

## ACTS OF TAX EVASION AND FRAUD AND FINANCIAL IMPACT OF THESE PHENOMENA IN THE EUROPEAN UNION

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### **Abstract**

*Tax evasion has always been one of the most serious problems a country is facing, regardless of its level of development. At EU level, the situation is no different, largely due to lack of legislation to regulate this phenomenon. However, major reform efforts made in recent years by all Member States and EU bodies have brought additional clarity.*

**Keywords:** *tax evasion, tax fraud, financial impact, suspected fraud, EU,*

**JEL Classification:** G28, H26

### **Introduction**

Tax evasion is one of the economic and social phenomena of the utmost importance. In the context of strengthening international economic cooperation and development between states with different tax systems, tax evasion occurs worldwide. Unfortunately, what can be done effectively in this area is limiting this phenomenon at the maximum possible, as it is virtually impossible to eradicate it.

The international *geography* of tax evasion shows the global spread of the phenomenon that includes all countries, whether highly developed or developing states, situation which is found in the European Union as well.

Tax evasion has a critical evolution determined by the action of several factors, such as taxation levels, the dynamics of the real economy, the institutional and legal frame and other internal and external factors. The escapist phenomenon is very complex. Therefore, it has to be monitored at all times to be fought.

In the EU a department has been established for the education and informing Member States and their taxpayers, in connection with the proper preparation of tax returns and keeping of accurate work-related records. Also, they

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are informed in connection with sanctions and penalties applicable to those who violate the law.

The EU budget is an anonymous funding source. It represents the joint effort and commitment of Member States and EU citizens to turn their vision into reality by supporting economic and social solidarity, promoting research, technological development and training and promoting sustainable development worldwide.

The Commission and Member States coordinate their measures to protect the EU budget and to fight fraud and other illegal activities affecting it. Indeed, Member States should be as rigorous in protecting the EU budget and controlling expenditure in national budgets.

Member States are in proper position to fulfill this role. National authorities are in fact responsible for the supervision and daily management of the greater part of the Community budget, approximately 80% of the EU's annual budget. The Commission has a general supervisory role, setting standards and conformity assessment. Major reform efforts made in recent years have brought additional clarity regarding the roles of authorities concerned, and, through increased vigilance at all levels, sound financial management of EU funds is improving gradually throughout the EU.

During recent years, tax evasion has been one of the most serious problems in the economy of any country, whether developed or developing. With the EU creation and enlargement, this phenomenon has seen an upward trend, given in part to the absence of legislation to regulate the situation.

Thus, all EU Member States together with its governing bodies are trying to fight this phenomenon of fraud. The European Commission has a general supervisory role, setting standards and conformity assessment. Major reform efforts made in recent years by all Member States and EU bodies have brought additional clarity. Thus, the bodies of the Union provide detailed statistics on irregularities and suspected fraud and exchange information on the quality and speed of data concerning irregularities affecting the EU budget.

Although tax evasion is not legislated at EU level, the Community legislation compels Member States to report suspicions of fraud and other detected irregularities, affecting the Communities' financial interests. But precisely in this context, it is important to distinguish between fraud and other irregularities. An irregularity is any infringement of a Community provision by an economic operator who may or might harm the Communities' financial interests [Regulation (EC, Euratom) no. 2988/95]. Fraud is a wrongdoing committed intentionally, which represents criminal offense [Convention on protection of the European Communities' financial interests, OJ C 316, 27.11.1995].

In 2007-2008 the situation per areas where Member States implement the budget, is described as follows:

Area	Number of reported irregularities		Total financial impact of such irregularities, including suspected fraud (million of Euros)		Assessed financial impact exclusively for suspected fraud (million of Euros)	
	2007 <sup>2</sup>	2008	2007 <sup>3</sup>	2008	2007	2008
Agriculture (FEOGA and FEADR)	1 548	1 133	155	102,3	44,8 (~0,1% of allocated funds)	4 (0,01% of allocated funds)
Structural funds and Cohesion Fund	3 756	4 007	804	585,2	141 (~0,31% of allocated funds)	57 (~0,11% of allocated funds)
Pre-accession funds	332	523	32	61	5 (~0,38 % of allocated funds)	13 (~0,9% of allocated funds)
Direct expenditure	411	932	33	34,7	18,1 (~0,17% of allocated funds)	3,2 (~0,03% of allocated funds)
Total expenditure	6 047	6 595	1 024	783,2	208,9 (~0,22% of expenditure in all four areas)	77,2 (~ 0,07% of expenditure in all four areas)
Own resources <sup>4</sup>	6 097	5 344	401	351	130,78 (~0,81% of total value of own resources <sup>5</sup> )	75 (~0,46% of total value of own resources)

Source: Commission's Report to the European Commission and Council.

