

FREEDOM OF ADMINISTRATION IN THE TAX LAW AND ABUSE OF RIGHT

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Abstract

Taxes are „the evil” in the absence of which the established companies cannot exist. The states need taxes in order to be able to fulfill the tasks for which they exist, and people – social beings by their nature – need states. But in their increasing need for revenues, states misuse the taxation right and the defense means of taxpayers for this purpose are limited. Between the need of the state for resources and the tax liabilities of taxpayers there must be a balance, its lack being injurious for both parties to the legal and tax report.

Keywords: *tax, taxable matter and economic reality, tax authority, appreciation right, freedom of management, abuse of right*

Introduction

The tax continues to be associated with constraint and oppression because it is, incontestably, a burden. This nature of the tax is revealed by its very legal definition when speaking about it as a “mandatory deduction, without consideration and non-refundable, for meeting needs of general interest”. Of course, it is a different burden than the robbery, the tribute or the requisitioning preceding it and in relation to which it represents progress, but just how big are the differences between the tax and the deductions preceding it? The impost, the tribute were levied sword in hand! The tax is usually paid willingly and, in case of refusal, it is levied by using more subtle means of coercion: enforcement by garnishment or by selling the tax debtor’s assets. Therefore, in our opinion, the tax seems an advanced tribute while, according to some authors, it represents even a “liberal technique” since it is the means of making citizens contribute to the needs of society and the personal needs of their leaders, leaving them maximum freedom”¹.

Taxes, however coercive they are, should be regarded with understanding, because it is taxes that allow the operation of organized societies. For this reason, whether we pay them out of conviction or because we cannot avoid paying them (when avoiding paying them, people risk even criminal penalties), as long as the economies of countries are not sufficiently developed and the monetary resources are not sufficient for the population to be released from the burden of taxes, taxes will continue to be part of our life. And, as long as taxes exist, our individual freedom will be limited and the freedom of company administration will be limited, as well.

But how and why is this limitation of our freedom produced by means of taxes? The answer seems simple: the State collects a share of our revenue and our assets and it wants the share it collects to be as large as possible. And, in order for this share to be as large as possible, the State restricts our possibilities to decrease the taxable income, undertaking the right to control our documents and actions by which we attempt to ease our fiscal burden and to reconsider them according to its interests.

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¹ G. Ardant, Histoire de l’impôt, quoted by M. Bouvier.

1. Ideally taxable economic reality

The State, the tax authority and the lawmaker, in particular, have their eyes on the economic reality because this is the income that can be taxed, this is the source that keeps them alive. Nevertheless, in fact, there are important differences between the economic and the legal reality, between the taxable and the taxed reality for multiple reasons, some of them assignable to the State, others to the tax payers. Of course, the State and the tax authorities intend to tax reality and not appearances, but the State must act this way even when reality is less favorable to it than appearances.

However, the State is interested in the economic reality under multiple aspects: it generates it by the way in which it regulates social relationships, it develops it or, on the contrary, it makes it regress through its policies and the measures it adopts and implements, as well as by the way and efficiency with which it manages its revenue, among which fees, taxes and contributions are the most important.

The legal position of the State in the relationship regulated by the tax law is difficult to be qualified: a third party with regard to the private law legal relationships in which tax payers enter, the State is interested in these relationships because they generate taxable income and because the State is the eternal creditor (the State is rarely a debtor) of its tax payers, to which, most often, it is related only by citizenship relationships, without such a relationship being absolutely necessary for them to hold the position of tax debtors. Yet, in addition to the fact that the State has the position of tax creditor directly from and according to the law, the State enjoys other privileges as well: it has on its side not only the law (that it makes itself), but also the public force (that it also organizes and maintains) and, in the legal relationship under the tax law, regulated by public law norms, the parties are not on an equal position and the tax payer is the one who, in the relationship regulated by the tax law, has a position of inferiority to the State. The tax payer has an obligation (fundamental duty) to pay taxes but, in exchange for it, the State has no obligation for a consideration². As a principle, the tax payer's obligation to pay the tax has no correlative right. Of course, this is not the case for fees and contributions, the former usually being owed for a service supplied by a public institution and the contributions, for returning in various forms (pensions, aids, medical services) to the payers.

