

THE AMPLITUDE OF TAX EVASION AFFECTS FAIR COMPETITION

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Winning likes no competition

Publius Syrus (fl. 85–43 BC), was a [Latin](#) writer of [sententiae](#).

He was a [Syrian](#) who was brought as a slave to [Italy](#), but by his wit and talent he won the favour of his master, who freed and educated him.

Abstract:

The article highlights the importance of the fight against tax evasion; it has reached an alarming level in Romania, thus affecting the competitive environment. Most of the consumer goods are to be produced or reproduced, which involves a series of costs: using energy, the human resource for the work provided, etc. Therefore the producers of these goods are to regularly obtain the means which allow them to produce the goods. This is where two fundamental mechanisms become relevant: commercial payments and taxes. People pay in both cases, but there two different situations. The commercial payment is done by the buyer, namely the person purchasing a product or a service for which one pays a price. In this case, producers can manage their business based on self-financing, which means they can cover at least the production costs from selling the goods produced; thus the continuation and development of their activity is motivated. The sales volume defines the dimensions of their activity. If there are producers among them who do not pay the taxes established by the state, and that amount is not paid to the budget and is used to finance the business, it represents an unequal and unfair encounter with the honest producers. We shall present ways which can contribute to the diminishing of tax evasion in Romania.

Keywords: *tax evasion, underground economy, corruption, competition, market.*

1. Introduction

Tax evasion is a negative phenomenon affecting the state budget, considering that part of the resources do not reach it and spending should be reduced; thus the public functions and services are limited, even if they should be provided by the state during its development towards raising living standards.

Tax evasion is especially harmful to the economy as its size increases, since it represents a factor of spreading the feeling that "one can do without paying taxes". Unless strict measures are taken to limit this phenomenon, the consequences are severe and continuously generate its expansion. This approach enhances incorrect behaviour according to which "if others do not pay, why should I pay?"

This behaviour occurs along with other issues when individual incomes are generally low, when companies hide part of their business; however they also occur in developed economies, in a globalized economy, by hiding transactions.

In case of low incomes, people talk of labour tax evasion, illegal employment; it is usually used when either the legislative system is not sufficiently developed to cover all areas of activity to be identified and taxed, or when audits are not carried out properly. This phenomenon is serious considering that individuals who engage in such activities do not pay social insurance, health insurance, employment related taxes. This has negative consequences, especially for those individuals, as they cannot prove they have constant income under contracts or employment relationships legally binding and they cannot benefit from adequate social and health assistance; it usually has negative consequences to the state, which cannot protect them from employers' abuses regarding working hours, wage levels. Such behaviours put the individuals in a position of being slaves of precarious living standards; even if they have high income, they have limited access to bank financing for purchasing housing or long-term goods, so that their development is endangered. Moreover, if they obtain higher incomes,

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they cannot prove their origin and they can be seized; besides they are exposed to developing illegal activities.

Tax evasion also manifests within companies, business in general, by carrying out activities hidden from the normal process of taxation, which can be carried out only by people who cannot be legally employed and which can be subject to abuses.

The phenomenon is very serious in this case as well; not only are there people employed without paying taxes for the work used, but, even more, no taxes are paid to the state budget for the entire activity or business. In these cases tax evasion is much higher, and the budget lacks larger or even significant amounts. In these cases the causes generally are: ineffective legislation, with too many changes, but also superficial audits.

However there are more consequences of tax evasion. Areas in which tax evasion is present are numerous: trade, construction, agriculture, tourism.

Tax evasion and even tax fraud are phenomena threatening the correct, loyal competitive environment; confrontation is unequal and in most cases the result of confrontation is a vicious one.

2. The impact of tax evasion

The impact of tax evasion has serious consequences which are internationally recognized as governance and implementation of public policies are affected.

Fighting tax evasion is a must, as illicit financial flows (IFFs), specifically all capital outflow from the private sector which are not registered and involve acquired, transferred or illicitly used funds, are typically generated by legal and illegal tax evasion such as: incorrect determination of transfer prices, notwithstanding the principle that taxes should be applied where profits are obtained and whereas tax evasion and circumvention duties have been identified in all the main texts and international conferences on development financing as the major obstacles to domestic revenue mobilization for development.

According to estimates made by experts and international organizations based on the report issued by Global Financial Integrity in 2014¹, the combined volume of foreign direct investment (FDI) and official development assistance (ODA) in 2003-2012 is slightly lower than the volume of illegal capital outputs. At the same time the FFI volume is about ten times higher than the total amount of funds for the emerging countries which should aim at eradicating poverty and reaching welfare and sustainable development; according to estimates, it represents an illicit annual leak of USD 1,000 billion for the developing countries.

The existence of appreciable size informal sectors in the economies of developing countries makes taxation of general revenue almost impossible; a significant proportion of GDP is not taxable in the countries where much of the population lives in poverty, which is adverse also on budget and performance of public policies.

