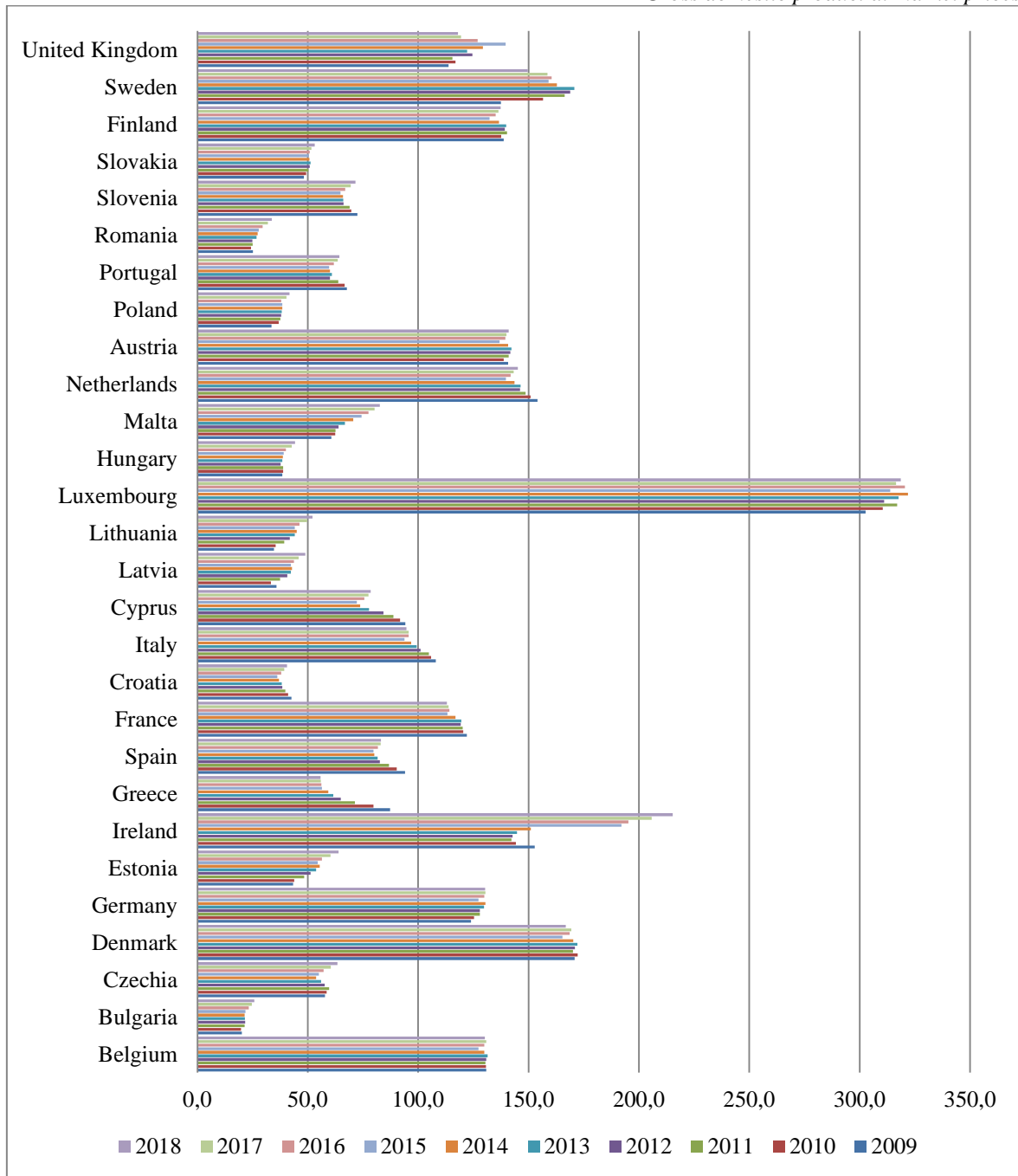
Furthermore is relevant for the research purpose to highlight that the Organisation for Economic Co-operation and Development (OECD) has made significant contributions to the foundation of international strategies to combat tax evasion. The OECD and G-20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) provided a so-called Action Plan focused on 15 main actions regarding tax planning strategies, such as:

- Action 1 "Digital economy" (Horizontal)
- Action 2 "Neutralise the effects of hybrid mismatch arrangements" (Coherence)
- Action 3 "Strengthen CFC rules" (Coherence)
- Action 4 "Limit interest deductibility" (Coherence)
- Action 5 – 1st component – "Preferential tax regimes" (Substance)
- Action 5 – 2nd component – "Exchange of information on tax rulings" (Transparency)
- Action 6 "Prevent treaty abuse" (Substance)
- Action 7 "Prevent the artificial avoidance of PE status" (Substance)
- Actions 8-10 "Aligning transfer pricing outcomes with value creation (Substance) :
 - Intangibles
 - Risk and capital
 - Other high-risk transactions
- Action 11 "Data analysis" (Transparency)
- Action 12 "Mandatory disclosure rules" (Transparency)
- Action 13 "Re-examine transfer pricing documentation" (Transparency)
- Action 14 "Dispute resolution" (Transparency)
- Action 15 "Multilateral instrument" (Horizontal)

4. Findings and empirical results

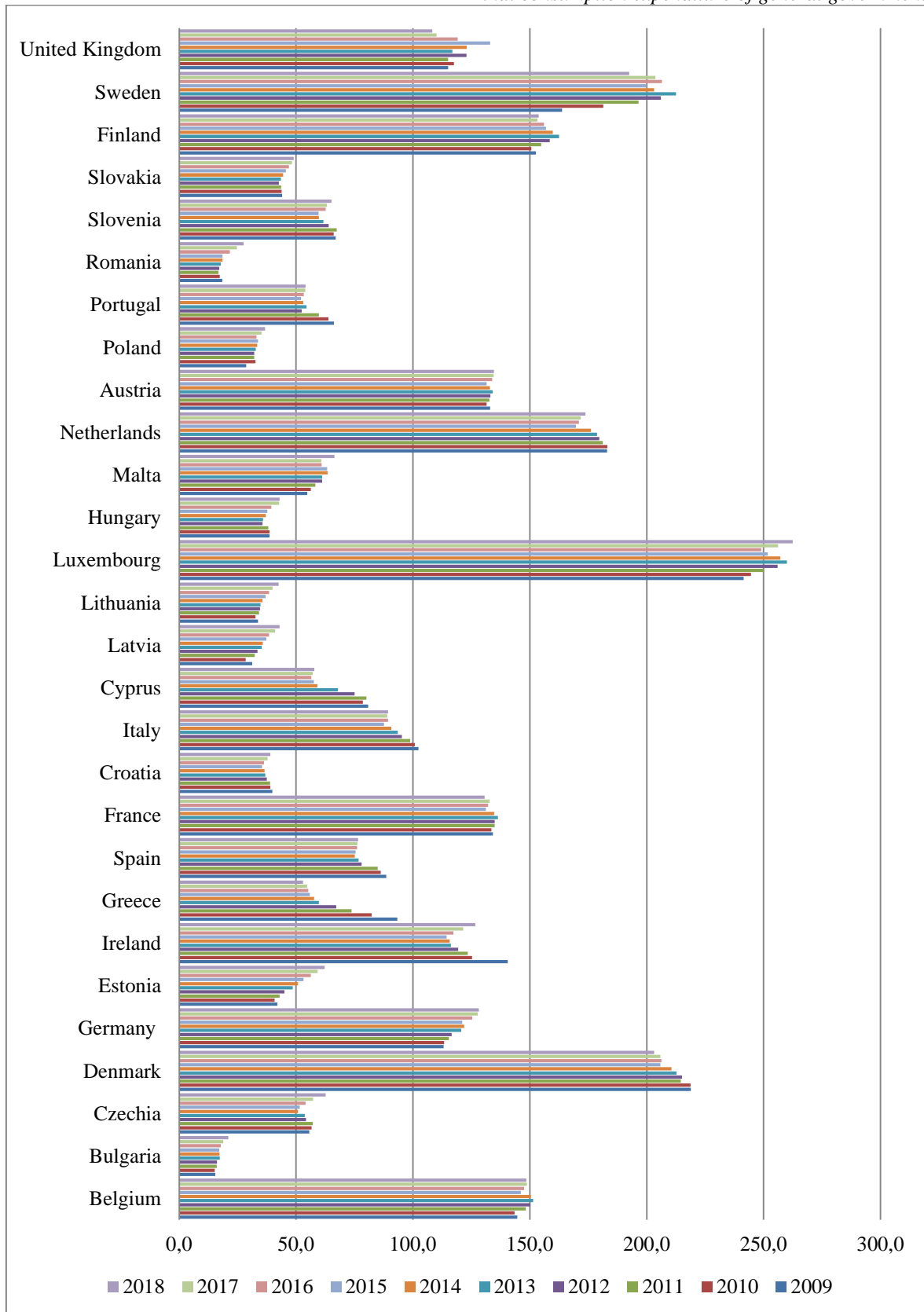
The empirical results are relevant to the research objective and focus on the member states of the European Union, ie Belgium, Bulgaria, Czech Republic, Denmark, Germany, Estonia, Ireland, Greece, Spain, France, Croatia, Italy, Cyprus, Latvia, Lithuania, Luxembourg, Hungary, Malta, Netherlands, Austria, Poland, Portugal, Romania, Slovenia, Slovakia, Finland, Sweden, United Kingdom (before BREXIT). The following figures highlight the real state of the economies of the European countries.