Being interested in the reality it taxes and in its claims and having full powers to act, the State also granted to itself the right of inspection over this economic reality, over the tax payers' documents and actions and undertook the right of assessment of such documents and actions and the right to decide by itself whether such documents and actions comply with the regulations that it adopted as well and to which, it is true, we have agreed through the representatives sent to the Parliament. It is a power that is often abused by the authority and before which the tax payer has few means of defense.

Nevertheless, in fact, nowhere in the world do the States tax everything that, theoretically, might be taxed, but only what should actually be taxed. Taxable reality and taxed reality are two different things. The State tries to get as much as possible, tax payers try to give as less as possible and each of them acts according to its goal. For this reason, the economic reality in the matter of taxes is always opposed, with more or less success, by the legal reality, but the latter also includes, unfortunately, the differentiated treatment of tax payers and the advantages (not always fair) granted to some of them by the State itself. The immeasurable rapacity of the State, in its chase for resources, is opposed by tax resistance in various forms: some of them legal, others illegal.

² The statement is valid only for taxes. As we have seen, taxes are usually owed for the service supplied and contributions return to their payers in the form of pensions, aids etc.

Between these extremes, only the midway is left, which is characterized by moderation, proportionality, dialogue, respect to the law and to the rights of others, equality before the law and authority, individual freedom and freedom of trade. And justice, which is called to temper the excesses of any party in the relationship regulated by the tax law and to penalize them.

2. Exercise of the right of assessment and the principle of proportionality

Since the State is interested in the economic reality, the right of assessment in relation to the tax payers' documents and actions is acknowledged to it, as a principle. Nevertheless, the principle thus stated in art. 6 of the Fiscal Procedure Code ("exercise of the right of assessment") **is not found in any other regulation**, and its clarification in the Romanian Tax Procedure Code seems to us to establish **not a normal rule of conduct**, but a provision likely to **grant to the tax body a right and full power of assessment**.

Indeed, according to art. 6 of the Tax Procedure Code, *„the tax authority is entitled to assess, within the limits of its duties and competences, the relevance of fiscal situations and to adopt a solution admitted by law, grounded on full findings on all the clarifying circumstances in the case”*.

The agreement between the conduct of civil servants and their decisions, on the one hand, and the law, on the other hand, is the obligation of every civil servant, authority or magistracy and not just of the fiscal agent, an obligation derived from the principle of lawfulness, which is a fundamental principle in all the law systems, for all branches of law. This principle is also established by art. 1, paragraphs 3) and 5) and art. 16, paragraph 2) of the Constitution of Romania, which sets forth strict compliance with the law by all its recipients: the citizens and the State, the latter meaning its institutions and its civil servants. For this reason, the principle of the rule of law must be an integral part of the administrative-fiscal culture as well.

In a democratic country, the rule of law appears as an answer to the need for legitimacy, the rule of law being required for the exercise of public power. The collection of taxes, fees and contributions is vital for any State (because it allows its operation), but their good administration cannot be a goal in itself, but also a method of materializing the rule of law in the sensitive field of taxation, which is a part of our life, both as a society and as individuals.

In the Community law, **lawfulness, and not the exercise of the right of assessment, is regarded as a principle of good administration**, the idea being formulated in the Recommendation CM/Rec(2007)7 of 20.06.2007 of the Committee of Ministers of the Council of Europe to the member states of the Council of Europe on good administration. Art. 2 of this recommendation refers to the principle of lawfulness in administration, which also includes the tax planning, and has the following wording:

„(1) Public authorities shall act in accordance with the law. They shall not take arbitrary measures, even when exercising their discretion.

(2) They shall comply with domestic law, international law and the general principles of law governing their organization, functioning and activities.

(3) They shall act in accordance with rules defining their powers and procedures laid down in their governing rules.

(4) They shall exercise their powers only if the established facts and the applicable law entitle them to do so and solely for the purpose for which they have been conferred”.

It results that, in compliance with the rules of national law, as well as with the rules of the Community law, the requirements of lawfulness of the administrative decisions also include those regarding their issuance by the competent body, based on and by enforcement of the law, since the relation between the administrative decisions and the law is one of subordination. The Constitutional Court has constantly decided, in agreement with our Constitution, as well as with

the ECHR and the CJEC case law, that lawfulness should lay at the basis of all legal relationships in a rule of law and that the rule of law governs the entire activity of public authorities.