“Protection of the Communities' financial interests – Fight against fraud – Annual Report 2008”

We consider interesting to present the situation for each area in 2004-2008 for a better understanding of how tax evasion occurs in the European Union and the measures it has adopted as regards tax fraud cases.

### **Agricultural expenditure (European Agricultural Guarantee Fund and the European Agricultural Fund for Rural Development)**

Irregularities reported in the case of agricultural expenditure were on a downward trend compared to 2007; their percentage in 2008 was 27%. Of these, 7% of them are suspected fraud, registering a downward trend. The estimated financial impact was 4 million Euros.

<sup>2</sup> For certain areas, the statistics has been updated following the 2007 report

<sup>3</sup> Idem

<sup>4</sup> Customs duties and farming tax

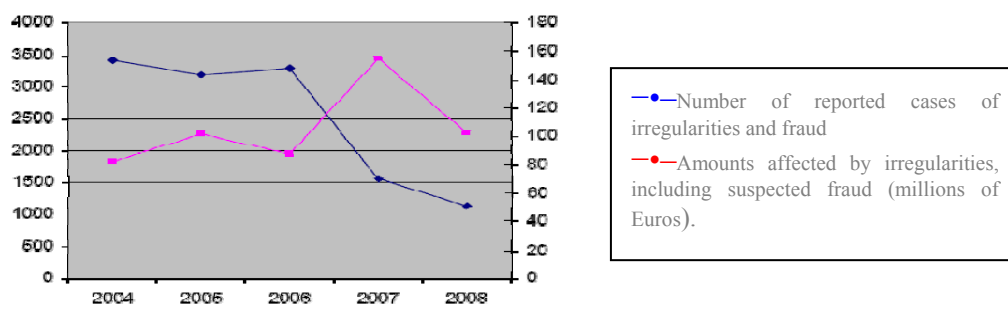
<sup>5</sup> This percent is calculated based on own traditional assessment in the 2008 general budget and not based on accounting records.

The most affected areas were fruit and vegetable sectors, rural development and the vineyard production sector. Together, they represent more than 70% of the total amount affected by the large number of irregularities as shown in Chart No.1.

*Chart 1: Number of irregularities and estimated financial impact – agricultural expenditure – 2004- 2008*

Number of cases

Amounts affected by irregularities



Source: Commission's Report to the European Commission and Council.  
 "Protection of the Communities' financial interests – Fight against fraud – Annual Report 2008"

The European Union has provided under Article 32 of Regulation (EC) no. 1290/2005 of the Council, the implementation of an automatic mechanism for checking the amounts unduly paid. If a Member State does not recover from the beneficiary an amount unduly paid within four years after the first act of administrative or judicial finding (or eight years from bringing an action in a national court), 50% of the unrecovered amount is supported by the relevant Member State budget, within the annual check of EAGGF and EAFRD accounts.

Since 2008, the European Union has imposed more drastic measures according to which, if improper payments are the result of administrative errors committed by national authorities, the entire amount is deducted from the annual accounts of the concerned paying agencies and therefore excluded from the Community financing.

Because of this mechanism of "50-50" checking that has been applied in recent years by charging some of the unrecovered amounts to Member States, the amount outstanding to the EU budget was reduced to approximately 900 million Euros.

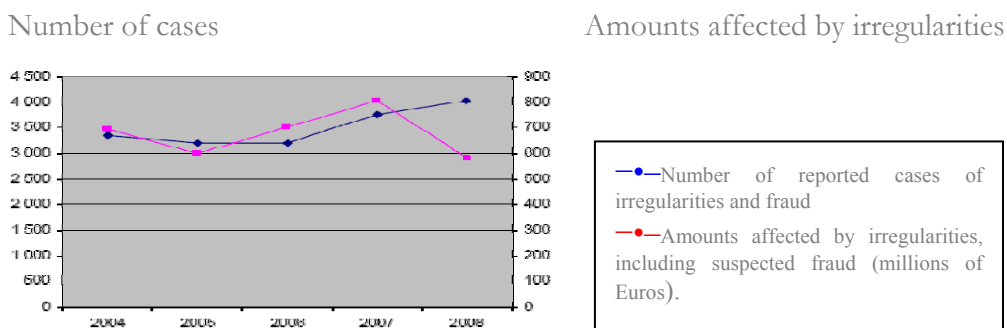
### Structural Funds and the Cohesion Fund

As regards Structural Funds and the Cohesion Fund, the number of reported irregularities increased by 6.7% in 2008 compared to the previous year, while their

financial impact declined by 27%. Suspected fraud accounted for 7.4% of irregularities communicated, with an estimated financial impact of 57 million Euros, on a downward trend compared to 2007.

