

THE LINK BETWEEN TAX AMNESTY AND FINANCIAL STATEMENT FRAUD

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Abstract

The aim of this paper is to evaluate the link of financial statement fraud occurred by tax evaders and amnesties granted in Albania. For this purpose, we have oriented this study toward financial statement fraud, mainly cases studies of frauds for tax purposes. In this paper, we analyze fiscal amnesties, which often offer for tax evaders the opportunity to satisfy their financial obligations by paying less than honest taxpayers. We find that lack of constraint of amnesties amended in Albania hadn't intensified the fight against evasion, unfortunately, it seems that the most main beneficiaries amnesties appear to be tax evaders.

Keywords: Tax amnesty, Financial Statement, Fraud, Tax evaders

INTRODUCTION

The government can raise revenue through taxes, threatening citizens with civil and criminal penalties to induce them to comply. Thus, taxes can be modeled as prices paid by citizens to avoid expected fines and penalties. Accordingly, we speak of a service (fiscal release) sold at a price. Amnesties may then be viewed as a case of price discrimination (Marchese & Cassone, 2000). Bose & Jetter, 2012, demonstrates that, even if there are no changes in enforcement intensities, and thus the probability of detection of delinquent taxpayers, an improvement in economic opportunities in the legal (or formal) sector (often as a result of economic liberalization) may result in tax amnesty inducing voluntary payment of due taxes.

Tax amnesties are government programs that typically allow a short period for tax evaders to voluntarily repay previously evaded taxes without being subject to penalties and prosecution that discovery of such tax evasion normally brings (Luitel & Sobel, 2007). On some

occasions, tax evaders who have already been detected by way of inspection have been allowed to participate in such amnesties, whilst on others this possibility has been expressly prohibited; some countries have offered amnesties for very specific types of fraud, with others legislating for the totality of the tax regimes currently in force and effect (Lopez-Laborda & Rodrigo, 2003).

Tax amnesties can sharply vary in their characteristics and provisions from country to country and in different time periods, e.g. they can be offered either on a permanent or on a temporary basis, to all citizen or only to those fulfilling some requirements, at a low or a high relative “price” with reference to the expected payment of the perspective participants under ordinary rules, etc. (Marchese & Privileggi, 2004). Amnesties are often granted at the same time for more than one fiscal obligation. Thus, some evaders may buy a long-lasting service (if the prescription term of their financial obligation is far-off in the future), while others can only buy a shorter one. Amnesties may be pooled to meet a constitutional constraint. Thus, the government cannot offer the amnesty solely to evaders of a particular threat cycle but must offer it to evaders of all current cycles. If there is such a constitutional constraint, the interval between amnesties is longer and the tax rate should follow a cyclical path (falling when the amnesty approaches and increasing afterward) to perform its task of sorting out taxpayers. If the tax rate is not changed, it should be possible to observe a cyclical path of evasion (increasing when the amnesty approaches and falling afterward) (Marchese & Cassone, 2000).

The purpose of this paper is to evaluate the link of financial statement fraud occurred by tax evaders and amnesties granted in Albania. To attain this objective we have to study the current reporting situation in Albania and the amnesties offered. For this reason, we have oriented our study toward financial statement fraud, mainly cases studies of frauds for tax purposes.

LITERATURE REVIEW

Tax amnesties are a debatable subject. While tax amnesties have been used as a policy tool to increase revenue collection by many governments, they have generated mixed results: some have failed while others have succeeded (Bose & Jetter, 2012).

Its apparent advantages, such as the relatively rapid recovery of tax liabilities and the inclusion of new taxpayers in the tax authorities’ records, have to be weighed against the harmful effects that such measures might have on normally honest individuals (Lopez-Laborda & Rodrigo, 2003). Malik and Schwab augmented in favor of tax amnesties that some evaders would like to rejoin the tax system, but do not because of fines and possible public embarrassment they might face if they reveal their evasion. If an amnesty is offered, these

people can rejoin the tax system without facing fines and this embarrassment (Malik & Schwab, 1991). Meanwhile, Luitel & Sobel, 2007, argument that if an individual evaluates the costs and benefits of evasion, and makes the decision to evade taxes, this decision would be unaffected by the announcement of the amnesty because it does not change the expected marginal costs and expected marginal benefits of evasion.

On the other hand, some question whether tax amnesties really produce additional revenue, given that they simply collect revenue that would (or could) have been raised by normal enforcement procedures anyway (recovered taxes and fines). Critics also contend that tax amnesties provide incentives for otherwise honest taxpayers to start evading taxes because they will anticipate the offering of future amnesties, thereby weakening tax compliance and fostering a perception of inefficiency in the tax system and lowering revenue in the long run (Luitel & Sobel, 2007). Marchese & Cassone, 2000 assume that citizens expect periodic tax amnesties. This assumes the worst case for the government because some taxpayers will choose not to pay current taxes, and wait for an amnesty. If, however, it can be shown that anticipated amnesties do not necessarily lower government net revenue, a fortiori amnesty will not have an adverse effect when not expected at all.

Since amnesties are often offered as part of a package of new laws and policies, it is difficult to isolate their impact. Stella, 1991 stated that the revenue collected during the amnesty couldn't measure the success of an amnesty.

Standard tax-evasion analysis ignores, however, one important fact, which is, according to Falkinger & Walther, 1991 view, crucial for the design of an efficient anti-evasion policy. Taxpayers typically differ in their attitude towards tax evasion. While some of them evade tax on a considerable level, others evade only relatively small amounts. Of course, it would be most desirable for the struggle against tax evasion to separate taxpayers with a relatively high inclination to evasion from the others. Additional auditing resources could be concentrated on the group with high evasion and would, therefore, be much more efficient. Furthermore, intensifying specifically the fight against high evasion will find broader political acceptance than tightening the anti-evasion policy in general. Unfortunately, it is also clear that, due to the asymmetric nature of the underlying information structure, the tax authority usually does not know in advance who is more inclined to evade tax and who less (Falkinger & Walther, 1991).

