

## Tax Evasion – An Important Form of the Illegal Economy

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### Abstract

*The tax evasion is one of the most important and complex economic-social phenomena causing problems to almost all existent countries which try to limit as much as possible its undesirable consequences. Terms of the way in which it is committed, the tax evasion bears two ways of manifestation: evasion accomplished at the law shelter (legal evasion) and the evasion accomplished by breaching the law, being illegal or fraudulent.*

**Key words:** *illegal economy, tax evasion, black market*

### Causes of the Illegal Economy

The technical literature confirms other concepts with the aim of assessing the illegal economy significance. One of these concepts is the *black market*. This concept does not bring any novelty towards the illegal economy concept. Therefore, the use of the grade “black” is meant to underline the opaque character of the respective economic activity and certainly, the use of the term “market” is meant to emphasize the fact that it is about transactions with goods. This latter remark may determine us to consider that in fact the *black market* concept is more limited than the one of the *illegal economy*, as it limits the goods and services area operated through the market.

Another concept opposed to the official economy is the one of *gray market*. This concept does not properly design the illegal economy, but a part of it, meaning the one comprising the economic activities conducted at the boundary time work: either by playing an ineffective role near the ambiguous and incomplete time work (paralegal activities), or by exploiting the time work lack of generality (metalegal activities). But how could the difference between the illegal market (which can be conceptually assimilated with the black market) and the gray market is made? In our opinion, the gray market may be considered either a black market in train of becoming official, or an official market in train of becoming “black”.

In case of both assumptions, the economic analysis has interesting issues to establish. The non registration of the economic operations concept is firstly closed to the one of the illegal economy, many authors considering that both terms are synonymous.

The informal character of the illegal economy makes immediate reference to the non registration of the economic operations concept. The tax evasion or fiscal fraud concepts, used

with reference to the illegal economy, are more complex concepts and besides they regard the illegal economy only from the participation at the economic activity at the budgetary incomes perspective, which is too restrictive for the present topic.

The causes of the illegal economy apparition, maintenance and development must be searched in three main directions<sup>1</sup>:

1. Institutional causes;
2. Conjunctional causes;

This category also comprises:

- The fiscal administration weaknesses: the Government incapacity of controlling and cashing in time all economic agents' budgetary obligations.
  - Fiscal penal weaknesses: the Government incapacity of sanctioning accordingly and sufficiently or imposing a sufficient compensation for any breach of the fiscal rules.
  - Phenomenological obstructing: development of certain special processes or phenomena causing perturbation of the institutional or behavioral transparency, during a certain period of time or a certain economic area (for example the en mass privatization process).
3. Psycho-sociologic causes.

From this typological presentation a series of similitudes are to be identified, even identities with cases from the Romanian economy in transition. It is quite obvious that certain characteristics such as the ones regarding the normative ambiguity, incoherence, incompleteness and asymmetry are more present and have visible effects at almost all activities levels with paying character.

The illegal economy represents an answer of the economic system to the existent governmental management act. Therefore, the more the illegal economy is extended, the more the governmental management is weaker. What the illegal economy signals may and must be used not only for the governmental act development, on long term, even for the illegal economy restriction. Although the illegal economy represents the result of the institutional society quality, it is meant to become futile: using the functions and signals conveyed by the illegal economy, this may be reduced to a limit above which (like other microeconomic variables such the inflation of unemployment rate) may be considered inexistent. A more courageous argues might prove that the costs by means of which the illegal economy signals the institutional or economic discrepancies are the smallest. Further more, it might be proved that the risks that the illegal economy assumes in order to exploit the institutional inconsistencies bear the smallest prices for the formal society.

The main functions of the illegal economy<sup>2</sup> are the following:

1. resources allotment signalizing function: refers to the fact that by using certain economic resources (material, financial, labor force), the illegal economy conveys signals (especially by means of the parallel prices), regarding the resources structure and the way, degree and quality of their use;
2. economic behavior signalizing function: it refers to the illegal economy adverse effects towards certain standard economic behaviors (example: the existence of a monetary surplus to the population, without being accompanied by the increase of the currency demand, as the expectations are directed to the future rate of exchange increase, clearly indicating that

<sup>1</sup> Dinga, E. - The illegal economy - an adversary? ... Or partner? ..., *Economic Tribune*, No. 21-22/2001

<sup>2</sup> Dinga, E. - The illegal economy - an adversary? ... Or partner? ..., *Economic Tribune*, No. 21-22/2001

the currency black market is still working; or the unemployment indemnification substantial reduction not being succeeded by searching a new place of employment behavior by the unemployed, indicates that the informal labor market still exists etc.);

