

# The Effect of Tax Rates on Fiscal Evasion and Avoidance

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## Abstract:

In order to find elements that destimulate fiscal evasion or avoidance, we have submitted six elements, through the questionnaire, to determine which elements are that destimulate the fiscal evasion and avoidance, and evaluate their impact. This paper is focused in customs duty avoidance. The elements that we have submitted to evaluate their power, are: Powerful control during customs clearance, more efficient post clearance control, probability of subject investigation, higher fines, lower tax rate, consciousness of companies. In this research, we collected 248 answers, and can present these results: Fiscal policy or lower tax rate is a powerful element that can't stimulate a tax evasion and/or avoidance, for this element we received 68 answers from respondents or 27.42%. The other element is powerful control from customs during clearance, for this element we received 52 answers from respondents or 20.97%. The next element following is consciousness of companies, for this element are 36 answers from respondents or 12.90%. The next element investigation are 33 answers or 12.90%, post clearance control are 31 respondents or 12%, the last element is higher fines, that are 28 respondents or 11.29%. As presented, all the elements are very close to each other, except first and second element, which are: lower tax rate and powerful control from customs during clearance. These elements have more effect, that destimulate tax evasion and avoidance.

*Keywords: tax rates, fiscal evasion, fiscal avoidance, elements of destimulate.*

## 1. Introduction:

We have submitted some elements that can to destimulate the evasion and avoidance, but the one element that was order to tested is *tax rates*, if have effect tax rates on fiscal evasion and avoidance. The other elements that we have submitted are: Effect of customs control on tax evasion and avoidance, Awareness of taxpayers on tax evasion, Post Clearance Audit (PCA), Investigation and enforcement and in this case are compared with other elements, where the element which is the first and powerful, is tax rates, where shows effect on tax evasion and tax avoidance. Is that increasing tax rates beyond a certain point will be counter-productive for raising further tax revenue as Laffer effect, higher tax rate by increasing their evasion activity (Alm declared (6)), one percentage-point increase in the tax rate is associated with a 3 percent increase in evasion (R. Fisman & Sh. Wei 2001), there is significant relationship between the tax rates and tax avoidance and tax evasion (Adebisi, J. F. Phd and Gbegi D.O. 2013). To increase effect of the customs control, In order to destimulate the evasion and avoidance, needs for

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continued and deepening cooperation between customs authorities and investigators, ensuring the quality, accessibility and timeliness of collected data, and pursuing measures to improve the capacity for electronic risk profiling (European Commission, 2014). Fiscal awareness is the individual perception of each citizen with respect to fiscal ethics and with respect to the fiscal morale of the society in which he or she lives. Tax evasion affected by the attitude of awareness of the taxpayer and tax morale is present in every taxpayer (DusaSumartayer and AtinHafidiah, 2014). The next, post clearance audit and the investigation, shows the effect on tax evasion and avoidance.

## **2. Methodology:**

Methodology: Survey was realized through questionnaires, which were distributed 248 questionnaires. Questionnaires were distributed mainly to the importing companies, officers that realize controls to businesses, customs agents, accountants and international transport companies.

## **3. Review Literature:**

### **3.1. Effect of tax rates on tax evasion and avoidance**

One implication of the Laffer Curve is that increasing tax rates beyond a certain point will be counter-productive for raising further tax revenue. The Laffer Curve also highlights that tax rate cuts in this framework do not amount to tax cuts. Effective tax rates can increase when the official tax rate is cut. In fact, this is exactly what causes the Laffer effect here. Moreover, tax rate cuts raise effective taxes only by making tax evaders pay more taxes only by making tax evaders pay more taxes. Honest taxpayers will end up paying less taxes, while the government's tax revenues increase. So the model shows that tax rate cuts can increase tax compliance so much that tax revenue increases in response (Tomas K. Papp and Elod Takats). Claiming that a higher tax rate encourages evasion. In this case the theory does not provide a clear prediction, that the optimal tax analysis does not offer any clear conclusion on this point. Although most of the theoretical models predict that reported income increases with the tax rate, widely held empirical evidence runs in the opposite direction. Most empirical studies support the idea that a higher tax rate encourages evasion, even though some papers are doubtful about this result (Maria Jesus Freire-Seren, Judith Pamades, 2013), As Alm declares in (6) "My basic conclusion is a simple one: we have learned a lot in the last 40 years but there are still major gaps in our understanding. Indeed, we are still trying to answer many basic questions... Do higher tax rates encourage/discourage tax compliance? Higher tax rates by increasing their evasion activity. Other studies that do include a marginal tax rate variable obtain mixed results, ranging from no effect to a positive effect (Steven E Crane and FarrokhNourzad, 1999). So, Graetz, Reinganum and Wilde 1986, said, recent to analyze this issue in a game theoretic context have even resulted in a negative relationship between tax rates and evasion. One percentage-point increase in the tax rate is associated with a 3 percent increase in evasion. In this way higher tax rates provoke tax evasion (Raymond Fisman and Shang-Jim Wei, 2001). Supposedly that tax rates go up, people report less taxable income, because they are engaging in more tax evasion (Jon Bakija and Williams College, 2011). There is a significant relationship between the tax