However, if we admit that the exercise of the tax authority's right of assessment, as set forth in the Tax Procedure Code, has the value of a principle, then we should also show that **this right of assessment can only be limited**, because **where the citizen's right begins, the administration's right of assessment ends**.

Even where the lawmaker uses expressions related to the full power assigned to the tax authority (for instance, the use in the text of the law of the words „can”, „is entitled” etc.), this cannot be interpreted as a freedom or as a power outside the law, but as one within its limits. In compliance with the principle established in art. 16, paragraph (2) of the Constitution, the exercise of the right of assessment cannot be conceived outside the law. In any case, the exercise of the right of assessment by the tax authority, by infringing the limits of competence or by infringing the tax law or the rights and freedoms of citizens, represents an infringement of the principle of lawfulness and is a form of manifesting the excess of power.

There are situations in which the tax authority has the obligation and not only the right to assess, but it seems that for the lawmaker there is no difference between the obligation to estimate and the right to estimate. Thus, art. 67 (Estimation of the tax base) of the Tax Procedure Code, in paragraph (1) states that *„If the tax authority cannot establish the size of the tax base, then it has to estimate it. In this case, all the data and documents relevant for the estimation must be taken into consideration. The estimation consists in identifying those elements that are the closest to the tax facts”,* and paragraph (2) states that *„In the situations in which, according to the law, the tax authorities are entitled to estimate the tax base, they shall take into consideration the market price of the taxable transaction or good, as defined by the Tax Code”.*

The Tax Code provides for situations in which the tax authority (as well as the tax payers, for instance art. 81 of the Tax Code³) has the obligation to make necessary estimations, in particular for establishing the taxable base and assessing it, when the tax payer fails to do it itself and sometimes sets forth criteria or strict rules within whose limits and based on which the tax authority can make estimations. Thus, art. 67 paragraph (2) sets forth as a criterion for assessing the tax base the market price of the transaction or the good. In case of tax documents lost, destroyed or deteriorated of economic agents paying excises, art. 213 of the Tax Code sets forth a strict rule stating that first of all, they have the obligation, within 30 calendar days after recording the loss, destruction or deterioration, to restore the excises related to such transactions based on the accounting records. In case of the economic operator's failure to restore the tax liabilities, *the competent tax authority shall establish their amount by estimation, multiplying the number of documents lost, destroyed or deteriorated by the average of excises recorded in the delivery*

³ Art. 81 – Estimated income statements of the Tax Procedure Code has the following content: (1) Tax payers, as well as unincorporated associations, starting an activity during the fiscal year shall submit to the competent tax authority a statement regarding the income and expenditure estimated for the fiscal year, within 15 days after the occurrence of such event. Tax payers obtaining income for which the tax is collected by tax deduction at source shall be exempted from the provisions of this paragraph. (2) Tax payers obtaining income from the assignment of the use of goods in their personal assets shall submit a statement regarding the estimated income, within 15 days after conclusion of the agreement between the parties. The statement regarding the estimated income shall be submitted upon registration of the agreement concluded between the parties with the tax authority. (3) Tax payers recording losses in the previous year and those recording income during shorter periods than the fiscal year, as well as those that, for objective reasons, estimate to obtain income different at least by 20% to the previous fiscal year, shall also submit the statement regarding the estimated income together with the statement regarding the obtained income. (4) Tax payers establishing their net income based on standard income, as well as those for whom expenses are established based on a fixed amount and who opted for establishing the net income in real system shall also submit the statement regarding the estimated income together with application for options.

invoices during the last 6 months of activity, prior to the date of finding the loss, destruction or deterioration of the tax documents.

However, things become more complicated when and if the tax authority is acknowledged a right of assessment regarding the description of legal operations, the interpretation of contractual provisions, the possibility of invoking the nullity of legal documents etc. When its right of assessment is exercised in relation to documents and operations presumed to be concluded or carried out according to the law and in good faith and the interpretation made has different consequences in respect of tax liabilities. For instance, could the tax authority describe a partnership agreement as actually being a lease agreement, claiming that this is the correct interpretation of the parties' operation? Could the same tax authority find a contractual provision null claiming that it infringes an imperative provision of the law or that the document is made by breaking the law? Could the tax authority do what only the judge can do: to find the simulation, nullity, to interpret the will of the parties or to conclude that the real will is not consistent with the will declared in the document?