3. quantification of the opportunity prices signaling function: the illegal economy “calculates” a kind of shade-prices constituting for any economic topic (especially for the invertors –share holders, creditors, etc.) the real opportunity costs of their economic decisions;
4. economic shocks absorption function: often, the illegal economy plays the role of a depreciation factor of certain economic shocks which are produced either on the goods and services market, on the labor market, or on the money-currency market. This role is a civic one and by exaggeration, we may say that the aim of the illegal economy is the one of exploiting the shocks and discrepancies which are produced at the level of the official economy, as this represents the point from which it extracts the most part of the non registered profits;
5. institutional shocks absorption function: this function is strictly linked to previous function, in the sense that, often the economic shocks are the result of certain radical and sudden institutional modifications;
6. economic “down-time” filling function: the illegal economy, being forced to be maintained in the opacity area towards the Government, as shown, will proceed o the exploitation of those resources and opportunities which are often ignored or incompletely used by the official economy; besides, the illegal economy may be due to the extremely high profit rate (as a result of the tax evasion) more interested in certain economic necessities towards which the official economy still remains careless;
7. ferend law function: just by institutional inconsistencies or official economy management discrepancies (including of the corruption and bureaucracy) the illegal economy constitutes, if it is very well “deciphered”, an important source of normative, organizational and managerial suggestions. The axiological theory asserts that the breach of a norm shall represent the first sign of its necessity of being perfected (in any sense, including the one of replacing). Mainly the illegal economy signals those areas and directions within the economic system which are not sufficiently and correctly covered.

## **Notion and Forms of the Tax Evasion**

The politic speech within the entire world unanimously convicts the tax evasion. Although, the perspectives regarding this phenomenon had not change yet. Despite all sanctions, it still persists in all countries and all periods. Furthermore, it remains indifferent towards the people’s convictions.

The tax evasion is one of the most important and complex economic-social phenomenons causing problems to almost all existent countries which try to limit as much as possible its undesirable consequences. Unfortunately its eradication is practically impossible. The tax evasion effects become directly effective towards the fiscal incomes level, leads to distortions within the market system and may contribute to social inequities due to the tax payers’ different “access” and “tendency” towards the tax evasion.

Terms of the way in which it is committed, the tax evasion bears two ways of manifestation: evasion accomplished at the law shelter (legal evasion) and the evasion accomplished by breaching the law, being illegal or fraudulent.

“The tax evasion has always been active and ingenious because the fisc hitting the individuals in their fortune, it scratches their most sensitive part: their monetary interest”<sup>3</sup>.

The most common sense in which the tax evasion is known is “the art of avoiding the collapse on the fiscal law attractor”.

The legal evasion is the tax payers’ action of omitting the law by recurring to a combination, unforeseen by the law and therefore tolerated by tracking. It can become possible only due to a mistake or deficiency of the law and it is frequent especially when new kinds of enterprises or taxes appear.

The illicit tax evasion represents the tax payers’ action of breaching the legal provisions with the aim of not paying the correspondent tax”<sup>4</sup>.

The description of tax evasion as being licit and illicit is necessary and useful as it offers the theoretical possibility of estimating the phenomenon dimension on both forms of manifestation. As the legal evasion is distinguished from the illegal evasion, a frontier must be traced in order to make the difference between the two domains. In practice, the delimitation operation is as much uncertain as the distinction between the fraud and the evasion. The uncertainty has its origin in two factors: the legal and illegal interpretation.

According to the fiscal and penal law, the fiscal fraud delinquency presents three classic constitutive elements: legal, material and deliberate purpose.

The legal element represents a clear necessity. The legality incrimination principle offers the tax payer a warranty against the state abuse. The conviction for fiscal fraud is possible only on the basis of an adequate legislative text (according to art. 9.6 of the law regarding the fiscal evasion combating, in case of Romania).

The material element supposes that the fraud doesn’t have to be considered in latency. In order to be convicted an external fact must be proved. According to our legislation as well as the other countries, the fraud attempt is also punished. This extension raises the problem of the frontier between the attempt and the fraud. The fraud manifests by means of omission (which is very frequent and may bear two forms: omission of statement or omission of an element with value) and by means of action implying the concealment of the element which is to be taxed.

*The deliberate purpose* is the most delicate element of the fiscal fraud, a common point not having been established yet between the doctrine and the positive law. However, in order to prove the intention, the tax payer must have had knowledge about breaching a legal fiscal disposal. Then the tax payer acted voluntary or conscious. Therefore it has to be proved that the act of fiscal fraud was deliberately committed, without any constraint.

## Manifestations of Tax Evasion

### Sociologic Manifestations of Tax Evasion and Fiscal Fraud

The generalization of the phenomenon is linked to the human condition and its selfish character, to the human feeling of being confiscated his labor results without receiving the equivalent in exchange under other form (public services). “There is a tax payer’s psychology according to which he never pays more than he cannot afford to pay. The human nature always had the tendency to place the general interest behind the particular interest; he is tended to consider the

<sup>3</sup> Cordescu, V. – *Evaziunea fiscală în România*, teză de doctorat în Științe economice, 1936

<sup>4</sup> Cordescu, V. – *Evaziunea fiscală în România*, teză de doctorat în Științe economice, 1936

taxes a prejudice more than a legal contribution to the public expenses and always disregards the one who wants to diminish his patrimony”<sup>5</sup>.