Figure no.1 Percentage of EU28 total per capita (based on million euro), current prices
 Gross domestic product at market prices



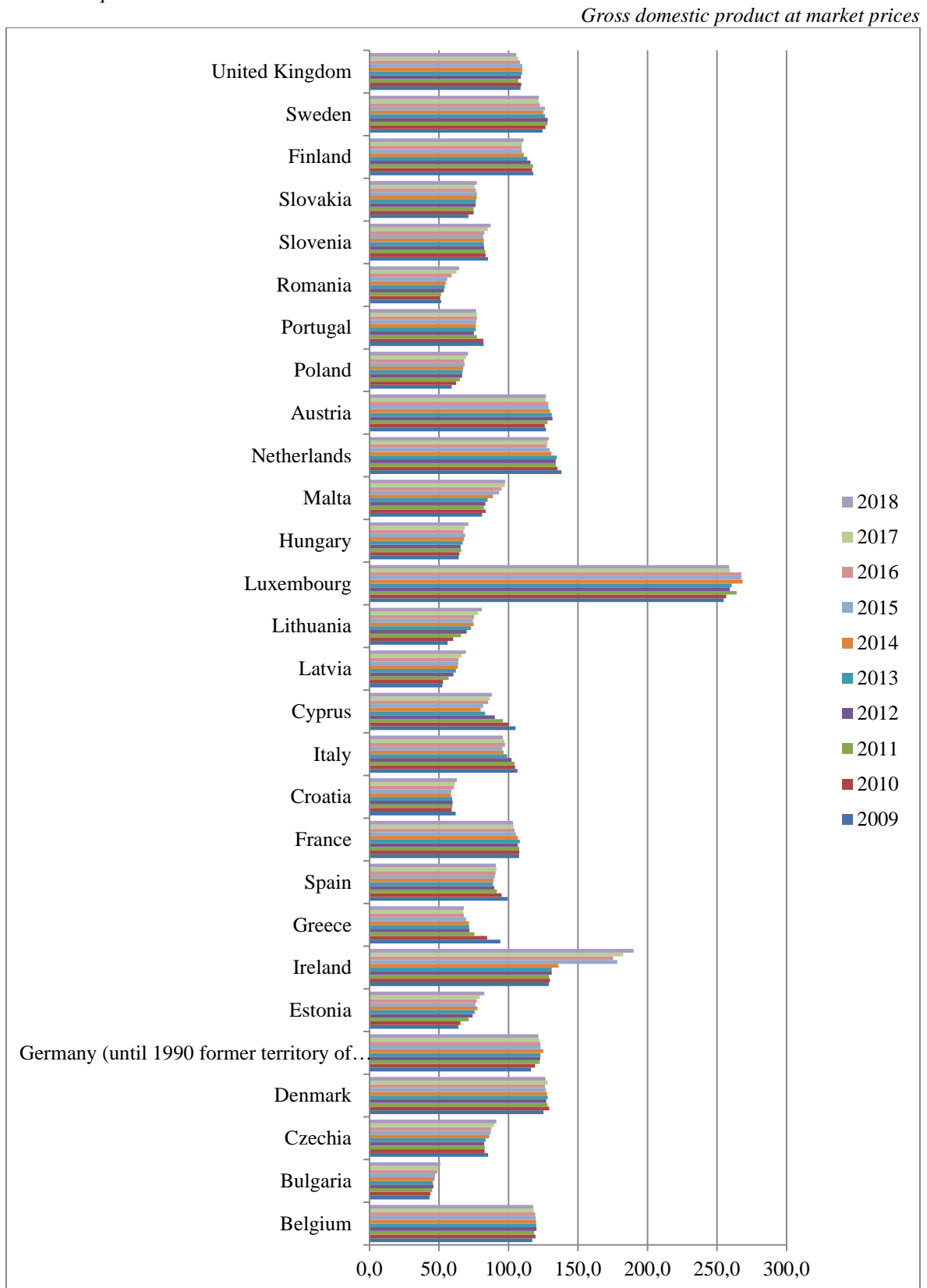
Source : Author's computations based on the primary data provided by EUROSTAT

Figure no.2 Percentage of EU28 total per capita (based on million euro), current prices
 Final consumption expenditure of general government



Source: Author's computations based on the primary data provided by EUROSTAT

Figure no. 3 Percentage of EU28 total per capita (based on million purchasing power standards), current prices



Source: Author's computations based on the primary data provided by EUROSTAT

The following graphical figure represents evolution of tax revenue as percentage of GDP (%) in Central Europe and the Baltics for the period 1994-2017. The so-called group of Central Europe and the Baltics includes the following countries Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland,, Romania, Slovak Republic, and Slovenia.

Figure no.4 The evolution of tax revenue as percentage of GDP (%) in Central Europe and the Baltics for the period 1994-2017



Source: Author's computations based on the primary data provided by World Bank, International Monetary Fund and OECD

5. Conclusions

Tax evasion is a phenomenon with negative implications on economic growth and the standard of living. Also, the tax evasion contributes to reducing the degree of collecting the budgetary incomes and implicitly to the increase of the poverty level. Tax evasion has a direct causal linkage with the level of corruption of a country. Tax authorities and the other specialized agencies have a major responsibility in implementing effective strategies to combat tax evasion. Tax transparency has a certain contribution in the positive influence on the voluntary compliance behavior of the taxpayers, especially in the case of developing countries. The tax optimization is very important. Moreover, policymakers should ensure a stable and predictable legislative framework regarding tax evasion. For instance, Caraus et. al (2016) suggested that an optimal measure to combat tax evasion implies an efficient reduction of bureaucracy, an improvement of the IT platforms used in the fiscal inspection process and an improved implementation of risk analysis. However, a sustainable strategy to combat tax evasion should be based on efficient measures of socio-economic policy.

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