However, not acknowledging any right of assessment to the tax authority in relation to the lawfulness of documents and operations means not only depriving the authority of the right and the possibility to suppress obvious tax evasion actions itself, but also putting it in the position of witnessing helpless their multiplication, by the reproduction of the tax evasion procedure by other tax payers as well. Acknowledging an unlimited right of assessment to the tax authority means endangering legal relationships and even eliminating the presumption of the parties' good faith in the legal documents that may also generate tax liabilities. However, refusing any right of assessment to the tax authority may result in creating conditions for the avoidance of tax payments or for hiding the tax base, by means of legal tricks that could not be subject to judicial review as well.

We believe that, in the exercise of the right of assessment, the tax authority is bound by the **principle of proportionality and moderation**, in agreement with which the use of the right cannot be discretionary, and its assessments, conclusions and measures cannot be arbitrary. **The tax authority must act, in fulfilling the duties falling upon it, reasonably and moderately, and its decisions must ensure a fair proportion between the goal pursued and the means used for its achievement.** However, the limits within which the tax authority acted cannot avoid judicial review under any circumstance.

3. Exercise of the right of assessment versus freedom of administration

The exercise of the right of assessment and the active role of the tax authority cannot have as consequence either the examination or the influencing, directly, of the tax payers' activity and tax planning, no matter their capacity (individual or legal entity, national or foreign), the nature of the capital (private, state-owned, mixed, national, foreign) etc., such an intervention being opposed by the **principle of the freedom of administration (administration) or prohibition of interference in the company administration.**

The **freedom of administration** means the taxpayer's right to **act and make administration decisions resulting in the decrease of the tax burden, the payment of the smallest tax.** The principle of the freedom of administration is a product of the judicial practice, priority having (apparently) the French and the Belgian courts, but which we also find in the case law of the Supreme Court of the United States. Nevertheless, the idea is old in the doctrine and we find it long before that, in a form that is quite close to the content, in Adam Smith's work „The Wealth of Nations” (resumed in recent works) and applied in the mentioned decision of the US Supreme Court, on which we will return.

For all taxpayers, tax planning has become an art, a science, an industry, where people speak more and more and even aggressively about “tax strategies”, “optimization of decisions with tax impact”, “tax optimization”, “tax-planning” and even about the “eulogy to be brought to tax ability”. Today, people admit that, just like in common law (civil, commercial) notions such as “good family father” or „prudent and well-advised administrator” are used, in the tax matter there is a “good tax planning” or a “good financial management”.

Everywhere, the authority is abusive and excessive and in a permanent conflict with the taxpayers, who are unhappy with the increasing burden of taxes imposed on them by the states continuously searching for tax base and methods of increasing their share. Therefore, the fact that science has adopted a balanced position and has served not only the authority – to which it has provided arguments for justifying the right of taxation, as well as for perfecting the means and methods of taxation, also criticizing its excesses and proving their negative consequences – but also the taxpayers, to whom it has provided solid arguments not for justifying the useless forms of tax resistance, more or less violent, such as protests, anti-tax movements or illicit tax avoidance, but for reducing the tax burden weighing too much on their shoulders, with the means of and according to the law, cannot be random as well.

France is a good example in this respect because it is not just the country that, in the middle of last century, gave the world one of the most effective taxes (the value added tax), or the country that has experienced all forms of tax resistance: from violent protests and evasion to organized movements at national level (Poujadism and Nicoudism being the most recent and known ones)⁴, but also the country in which a valuable and rich doctrine justifies the taxpayers’ right to reduce their tax burden without breaking the law. Thus, the recent French doctrine shows that *“since paying taxes is an honorable obligation, the good family father and the good administrator also have the duty to pay the lowest tax possible, of choosing the less taxable way”*⁵, and that *“wanting to pay the highest taxes may be, for some people, a proof of holiness or heroism, but most people will be convinced that it is rather a proof of craziness and, in no case, a model of family father worth to be followed”*⁶. Two centuries ago, in England, Adam Smith said almost the same thing and his arguments will be resumed and developed by judges of the US Supreme Court.