METHODOLOGY

The main objective of the paper was to identify the link between fiscal amnesties and fraud in the financial statements of the Albanian business. For this reason, it was first necessary to study the current financial reporting situation in Albania. The poor quality of the financial statements

prepared generally comes from the limited demand for financial information from third parties, the dominance of reporting for tax purposes in the absence of other purposes, the limited incentive for enforcement by the relevant authorities and disabilities accountants and auditors (World Bank, 2006).

In a study by Qurku (Feruni), 2013 from the analysis of aggregated data, entities recognize the dominance of accounting rules as well as of fiscal rules when reporting the financial statements. From the analysis of collected data, it can be seen that Albanian business is confronted with the reality of double financial and fiscal reporting.

However, the Albanian Financial Statements are oriented towards the needs of tax authorities than to the needs of investors. Tax authorities' requirements for accounting information continue to dominate creditors' or investors' requirements (Duhaxhiu & Kapllani, 2012). Taxes use these statements to calculate gross profit, to control expenditures and income, accrued tax revenue amounts, and to confirm audit report.

The total tax rate (% of profit) in Albania reported by Doing business is 36.5%. According to Baralexis, 2004, if the perception of tax rates is high, many entities tend to avoid taxation using profit management techniques. For this reason, the methodology applied in this study will be based on identifying cases of business that has become known as evaders reporting fraudulent financial statements or who have reported fictitious evidence.

The tax burden has encouraged the avoidance of tax liabilities (mainly value added tax). The cases taken in our study are reports for tax purposes. These cases are mainly business for which the prosecution or tax authorities have investigated and disclosed these financial frauds and not only. Mainly these financial frauds are directly related to the final data received from the financial statements reported for 40 businesses.

Classified by legal form, 33 of these entities are limited liability companies, 5 corporations, 1 sole proprietorship and 1 branch of a foreign company.

The cases taken in the study were obtained from public reports mainly of investigative or tax authorities for entities that have made financial frauds. Although these cases have been made public, we have preferred that the names of these entities should not be disclosed in the study, as it is not in the objectives of the study to record them.

ANALYSIS AND FINDINGS

From the analysis of the cases that we have created the database and at the same time from the analysis of the current reporting situation in Albania we can say that the security of the sentence in the case of fraud is present and is well regulated by law. But the improvement of rules and legislation does not mean the disappearance of motives for these individuals or

economic entities not to be involved in fraud. Apparently, most of these cases had created some sort of security for not revealing the fraud they had done. This “Security” deriving from the fact that this fraud was carried out in cooperation with responsible persons of the authorities who were responsible precisely to prevent the commission of these frauds.

At the same time, another factor that seems to have “contributed positively” to the commitment of these frauds was fiscal amnesties, which during the study period (2008-2014) were not uncommon. Beyond all the positive effects associated with fiscal amnesties, undoubtedly one of the most damaging effects associated with fiscal amnesties is the risk of amnestying money gained from fraud or illegal activities, thus creating the perception that the punishment even after fraud has been discovered can be amnestied. According to Luitel & Sobel, 2007 repeated broad-based amnesties produce little or no additional short-run revenue, while creating increasing long-run revenue losses due to reduce compliance that grows as additional amnesties are offered

It is worth mentioning that: Based on the “List of taxpayers benefiting from Law 39/2014 “On the remission of administrative penalties in the form of fines”, it is noticed that the value of the forgiven fines of only 14 subjects over 40 that we have taken into the survey, occupy 54% of the value of the beneficiaries of this “Fiscal Amnesty”. It should be noted that from this amnesty there were about 59411 and 58243 private entities and 1,208 public entities. The total amount amnestied was about ALL 3 billion. Part of the forgiveness was also fined that were in the process of administrative appeal or judicial appeals.

According to Wells, 2004: "If the punishment is certain and rapid", there are reasons to be harsh" but in our opinion, when these two factors are missing, it should be a tough punishment as a preventative factor. From the analysis of the cases considered, it results that most of the court's decisions for responsible persons or business involved in fraud have been a shortened trial by bringing down the corresponding penalties.

It is also important to mention that in these trials only the financial loss that these frauds have caused to the responsible state bodies (Customs, Taxes, Insurance Fund etc.) have been taken into account but have not taken into account the loss that these frauds have caused to third parties other or environmental damages. We think that this has affected the reduction of the sentence.

CONCLUSIONS

The reason why a separation into relatively honest and relatively dishonest taxpayers as Falkinger & Walther, 1991 recommended, seems desirable is that such separation opens up the possibility of intensifying the specific fight against egregious evasion. It seems that amnesties

occurred in Albania during the last decade was too often and these amnesties have allowed tax evaders to repay previously evaded taxes. These amnesties didn't separate taxpayers and didn't meet a constitutional constraint that would prevent the participation of entities that previously has become known as evaders reporting financial statements or who have reported factious evidence (this separation in these cases would be easily identifiable). Of course these lack of constraint hadn't intensified the fight against evasion, unfortunately, it seems that the most main beneficiaries of this amnesty appear to be these tax evaders.

This study was limited to a small number of case studies in Albania occurred in the last tax amnesty. It is therefore recommended that further research is conducted on the same topic but capturing a high number of cases extended in a wider period of time.

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