In the emerging countries, government revenue from corporate taxation constitutes a major proportion, combined with the fact that in the recent years the developing countries applied progressive reduction of tax rates to companies, which are particularly affected by tax evasion manifested by companies eluding taxes.

A very important role is represented by tax havens and secrecy jurisdictions allowing banking and financial information secrecy, combined with regimes applying "zero" tax to attract capital and revenues that should have been taxed in other countries, which generate harmful tax competition, undermine the equity of fiscal regime and distort trade and investment, particularly affecting developing countries, which causes annual losses of tax revenue estimated at 189 billion dollars.

¹ <http://www.gfintegrity.org/wp-content/uploads/2014/12/Illicit-Financial-Flows-from-Developing-Countries-2003-2012.pdf>

Economic and financial globalization and the current international context of trade liberalization and gradual elimination of trade barriers in the recent decades has intensified cross-border marketing of goods and services; it also caused difficulties for the emerging countries that depend heavily on trade taxes, especially the least developed countries, which are forced to compensate the decline in trade taxes and to turn to other types of domestic resources, especially a well-balanced mix of taxes.

Because taxes can remain reliable and sustainable source to finance development and provide stability compared to the traditional mechanisms for development financing such as concessional loans only if there is an honest, well-balanced, efficient and transparent tax regime, an effective administration to promote tax compliance, and government revenues are used transparently and responsibly.

Substantial obstacles faced by emerging countries from political, legislative, administrative, technical and legal view in raising tax revenues, the insufficient human and financial resources to collect taxes and the weak administrative capacity make it difficult to collect taxes from transnational businesses, as well as the lack of tax collection infrastructure, the exodus of qualified personnel from tax administration, corruption, lack of legitimacy of the political system for not taking part in international cooperation in tax matters, uneven distribution of income and faulty fiscal governance.

All these and many more contribute in a diverse manner to the uneven confrontation in a vitiated competition between companies; some choose unfair practices such as not paying taxes, creating an environment that is not auspicious to harmonious development, using the available resources in an inadequate way, highlighted by a flawed governance.

3. Tax evasion in Romania

The fight against illicit tax evasion is essential to ensure a greater degree of fairness and economic efficiency both at the international, European and national level. Unlike illegal tax evasion which is illegal, lawful tax evasion normally falls within the law. However, several forms of lawful tax evasion do not meet the spirit of the law, forcing the interpretation of what is "legal" in order to minimize the overall tax contribution of a company.

Through aggressive tax planning techniques, some companies exploit legal loopholes of the tax systems and the inconsistencies between the national regulations to avoid paying taxes due. In addition, tax systems in many countries allow companies to artificially transfer their profits to those jurisdictions; the effect of this practice is to encourage aggressive tax planning. The fair distribution of responsibilities between taxpayers, fair competition between companies and equitable collection between Member States of income taxes legitimately due to them are undermined through such activities. Fiscal policy is determined mainly nationally.

However, to ensure fairer taxation and to support the principle that taxation should reflect where the economic activity is performed, it is necessary to intensify the present efforts to combat illicit and licit tax evasion on the domestic market. Besides the necessary efforts from the member states to simplify and improve the effectiveness of the tax system, transparency in this area is crucial to achieving these objectives.

The extent of tax evasion shows how the state is involved at some point in diminishing this phenomenon.

The level of tax evasion in Romania can be appreciated as very high only if it reaches about 16% of GDP, according to calculations of the Fiscal Council in Romania.

Such a high level of tax evasion in 2013 is mainly that of the value added tax (12.21% of GDP), but also of the work related social insurance contributions (2.43% of GDP).

VAT tax evasion is the difference between the theoretical VAT default value of the economic activity, including the unobserved economy and the VAT revenue collected by the state on ESA95 methodology. This VAT tax evasion measure is not necessarily the exclusive

result of tax evasion, which may be explained by other causes such as: legitimate practices of VAT evasion, the company becomes insolvent, leading to a reduction in VAT collected receivables to the State and the accuracy of national accounts data, on which VAT is theoretically estimated.