The freedom of administration does not exclude, but, on the contrary, it supposes the inclusion of taxation into the calculation of each taxpayer’s administration decisions. The taxpayers’ knowledge of the tax law and the tax burden imposed on them is necessary not only for them to be able to meet their numerous tax liabilities, but also for their decisions to be consistent with the interest in paying the lowest tax possible, by taking into consideration the tax liabilities it generates, since the law itself sometimes explicitly provides the taxpayers with the right to opt for one decision or another⁷. But even when the law does not explicitly say it, the taxpayers’ decisions

⁴ After World War II, France has seen two spectacular oppositions against the tax authority. The first one, in the 50s, also known as “the protest of small shopkeepers” (similar to the riot of peasants in the previous centuries), led by Pierre Poujade, the owner of a small stationery business, who created the “The Union for the Defense of Traders and Artisans” which sent to the Parliament elected in 1956 an important number of members. His movement, without any plan, which started from the south of France and expanded to the whole country, also had violent forms. The second opposition was led by Gerard Nicoud, started in 1969 and had as starting point a rich region of France. The members created a Committee of Initiative and Defense and it also had violent forms both against the tax authority and against some politicians. Apud M. Bouvier, Finances publiques, p. 603

⁵ Patrick Serlooten in Droit fiscale des affaires, Précis Dalloz, 2006, 5th edition, p. 25.

⁶ Maurice Cozian, Précis de fiscalité des entreprises, Litec, 2007, 31st edition, p. 534.

⁷ For instance, for amortizing the technological equipment, namely the machines, tools and installations, as well as for computers and their peripheral equipment, the tax payer can opt for the straight-line method, decreasing or accelerated, and in case of any other depreciable fixed asset, the taxpayer can opt for the straight-line or decreasing depreciation method. See art. 24 letter b) and c) of the Tax Code.

having tax consequences can be limited only by imperative provisions of the law. Everything that is not explicitly prohibited by the law is allowed in the tax matter as well.

In a correct enforcement of this principle, the tax authority cannot take the place of auditors or financial examiners and cannot assess the quality or results of the activity, even improper, of the company's administrators, in relation either to the financial or the commercial administration. The tax authority cannot give administration lessons to the taxpayers, not even when their decisions are wrong, since any company has the right to do bad business. The company administrators can do anything that is in the company's interest and the way it is in the company's interest, since even the Romanian Tax Code in art. 3, letter b) acknowledges to the taxpayers not the right of "*following and understanding the tax burden imposed on them*", but that of "*establishing their influence as financial administrators on their tax burden*". In fact, we also find applications of this principle in the company law, in which only the control of the lawfulness of general assembly decisions is allowed and not the control of their opportunity as well, and the case law in this matter has been constant in this respect.

The principle of the freedom of administration supposes that:

- a) Taxpayers have the right to simply refuse to make a tax base by inactivity, by refusing to work, to obtain taxable income or profit, by refusing to invest their savings or to deposit them in banks subject to interest. However, we should note that this effect (of not making a tax base) is also produced by excessive taxation, when taxpayers are no longer interested in creating a tax base because this is (almost) entirely grasped by the state. Yet, in this case, the state incurs other consequences of its wrong tax policy as well, because inactivity increases the number of social assistance recipients, and implicitly the state's need for resources, but also increases pressure on the active taxpayers that the state must put in order to cover the deficit and/or the need for resources, a vicious circle thus being created.
- b) Taxpayers have the right to choose the method that generates the smallest tax burden. Thus, taxpayers can choose to take loans – thus increasing their expenses – and, when they possess internal resources, they have the right to administer and keep their savings unproductively; they also have the right to purchase the goods necessary for carrying out the activity not at the lowest prices in the market etc. Thus, the state that, by means of unreasonable authority measures, since they are contrary to the economic reality, aims at increasing the taxpayers' tax base by limiting deductible expenses, for instance, obtains a result that is contrary to the one expected because, on the one hand, the profit on which the tax is calculated is not real and, on the other hand, because such policies cause evasional behaviors, when the entire tax base is withdrawn from tax, or abandonment of activities, or increase of expenses, by other means, and decrease of the tax base;
- c) Taxpayers have the right, **uncensorable by the state authorities**, to be wrong, to do bad business or investment, to waste their money without profit and to oppose their decisions to the tax administration. Wrong decisions can be censored and sanctioned, in all situations, only by those with whom the decision-making factor is bound by relationships based upon which it has obligations of result and, in relation to the state, which is represented by the tax authority, the taxpayer has no such obligations, as a principle, and cannot be sanctioned because it does not produce profit, namely tax base. The taxpayer might still be in such a situation if, for instance, it received payment facilities or when the taxpayer, being subject to an insolvency procedure, was approved a reorganization plan that it does not implement.