Nevertheless not all socio-professional classes are equal in the eye of the fiscal evasion possibilities. There is a tax evasion (fraud) sociology. “The possibilities of the fisc elusion differ from a social class to another, terms of the incomes nature and origin or of the fortune submitted to the taxation, of the way of establishing the elements which are to be taxed, of the way of organizing the fiscal control and other specific factors”<sup>6</sup>.

Regarding the dimension of the ones causing fiscal frauds, all studies confirm that the fraud is an inverse mapping of the income or of the turnover. In other words, it is proportionally more important in case small tax payers than the large scale tax payers. As professor Jean-Claude Martinez underlines, this remark was made for all classes of taxes. The small-scale enterprises recur to fraud more than the large-scale ones because of the facilities and necessities. The facility is ensured by the familial character of the business. A family business benefits of its administration secret. The large-scale enterprises do not benefit of this administration secret.

## Technical Manifestations of the Evasion

### 1. Technical manifestations of the legal tax evasion

In the practice of the countries with market economy, the facts which have in view the favorable interpretation of the fiscal legislation, so the legal tax evasion cases, more frequent are the following:

- Constitution of the redemption funds or the surplus funds in a quantum larger than the one economically justified, diminishing the income which is to be taxed;
- Practice of certain private limited companies to invert a part of the profit in the acquisition of cars and technical equipment for which the state confers income tax reductions, measure meant to stimulate the accumulation. The re inverted profit should be used for the money maker activities development;
- The family associations as well as the occult (hidden) companies between the enterprising and his wife and children. The result of such operation is the separate taxation, the distribution of incomes on each shareholder, leading to the fiscal tasks diminution;
- The total income of the family members may be equally divided between them, regardless of each one’s contribution, obtaining a diminution of the income tax quantum which is due to the state;
- Constitution of warehouses by the parent or tutor in the minor child’s favor. The income correspondent to the warehouse, even though it is submitted to taxation, the tax paid is smaller compared to what it should be due on the income such divided;
- The use, within certain limits, of the legal provisions regarding the philanthropic donations, no matter if these took place or not, leads to the appropriation by fraud of one part of the realized income from the taxation;
- A tax payer has the possibility of making an option for the private individual income tax, or for the taxing system applicable for the incomes realized within the corporation. Making the option for the second fiscal system, the tax payer realizes an important appropriation by fraud of the income to be taxed as the system of taxation for corporations comprises several facilities which lead to a substantial diminution of fiscal tasks;

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<sup>5</sup> Martinez, J. C. – *Le fraude fiscale*, PUF, Paris, 1990

<sup>6</sup> Şaguna, D. D. – *Drept financiar și fiscal*, Editura All Beck, București 2003

- Taking into account several legal facilities regarding the exclusion, from the total expenses to be taxed with labor – professional training and field practice charges, the amounts paid for the research agreements having as subject priority national interest programs;
- Subtraction from the income to be taxed of the protocol charges and advertising outlays, no matter if they were performed or not;
- Favorable interpretation of the legal disposals which foresee important facilities (releases, discounts), for the contributions to the social, cultural and sportive activities;
- Domiciles abroad, in tax heaven (financial centers) which offer more favorable taxation than the ones in their own countries, for residents inverting for private individuals and other companies etc.

## 2. Technical manifestations of the illegal tax evasion

The fraud techniques may be classified terms of different criteria. A first criterion is the fiscal one, on the basis of which we may distinguish the fraud supported on the tax payment and the one taking place in the stage of the fiscal obligation payment. The first one is the most known. It consists of the base to be taxed either by the incomes, turnover or benefits diminution, either by fiscally deductible charges, the fraud which takes place at the liquidation (of the fiscal obligation payments), refers especially to customs duties and VTA. The existence of several taxation quotas incites to the amendment of certain goods from an imposed class to another one less imposed. Therefore, by a false bill of entry regarding the imported goods characteristics and usage, a tax reduction may be achieved by applying a lower quota than the due one.

Another criterion of classification is represented by the material criterion, which allows the distinction between two large fraud techniques: the fraud by dissimulation (hiding) the element to be taxed and the fraud by the deductible charges increase. Also terms of the material criterion we may distinguish the frauds by action and the frauds by omission.

The first ones suppose an active behavior, for example the use of a fictional transaction, meanwhile the others limit to abstinence, such as the incomes non statement.

Terms of the fraud authors, we may distinguish the frauds produced by private individuals and the ones committed by legal persons (morals). This distinction is interesting in what the sanctions concern.

The fraud may be geographically seen when it is about a national and international fiscal fraud.

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## Evaziunea fiscală – formă importantă a economiei subterane

### Rezumat

*Evaziunea fiscală reprezintă unul dintre cele mai complexe fenomene economico-sociale cu care se confruntă aproape toate țările care încearcă să limiteze consecințele nefaste ale acestuia. După modul de manifestare, distingem două tipuri de evaziune fiscală: evaziunea realizată la limita legii (evaziune legală) și evaziunea realizată prin extrapolarea insuficienței legislative (evaziune ilegală).*