The evolution on a 10 year sample had an increasing trend as seen in the chart below:

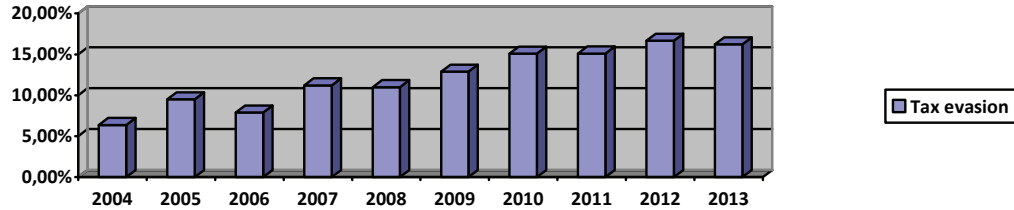


Figure 1 Chart on tax evasion in Romania

Tax evasion in 2013, the last analyzed year, is mainly VAT evasion (12.21% of GDP), followed by tax evasion in social security contributions (2.43%), then by income tax (0.76% of GDP), as shown in Annex 1 and in the chart below:

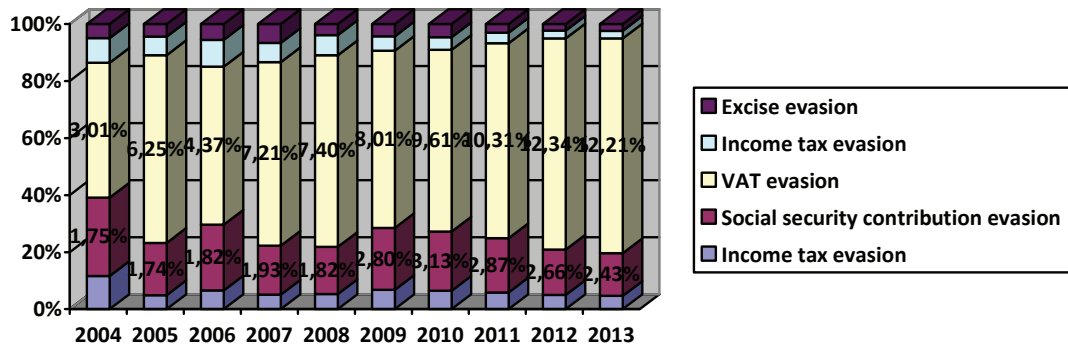


Figure 2 Chart on the main components of tax evasion in Romania¹

4. Conclusions and recommendations

Tax evasion keeps investors away from Romania, by the fact that the tax system is generally slow and there are political, legislative, administrative, technical and legal obstacles in collecting tax revenues.

At the same time there is a weak administrative ability in setting and raising tax revenues from transnational companies, the insufficient infrastructure to collect taxes, the exodus of qualified personnel from tax administration, corruption, lack of legitimacy of the political system, uneven distribution of income and the damage of the competitive environment for companies and faulty fiscal governance.

Recommendations on reducing tax evasion:

- **ensure fiscal stability** namely establishing one period within a year for amending taxes;
- **simplify and reduce or merge the level of taxes** and group them to be accessible to the taxpayer;
- **reduce and improve the fiscal transition to increased use of electronic media** so as to establish, monitor, pay and verify taxes including:
 - electronically establish and fill in statements on taxes and fees;

¹ <http://www.consiliulfiscal.ro/ra-2013.pdf>

- electronic payment system;
- electronic check the tax status of taxpayers.

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Tax evasion in Romania during a 10 year period

% of GDP	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Tax evasion from illegal labour	1,73%	1,57%	1,71%	1,84%	1,74%	2,92%	3,18%	3,14%	2,89%	2,61%
- income tax	0,51%	0,34%	0,38%	0,42%	0,42%	0,69%	0,75%	0,74%	0,69%	0,62%
- social security contribution	1,21%	1,24%	1,33%	1,42%	1,32%	2,23%	2,43%	2,40%	2,21%	1,99%
Tax evasion in the informal sector (population)	0,76%	0,64%	0,63%	0,66%	0,66%	0,75%	0,92%	0,62%	0,60%	0,58%
- income tax	0,23%	0,14%	0,14%	0,15%	0,16%	0,18%	0,22%	0,15%	0,14%	0,14%
- social security contribution	0,53%	0,51%	0,49%	0,51%	0,50%	0,57%	0,70%	0,47%	0,46%	0,44%
Income tax total evasion	0,74%	0,47%	0,52%	0,57%	0,58%	0,87%	0,97%	0,89%	0,83%	0,76%
Total contributions to social security evasion	1,75%	1,74%	1,82%	1,93%	1,82%	2,80%	3,13%	2,87%	2,66%	2,43%
VAT evasion	3,01%	6,25%	4,37%	7,21%	7,40%	8,01%	9,61%	10,31%	12,34%	12,21%
Income tax evasion	0,55%	0,62%	0,74%	0,75%	0,78%	0,65%	0,67%	0,56%	0,45%	0,44%
Excise and vice, alcohol and tobacco tax evasion	0,32%	0,42%	0,44%	0,75%	0,43%	0,56%	0,70%	0,47%	0,40%	0,39%
Total tax evasion	6,36%	9,50%	7,89%	11,21%	11,00%	12,89%	15,09%	15,10%	16,67%	16,23%
Gross value added from gray economy	14,48%	16,56%	19,18%	19,97%	19,57%	20,89%	24,78%	24,30%	24,53%	22,89%

Source : Fiscal Council based on data of the National Statistics Institute