

General Consideration on Legal Tax Evasion vs. Tax Fraud

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Abstract: The article is a brief overview of tax evasion as a complex social and economic phenomenon, of utmost importance, that today's states confront with; its consequences seek to limit as much as possible, by legal and fiscal means, the eradication, which, at this point, is virtually impossible. Tax evasion can be analysed from two points of view, the legal and the illegal aspect of the phenomenon or the fiscal fraud. The "fiscal paradises" had a very important role in the last years' activity.

Keywords: tax evasion; fiscal paradises; eradication; international tax system

JEL Classification: K49; K34

1. The Evolution and the Situation of the International Tax System

Globalization means the union of different national economies within a unique economic world. This appears as a result of the increasing investment and commercial flux, of increasing the mobility of labour and fast increase of technological changes. Dereglementation of financial markets, reducing the investment and commercial barriers, as well as the decreasing costs for communication and transport, impulse these tendencies.

Even if the expression „international tax system” is not proper, because there is no inter/supranational institution to take care of the way the international tax authorities administrate the specific aspects of taxing their own taxing basis, we will be using this syntax, in order to identify the sum of the world's tax systems

and the multitude of relations which appear between them notable, or less notable for the public.

In today's economic environment the high tax level is difficult to maintain. As the economic integration expands, the individuals and the companies gain more liberty to take advantage of foreign economic opportunities, this increasing the sensibility regarding the taxing level of the investments or localization decisions. Higher levels of taxation cause great economic losses in terms of capital mobility, and the international tax competition becomes more and more harsh, while the mobility of labour and capital increases.

In the last years, most of the developed countries had as goal the tax reformation in order to ensure themselves that their economies remain attractive for foreign investments. In the industrialized countries of the Organization for Development and Economic Cooperation (OCDE), the medium tax per income (the maximal quotation) decreased with 20% since 1980, and the medium tax per profit (the national maximal quotation) decreased with 6% only in the last 6 years. (Edwards & Rugi, 2002, p. 1)

2. The Beginning and the Evolution of the Modern Taxing Systems

The modern era started with a wave of reactions against taxing, which generated discontent when the growing costs of the war imposed rising taxes all around Europe, part of these actions had no success – as in Austria and Ireland – and others became historical turning points. The American war of independence was marked by the fight against customs taxes and contraband. In France, taxing was the one to put into light the conflict between the social classes, during the 1789 revolution, revolution marked by the customs robbery, burning the tax registers and the lower classes declaration that all the existing taxes are null and void.

The development of capitalism and liberal democracy did not mean the end of taxing, the first capitalist states reached the conclusion that taxes are necessary, but their mandatory character was in contradiction with the idea of free exchange. From that moment the taxation was a reason of greater discontent. For example, the Poujadist Movement in France in the 50's started in a village of the region Lot, as a protest against a preceptor's visit and represented a refusal of the all farmers and of the merchandisers to accept the taxes of a bureaucratic state, which they understood as being an ally with the tendency of lack of personality – in the historical conditions of the great stores and business birth, as well as of the great financial structures. This social movement concentrated on taxes, because they represent a pure expression of the absolute power of the state. (Mulgan&Murray, 1993, p. 3)

So, even in the most permissive democracies, the tension appeared surrounding the taxes legitimacy. The political intrigues surrounding this legitimacy, the way the revolts were led and the new compromises that were made, ensured the essence of the taxes' history.

Geoff Muigan and Robin Murray identify two historical transition moments. The first moment took place between the end of the XVIIIth and the beginning of the XIXth century, replaced an absolutist regime, with a capitalist one. In the absolutism, the taxes were paid, especially by the merchandisers and the poor. The nobles, and the church, the rich class of the cities were, largely, free of taxes, excepting periods of war. The economists and politicians of that time campaign against the privileges, arguing that every citizen should pay taxes, internal taxes should be lowered and income accumulation should be made from rents and fortune. With few exceptions, this was the program of the ministry of finance and of persons with economic views, but there was needed the revolution in France – and the fear of its spreading abroad – in order for this program to spread all around Europe.

The new order was characterized by five features: the end of privileges and feudal obligations, tax increase on the prime necessity goods (for example: salt) and increasing the addition on the taxes on the liquor and tobacco, the opening towards the taxation of rents and fortunes, increasing the centralization of the public finance and of the decision or the national treasury expenditures, as well as subordination of the fiscal administration and of the public finances to the parliamentary control, through budget.

The second crucial moment took place in 1890, as an answer to the sudden expansion of public expenditure to the increase of working class movement. This implied the passing from a unique tax to progressive taxes, centred on a new role of the income tax. In Great Britain of the 17th and 19th century, as most of the states, the direct taxes were the bigger percentage from the collected taxes. The first income tax was temporary applied in 1799 and became permanent in 1842, but its efficiency was modest.