rates and tax avoidance and tax evasion (Adebisi, J. F. Phd and Gbegi D.O. 2013). In the paper (Charles T. Clotfelter, 1983), relationship between tax rates and evasion is significant, because tax rates are an instrument that can be manipulated for policy goals and because such rate changes may have a substantial effect on evasion. This paper investigates the relationship between marginal tax rates and tax evasion. The data set used in the paper, the Internal Revenue Service's Taxpayer Compliance Measurement Program, survey for 1969, consists of observations of actual tax return data individuals. In this case in general, the findings suggest that marginal tax rates have a significant effect on the amount of the tax evasion. There show that higher tax rates cause more evasion and increase the resources wasted in the contest. Additionally, conditions under a government should enforce incentive compatible auditing in order to reduce wasted resources.

### **3.2. Effect of customs control on tax evasion and avoidance**

A customs control point or area is a station where government officers screen travelers taking goods into or out of a country or any other defined area with customs regulations. Screening may involve interview questions, inspections, and searches. Officers may restrict the entry or exit of certain goods, or impose fines, levies, customs fees, or taxes on items crossing the border. Customs control stations are often located at airports and along major roads and railways where they cross restricted borders. They are different from customs offices, which usually handle shipped goods. One of the main risks in customs operations is customs fraud, as activities for evading, or attempting to evade, payment of duties, generally on imports of commercial goods (Jovanka Biljanoska). To increase effect of the customs control, needs for continued and deepening cooperation between customs authorities and investigators, ensuring the quality, accessibility and timeliness of collected data, and pursuing measures to improve the capacity for electronic risk profiling (European Commission, 2014). The data indicate that tariff evasion takes place through misrepresentation of the import prices rather than underreporting of quantities or product misclassification. There are three potential channels through which importers may attempt to avoid or to minimize their tariff payments: (i) undercounting physical quantities of imported products; (ii) misrepresenting the price of imported products; and (iii) misclassifying high tariff products as a lower tariff variety. In this section, each channel caused the evasion methods (Beata S. Javorcik and Gaia Narciso). Based on systematic analyses of discrepancies in trade declarations - when available - for both partners, the paper of (Sebastien Jean and Cristina Mitaritonna, 2010) suggested that evasion of customs duties is greater in poorer countries, especially where the rule of law is limited. The fight against illicit financial flows and tax evasion became a priority for customs official (French Customs 2013, results).

### **3.3. Awareness of taxpayers on tax evasion**

Fiscal awareness is the individual perception of each citizen with respect to fiscal ethics and with respect to the fiscal morale of the society in which he or she lives. Fiscal awareness requires some degree of reflexive knowledge on behalf of the citizen. This knowledge concerns both the public revenues (how the state obtains its resources from

the citizens) and the public expenses, how the state spends its revenues in benefit of the citizens (Gloria Alarcon and Arielle Beyaert, 2010). Tax evasion affected by the attitude of awareness of the taxpayer and tax morale is present in every taxpayer (DusaSumartayer and AtinHafidiah, 2014). Awareness is an element in human beings to understand reality and how they act or behave towards reality. Some form of awareness to pay taxes that encourage taxpayers to pay taxes. Firstly, the realization that the tax is a form of participation in supporting the country's development. Knowing this, taxpayers want to pay taxes because they are not harmed from tax collection is done. Secondly, the awareness that the postponement of tax payments and the reduction of the tax burden is very detrimental to the country. Taxpayers want to pay taxes because it understands that the delay in payment of taxes and the reduction of the tax burden impact on the lack of financial resources, which can lead to delays in development of the country. Thirdly, the realization that taxes are set by law and can be enforced. Taxpayers will pay for the tax payment have realized a strong legal foundation and are the absolute duty of every citizen (Irianto, 2005). The roles of the individual income tax are required in the developed countries, in line with citizens' awareness of the tax payment obligation in accordance. Annette Alstadsaeter and Martin Jacob, 2013, show that lack of awareness of the tax code and complexity in compliance can increase tax evasion. The majority of misreporting cases remains undetected by the tax authority, but self-correction of tax evasion by taxpayers is the dominant type of detection.