As in previous years, the highest number of irregularities was reported by the European Regional Development Fund and the European Social Fund (approximately 88% of irregularities - see chart no. 2).

*Chart 2: Number of reported irregularities and estimated financial impact – structural measures – 2004 – 2008*



Source: Commission's Report to the European Commission and Council.

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As measures in 2008, the Commission adopted three decisions on the treatment of 24 cases of irregularities, for which the concerned Member States asked the Commission to bear the financial consequences of irrecoverable amounts.

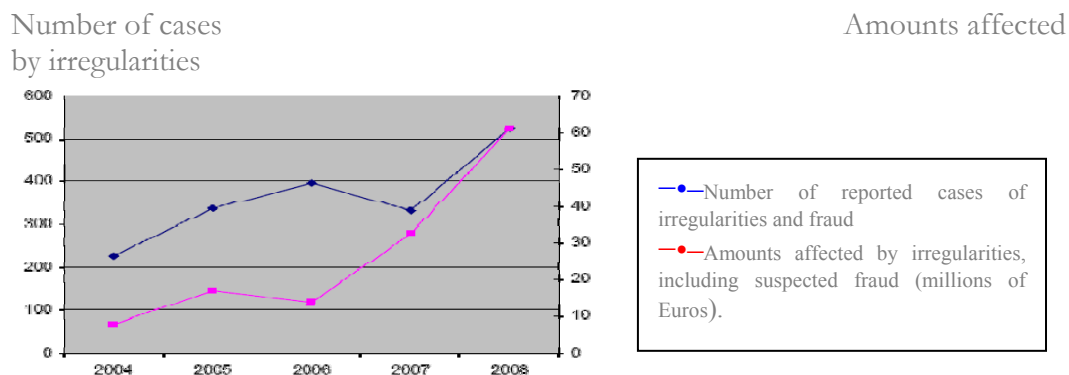
Thus the Commission, Court of Auditors and European Anti-Fraud Office, through its auditors, applied financial corrections to the States concerned.

### **Pre-accession funds**

As regards pre-accession funds (PHARE, SAPARD and ISPA - including, in 2008, CARDS, Transition Facility and Pre-accession assistance for Turkey), an increase was recorded both in the number of reported irregularities (an increase of 58% compared to 2007) and in terms of financial impact (an increase of approximately 5.4%).

Suspected fraud accounted for 21.7% of the irregularities reported in 2008, with an estimated financial impact to 13 million Euros, or about 0.94% of the total annual budget.

Chart 3: Number of reported irregularities and estimated financial impact – pre-accession funds – 2004-2008



Source: Commission's Report to the European Commission and Council.

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A good example of measures taken by the Union is Bulgaria, for which the Commission prepared a report on the management of funds from the European Union in July 2008. Thus, following allegations of irregularities, suspected fraud and possible conflicts of interest in awarding contracts, the Commission (OLAF) initiated investigations in the management of EU funds by the Bulgarian authorities. As a consequence, the Commission decided to temporarily interrupt the pre-accession funds and to block payments under various financial instruments until correct implementation by the Bulgarian authorities of corrective measures necessary to ensure proper financial management of EU funds.

### Own resources

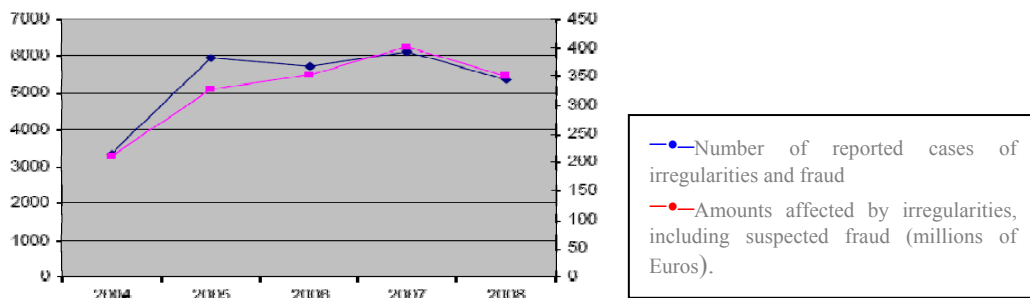
As regards own resources, the number of irregularities reported and estimated value in 2008 decreased by 12.5% compared to 2007. Suspected fraud is about 20% of cases of irregularities reported, accounting for an estimated financial impact of 75 million Euros, or about 0.46% of total own resources in 2008.

The most affected products were, as in previous years, TVs and monitors. The most frequent irregularities were false statements (wrong description, wrong value, origin and preferential regimes) and omissions of form (non-fulfillment of obligations or commitments). Tobacco came in the second position. Sectors such as clothing, tools, meat increased in importance. The segments of the automotive and motorcycle industry remained stable, while improvements occurred in the vegetable area.