In other countries, things evolved a little faster than in Great Britain: the income tax was introduced in Sweden in 1861, in Italy in 1864, in Japan in 1867, and in many federal German states at the beginning of the 19th century. The progressivity principle was adopted by the conservative Prussia – in 1891, in liberal Belgium – in 1893, and in democratic America – in 1894 (before being declare unconstitutional by the Supreme Court).

Until the beginning of the First World War, the direct progressive taxes became standard.

In the 70's in the countries members of OCDE, the income tax and the contributions at the social insurance represented the majority of the income from

taxes, and in many countries represented 2/3 of all the taxes. The countries, where industrialization was born later – Ireland, Spain, Portugal, Greece - quickly adopted the meaning of the income tax, and its importance in the total taxes.

2. Fiscal Paradises

The fiscal paradises play a key- role in the increase of capital movement and making new complex networks of transactions and interactions between states, multinational companies, very rich personas and simple individuals. In the last five years the controversial term fiscal paradise became financial offshore.

The fiscal paradises are territories that offer fiscal advantages to the offshore companies existing in those jurisdictions. If we make reference to the fiscal part of the strategy, favourable taxation may be realized only when the company that works in offshore regime is registered in a fiscal paradise. The offshore working regime is given by the development of the companies' affairs outside the territory of registration. This means that a company that works „offshore” may benefit from great advantages regarding its foreign operations, but may be treated (and taxed) as a resident company for the businesses developed within the jurisdiction of registration.

At the beginning of the 80's, the French Ministry of Finance asked for documentation paperwork over the fiscal paradises, materialized in the Gordon Report – published in 1983. According to the Gordon Report, „the fiscal paradise is any country which is considered as such and wants to be this way”. The definitions given to the fiscal paradises are not entirely satisfying, we may propose the conceptual view belonging to Roger Brunet: „ It is called fiscal paradise a territory in which physical persons or firms have the sensation that are less taxed than somewhere else”.

The existence of such fiscal alternatives became known in the international business right after the First World War. Since then, these special entities developed all over the world, being into a continuous evolution. In the actual economic context, characterized by an unseen rapidity of changes, becomes more and more difficult for a businessman to choose the most appropriate fiscal paradise.

Since 1980 the number of the offshore zones doubled, reaching from 30 to almost 60 territories. Many of them are territories dependent of the British crown, or ex British colonies, being in general within the area of influence of the great occidental financial powers.

The activities developed in these areas allow the increase of capital profit, but they have also powerful economical, political and social consequences upon other zones persons, inside some circles, the offshore zones are considered to be a threat to the global financial system because they allow a more flexible way of making the

financial situations (because of the relaxed regulation), and the offshore banks are more vulnerable than the others in front of rate exchange risk and insolvency. (Errico & Musalem, 1994, p. 4)

Some experts say that the offshore zones undermined the national governments (sabotaging the intention of taxing the physical/juridical persons), stimulated money laundry and weakened the power of international organisms which supervises the fiscal system.

It is estimated that the accumulated value of the gains from taxing obtained by the almost 70 offshore jurisdictions in the world is approximately 200 billion/year. (Diamond, 2003, p. 93)

3. Legal Tax Evasion vs. Fiscal Fraud

3.1. „Legal” Tax Evasion.

The migration abroad of the tax payers in order to decrease taxes has two ways of approach. One of them characterizes a tax payer who intends to break the fiscal rules of the residence country, using the discretion of the fiscal paradises and the logistic difficulties found outside the country by the fiscal investigators. These transactions hidden in offshore are elements taxable by the fisc, but the people pay taxes hope that their inspectors will never be the truth. This is called fiscal fraud. Another approach regards a person who pays taxes, who, in a very intelligent way, uses all the existing inadvertences and breaches in the national fiscal system in order to legally decrease his fiscal obligations, this being called legal tax evasion.

We present as follows a classification of the transactions made in offshore areas:

1. The transactions without fiscal impact are transactions which have no impact over the paid tax in the residence state. For example, a bank could open a branch in a fiscal paradise in order to avoid the national bank's request regarding the making of the legal reserves. Another company could use a branch registered in a fiscal paradise to avoid the currency control imposed by the country where it makes business. A fiscal paradise may be used to reduce the expropriation risks which come along with business developed in most third world countries.

2. Transactions with fiscal impact, but in accordance with the law – some examples are:

- using the convenience pavilions in order to obtain fiscal benefits (avoiding direct and indirect taxes over the international naval activities);
- intra-group loan operations (which delay the taxes over the interests from the loans);

- transactions between the branches of different companies (created to avoid AVT and to make some transactions which takes advantage of the law's breaches).
3. Aggressive fiscal planning operations – these are transactions made to reduce the fiscal duties by “forcing” the vulnerable sections in the law. An example could be the foundation of a new company of services in a fiscal paradise to furnish services to another branch of the same company localized in a third country. A method used at large scale by the multinational companies is represented by the usage of transfer prices, consisting of distorting evaluation of some international transactions in the purpose of total/partial transfer in a fiscal paradise of the obtained profits in the high fiscal areas.
4. Fiscal fraud – is represented by actions of those who try by fraud by avoiding fiscal duties. This might generate, by the simple omission, to declare the obtained income or by trying to create fiscal deduction in excess.