4. Economic reality, freedom of administration and abuse of right

The reason behind the tax law is that of ensuring the legal framework for establishing the tax base and the tax and ensuring the collection of the income. Thus, in a rigorous interpretation of the tax law, any attempt to reduce the tax base and the tax owed can be only an infringement of the law and the action taken for the purpose mentioned can be regarded only as an action breaking the law. In other words, since taxation is based on the economic reality, the tax administration has not only the temptation, but also the obligation to oppose this economic reality to a “legal reality”, by which the tax base is reduced.

However, the tax law does not stipulate that a taxpayer must pay the lowest tax possible, leaving to it the right to choose the method generating the lowest tax liability. Moreover, we should also remind the fact that, for the taxpayer, it is not the payment of taxes that is its reason of being, just like for the state, it is not the collection of the highest tax possible that is its reason of being. Moreover, the collection of the highest tax possible from the taxpayers, besides the fact that it can only occur for a short period, can only have one, catastrophic result for the state: the disappearance of the tax base and of the taxpayer. For this reason, the permanent dispute between the state and the taxpayer, besides the fact that should be regarded and accepted as something normal, is also generating positive results since it is the only way to follow in order to temper the parties' excesses and contribute to the improvement of tax laws.

Therefore, the taxpayers have the freedom to manage their individual household or business according to their interests, they have the uncensorable right to do good or bad business, they have the right to take advantage of the law and its shortcomings in their own interest and they have the **right to do everything that the law does not expressly prohibit**. They also have the right to choose, among all the possible methods, the one generating the lowest tax possible.

However, the freedom of administration that is acknowledged to taxpayers cannot be used so that, in its name, the rights of others could be overlooked, the rights of third parties could be infringed or the law could be broken. The exercise of the constitutional rights and freedoms, in good faith, is a fundamental duty of any taxpayer.

However, how does the bad faith, the abuse of right, the infringement of the rights of third parties and the infringement of law in tax matter manifest itself? Is the taxpayer trying to reduce its tax burden by legal constructions provided and admitted by law or offender? And who has the right to decide that a taxpayer reduced its tax burden legally or that it did it by infringing the law? Who and how can somebody draw the line separating the behavior allowed from the behavior punishable under the tax law? Can this right be assigned to a body or a civil servant of the tax administration or is it the exclusive prerogative of justice to state the right?

As a general rule, fraud represents an act of deception committed against the creditor by the debtor, an act by which the latter reduces its assets or causes or increases its insolvency. Every time a deed is concluded for the purpose of deceiving a third party, we are in the presence of a fraudulent act. Fraud, which coincides with bad faith and the abuse of right, may come in multiple forms (the doctrine has identified 11 forms of fraud), which can be classified in three large categories: *i*) fraud committed by one party to the detriment of the other contracting party (*de re ad rem fraud*), which presents no interest in tax matter; *ii*) fraud planned by the parties for deceiving third parties to the act (*de persona ad personam fraud*) and *iii*) fraud consisting in dissimulation in the form of a deed concluded by the parties for the purpose of avoiding an obligation imposed by law (*de contractu in contractum fraud* or *fraus legi*).⁸

⁸ See D. Gherasim, Buna credință în raporturile juridice civile, Editura Academiei, 1981, p. 91.

In case of the first two forms of fraud, *the author or authors act with the intention to damage another person: the co-contracting party or the creditor third party*, the latter being whether an individual or a legal entity. In these cases, the author or authors are aware of the fact that, by means of the fraudulent act, they cause damage to the co-contracting party or, as the case may be, the third party (creditor).

In case of the **fraud to the law**, the malevolent intention has *the purpose of eluding the imperative legal prescriptions in order to avoid their enforcement, by consciously and voluntarily adopting means that are illicit in their appearance but are directed against the obligations imposed by the imperative legal rule*. Fraud to the law does not represent a direct infringement of the law, but its indirect omission, by diverting some legal provisions from their finality.

Fraud to the law contains two elements: a material and an objective one, consisting in the procedure used, which, by itself, is not contrary to the law and the second one, intentional, which comprises the essence of this form of fraud and consists in eluding or avoiding the enforcement of a given text of law. **Fraud to the law is usually met and committed for the purpose of deceiving the administration bodies**, a category to which tax bodies also belong.