Chart 4: Number of reported irregularities and estimated financial impact — own resources — 2004-2008

Number of cases  
by irregularities

Amounts affected



Source: Commission's Report to the European Commission and Council. "Protection of the Communities' financial interests – Fight against fraud – Annual Report 2008"

Member States are compelled to recover established amounts. Where non-recovery of a debt is not attributable to a Member State, it may request the deletion of irrecoverable amounts. In this situation, in 2008, the Commission refused requests for deletion of Member States in 32 cases totaling approximately 17.4 million Euros, because it deemed that the non-recovery was attributed to Member States.

One of the measures which the Union can take is to initiate an investigation by the European Anti-Fraud Office, if the final report of a case it managed concludes that certain amounts have been unduly paid to a beneficiary or the beneficiary has not received them, although the beneficiary had to. Responsible authorities, usually Member States or third countries concerned, should recover those amounts. The European Anti-Fraud Office aims to implement these recovery procedures.

The methods used include: monitoring the recovery of own resources, regular inspections in the Member States to establish and recover resources, and not least specific monitoring of Member States followed by a recovery in each of the registered cases, which have a significant financial impact and involve mutual assistance.

Community legislation requires Member States to report all deficiencies within two months from the end of the quarter when the irregularity was subject to primary administrative or judicial finding and/or new information on a reported irregularity becomes known. The term from discovery to communication of irregularities should not exceed five months.

Analyzing the situation in this regard, the agriculture sector has recorded certain improvements - in 2008 the percentage of irregularities reported in the

stipulated deadline increased to 84% from 33% as it was in 2007. About the average time between discovery and reporting of irregularities, no details can be given concerning 2008 due to technical problems (introduction of a new technical module).

In terms of structural actions, the situation is positive with a rate of 86% of irregularities reported in due time in 2008 as compared to a rate of 75% recorded in 2007. In terms of finding and reporting period, it increased from 0.9 years in 2007 to 1.1 years in 2008. Both for agriculture and structural actions, Member States have offered a large number of reasons for late reporting.

The European legislation [Regulation (EC, Euratom) no. 2988/95] defines infringements that may harm the financial interests of the Community and imposed administrative sanctions. Thus, an action represents misconduct by an economic operator if, by reducing or losing revenue or existing unjustified expenditure can harm the general budget of the Community or budgets managed by it.

Any such infringement entails the removal of undue advantage by: obligation to pay amounts due or to repay amounts wrongly received and by total or partial loss of security provided in support of the request for an advantage granted upon receiving an advance.

One of the following administrative sanctions is applied in terms of international infringements or those committed intentionally:

- Payment of an administrative fine;
- Payment of a sum greater than the amounts wrongly received or evaded, bearing interest if necessary (calculated as percentage determined by specific rules and which cannot exceed the strictly required level in order to represent a deterrent factor);
- Total or partial withdrawal of a benefit granted by EU rules, even if the economic operator has unduly benefited only by a part of such advantage;
- Exclusion or removal of a benefit for a period after committing offense;
- Temporary withdrawal of approval or recognition necessary for participation in a Community aid scheme;
- Loss of a security or deposit provided to comply with conditions laid down by rules or reconstitution of security unduly released;
- Other purely economic sanctions.

Community administrative penalties may be imposed on all economic operators, and those compelled to take responsibility for infringement or to ensure that it is not committed.

Even if the European Union has adopted many measures to prevent and fight tax evasion by actions based on strategies, impact studies and work programs, they are not sufficient. We deem they should lead to improvements in tax legislation systematic correlation with the overall legal framework of Member States economies and the mutations involved in their socio-economic environment.

As a phenomenon present in the economic and social environment, with multiple manifestations, tax evasion is a threat to the delivery of the EU budget



revenue. The extent of this phenomenon is worrisome because the lack of prevention and control measures can have negative effects on the economic stability.

Total eradication of tax evasion is impossible, but the EU, by its means and subordinated institutions, must undertake to identify and fight tax evasion and its effects.

The global economic crisis and recent scandals related to tax evasion cases have spurred calls for fairness and transparency of the tax system, but without a thorough and systematic analysis of the Member States' internal mechanisms in conjunction with those of the Union, as regards tax evasion, it is difficult to trigger tools and measures leading to efficient fight and prevention of tax evasion.

In the modern world tax systems are not perfect, inequity free, but their improvement in this direction is a goal of the Member States.

## **Conclusions**

Even though the European Union has adopted many measures to prevent and fight tax evasion by actions based on strategies, impact studies and work programs, they are not sufficient. We deem they should lead to improvements in tax legislation systematic correlation with the overall legal framework of Member States economies and the mutations involved in their socio-economic environment.

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