Fiscal fraud may be, at its turn, divided into two categories:

- legal income tax evasion;
- illegal income tax evasion (ex. drugs traffic).

3.2. „Illegal” Tax Evasion (Fiscal Fraud)

Illegal tax evasion (fiscal fraud) refers to breaking directly the law, having as basis the international element, by making false transactions using firms with „ghost” character. Fiscal fraud means the infringement of the fiscal order, deliberately, in order to avoid taxation, correlated (most of the times) with inexact, incomplete information transmission, having the role to give to the author fiscal advantages.

As far as the „illegal” tax evasion is concerned, it may have the following forms:

1. developing activities generating undeclared income, unregistered and untaxed, by declaring lower income, or avoiding declaring some unit's income;
2. double fiscal evidences held by the contributor intending to hide the real income, and making fake declarations, falsifying the balance sheet, in order to falsify the results;
3. inclusion in the costs of some fake salary rights, this method having as main disadvantages the registration of the taxes as the firm's obligation towards the state;
4. Diminishing the WATT collected using the collecting actions with a fake character, not having as basis documents legally made for this purpose;

5. Foundation of new „ghost” firms(usually on foreign citizens names, very difficult to identify) which are used as a „curtain” to illegal commercial operations, the firms mentioned above not functioning at the mentioned centre (fake, most of the times) and being an important „provider” of illegal fiscal documents;
6. Transit commerce or temporary import doesn't impose custom tax payment, this offering the possibility of seal violation at the entrance custom point, selling the products on the countries' territory, and afterwards simulating their exit from the country.

The contraband, in its classic form, practiced at the customs points by introducing inside a country illegally of products as coffee, cigarettes, etc, facts that imply escaping from paying taxes (custom taxes, WATT).

In the most used way, the fiscal evasion is seen as a way of avoiding the fiscal laws, based on three action directions: promoting some fiscal favourable regimes based on numerous exonerations, fiscal facilities having as role to guide the contributor to tax evasion; applying some fiscal reglementation containing many gaps which interpretation may generate the phenomenon of tax evasion; not developing the operation which generates the taxing act, behaviour justified by an excessive fiscality, case in which the marginal rate of taxation becomes overwhelming, and the contributor prefers not to provide a supplementary working unit. Some economic phenomenon may transit from the illegal to legal area, depending on the options and decisions at political level. Practically, the operation of making a barrier between the „tolerated” tax evasion and tax fraud is not certain, and it's based on legal interpretation and law solutions.

4. Conclusions

The phenomenon of fighting against the forms of tax evasion has an increasing effect, usually, when the named ones to make the fiscal and fiscal control procedures, have established very diverse ways and means, realistic and efficient, well known being the fact that these forms of manifestation may have unexpected aspects. Neglecting the control of the tax evasion may lead to increasing the phenomenon until it gets to fiscal fraud or organized economical-financial crime. As well, the negative consequences of this phenomenon reflect upon the local and central budgetary balance, upon the stability of the national economies. In order to prevent and reduce the phenomenon of tax evasion we appreciate that the following factors should be taken into consideration:

- the systems of informing and assistance for the contributors' development, by specialized centres, organized within the territorial financial administrations;

- eliminating the overlaps of competences in the control actions, establishing, clearly, own objectives specific for each control organism;
- professional control activity, by perfecting the professional training and periodical examination of the personnel;
- establishing unique normative and procedures for each control activity;
- continuous perfecting of the f- in order to eliminate the present imperfections, as well as the fiscal procedure code - to ensure an equivalence between the contributors and the state's fiscal control organs;
- fiscality relaxation, specially at the level of fiscal obligations coming from salaries, taking into consideration the compulsions imposed by the international organisms regarding the drastic limitation of budgetary deficit;
- increasing the efficient collecting of taxation obligations.

Excessive taxation is the main reason for increasing the tax evasion, this, may be more than any other economic phenomenon, has a auto regenerative feature, meaning that, some firms avoidance of paying taxes leads inevitably to an increase of taxation, which, determines the „slipping” of more firms from the transparent economic zones to dark economy zones. In most cases this fact represents an affect of conservation instinct, a diminishing of the taxation basis taking place. The state authority must understand that only applying some drastic corrective measures cannot only by itself generate miraculous results in fighting against fiscal evasion, they must be sustained by removing the causes that generated it.

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