### **3.4. Post Clearance Audit (PCA)**

Post Clearance Audit have these objective that can be summarized as follows: a). To assure that Customs declarations have been completed in compliance with Customs requirements, via examination of a trader's systems, accounting records and premises; b). To verify that the amount of revenue legally due has been identified and paid; c). To facilitate international trade movements of the compliant trade sector; e). To ensure goods liable to specific import/export controls are properly declared, including prohibitions and restrictions, licenses, quota, etc.; d). To ensure conditions relating to specific approvals and authorizations are being observed, e.g. pre-authenticated transit documents, preferential origin/movement certificates, licenses, quota arrangements, Customs and excise warehouses and other simplified procedure arrangements. Post Clearance Audit should not be confused with "internal audit," which is a mechanism to verify and review, either conducted by a company to review its own internal procedures or by Customs to review Customs' own internal rules and procedures. Internal audits may be useful for management purposes and are an important part of an integrity programme but are quite distinct from the concept of Post Clearance Audit ( Guidelines for Post Clearance Audit, 2012). The World Customs Organization (WCO), in recognition of this need to adapt to the growing world economy, has spelt out in the Revised Kyoto Convention the need for Customs agencies to move towards post clearance controls to facilitate trade, which includes transitioning towards 'control based audit', which represents the auditing of traders' internal systems and controls as they relate to Customs requirements. The following Standards contained in the Revised. Kyoto Convention are of particular relevance; Standard 6.6: Customs control systems shall include audit-based controls; and Standard 6.10: The Customs shall evaluate

traders' commercial systems where those systems have an impact on Customs operations to ensure compliance with Customs requirements. A major difference between the conduct of PCA and more traditional approaches to auditing is the skill set and knowledge required of the auditor. Customs audit has typically been based on a sound knowledge of customs law and technical skills in tariff, valuation and origin. PCA however requires an understanding of how a business operates and how this relates to its transactions with the broader spectrum of regulatory agencies. If it is suspected fraud, or if it is the opinion of the PCA auditor that the noncompliance detected may be due to fraudulent activity on the part of the trade or individuals within the company, then this should be reported to the audit manager immediately. Suspected fraud against the border administration should be handed over to the relevant investigation authority either within or external to the agency. Fraud is a crime, and its investigation and prosecution involves skills very different to those of the auditor. Auditors should remember, however, that they may become prosecution witnesses, and their audit working papers would be used as evidence in any prosecution case. Therefore, all audit papers should be properly completed, filed, and stored securely.

### **3.5. Investigation and enforcement**

To develop an effective and efficient customs service capable of the detection, preventive and investigation of fraud and preparation of cases for the prosecution of offenders. His service must be flexible enough to respond to an intelligence-led strategy based on the latest methods of targeted risk assessment and modern technology to safeguard revenue and protect society. The service should also enforce compliance with national legislation, international legislation and international institutions (e.g. world customs organization (WCO), world trade organization (WTO), Un) through consistent application of the legal basis establishing the requisite customs powers and sanctions to enforce the customs. Kim, Jaisik and McCulugh, James (2007), in a paper for agriculture products, said: The increase of investigation rate had the strongest significant effect on customs tax compliance for agricultural produce. If subjects are selected for investigation, they have to bear a decrease in their income equal to the amount of fine and penalty, and furthermore, they might be sent to jail. Due to the strong punishment, the higher investigation rate can be the more powerful deterrent of customs tax evasion.

## **4. Results**

While above, we have made description about fiscal evasion and avoidance of the customs duty, which such is present in different countries, but in the different level. In this case, are submitted some elements, in order to found, which is the powerful element than have effect in destimulate the evasion and avoidance. as base element is tax rates. In following description the results:

Elements	Nr of Respondents	Percentage
Tax Rates	68	27.42
Control customs during of the clearance of goods	52	20.97
Awareness of taxpayers on tax evasion	36	14.52
Investigation and enforcement	33	12.90
Post Clearance Audit	30	12.00
Rate of fines	28	11.29
<b>Total</b>	<b>248</b>	<b>100 %</b>

Fiscal policy or lower tax rate is a powerful element that can't stimulate a tax evasion and/or avoidance, for this element we received 68 answers from respondents or 27.42%. The other element is powerful control from customs during clearance, for this element we received 52 answers from respondents or 20.97%. The next element following is consciousness of companies, for this element are 36 answers from respondents or 12.90%. The next element investigation are 33 answers or 12.90%, post clearance control are 31 respondents or 12%, the last element is higher fines, that are 28 respondents or 11.29%. As presented, all the elements are very close to each other, except first and second element, which are: lower tax rate and powerful control from customs during clearance. These elements have more effect, that destimulate tax evasion and avoidance.

Conclusion:

Tax rates, must to take in account then where the fiscal policy, is being designed, in order to destimulate or reduce the tax evasion and avoidance of customs duties.

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