But when a legal act is done so that the parties or only one of the parties would avoid paying the tax liabilities, **will such act be considered concluded by fraud to the law or by fraud to the interests of a third party** to the legal act concluded, **namely the state**, which is the tax creditor?

The obligation to pay the tax, when the obligating event occurred or was supposed to occur, is a legal obligation and the legal act concluded for the purpose of avoiding the payment of the tax is an act done by fraud to the interests of the state, in its capacity as tax creditor, as well as by fraud to the law, which establishes the obligation to pay the tax for the tax base produced or that was supposed to be produced. In other words, when the legal act concluded is aimed at avoiding the payment of the tax, the fraud to the interests of the third party (the state) and the fraud to the law are, in fact, one and the same thing.

In common law, the first **form of fraud (to the detriment of the co-contracting party)** is punishable by the annulment of the deceiving act by the courts, upon the request of the party whose rights were damaged⁹, and nullity is relative, therefore it can be invoked within the general three-year period of prescription.

In case of **the fraud committed for the purpose of deceiving third parties**, the fraudulent act, the concerted act of the parties¹⁰, can be annulled by the paulian action (revocatory). The admission of such an action, which is aimed at protecting the rights of creditors (the general legal lien) against the debtor's bad faith (not against its negligence as well) manifested through fraudulent acts, will make the fraudulent act void in relation to the creditor. When the debtor's assets decreased following **materials actions**, which occurred beyond its will, the creditor feeling damaged does not have the remedy of the paulian action available to it because there is no fraudulent cooperation against it.

The category of acts that may be contested by using the paulian action is very large, including both the unilateral and the bilateral acts, such as donations, sale, release of a debt, undue payment, assignment of claim, release of a prescription fulfilled and even court orders obtained by the debtor in defrauding its creditor etc. However, from the principle according to which **there must be a reduction in the debtor's wealth in order to be able to file the paulian action**, it

⁹ See for developments, D. Cosma, *Teoria generală a actului juridic civil*, Editura Științifică 1969.

¹⁰ In case of legal acts for valuable consideration, there must be a complicity of the co-contracting parties for the purpose of defrauding the interests of third parties. The bona fide purchaser is protected, except for the case in which it acquired free of charge. D. Cosma, *Teoria generală a actului juridic civil*, Editura Științifică 1969, p. 355.

results that, when the **debtor refuses to become rich, the revocatory action is inadmissible**, and this conclusion is important and is applicable in the tax matter as well.

In common law, the penalty for acts committed by fraud to the law is absolute nullity and this can only be enforced by the courts of law.

What will be the penalty and who will enforce it when the fraud to the law concerns the enforcement of the tax law? If a court of law is invested (either with a civil or with a criminal action), we believe that its right to find the absolute nullity of an act committed by fraud to the law, upon the request of the tax authority, cannot be questioned, since it has interest and, consequently, right and standing. In case of the criminal proceedings, the court has the obligation to rule, *ex officio*, on the total or partial annulment of the documents, such documents also including the acts committed by fraud to the law (of course, if the criminal proceedings regard acts of fraud to the law in their most serious form: the offence).

Can the tax authority check, find the fraud, judge and enforce the penalty or this remains the exclusive prerogative of the court, whose right and power to do it is questioned by nobody even in tax matter? Nevertheless, we have seen that the law grants to the tax authority an (excessively large) right of assessment. However, the right of assessment is not the same thing as the right to find the potential fraud and to decide and enforce the penalty, even if the penalty is one of type „not taking into consideration” a transaction, an act etc., since between “not taking into consideration a transaction” and deciding that the transaction is null, as regards the effects, there is no difference. In fact, it is the theory of the abuse of right that justifies the right of the tax authority to reclassify the taxpayers’ acts and actions, according to their economic goal, and such right of the tax authority represents a limitation of the freedom of company administration.

However, making a distinction between the fraudulent act and the normal and legal act of administration, as well as between what the law allows or prohibits, is not an easy task, it is not a task that could be assigned to anybody since it required not only a thorough knowledge (legal and economic), but also experience and good faith. This is where the importance of the right of assessment and the limits within which it can be admitted are obvious.

The provisions of art. 11 (Special provisions for the enforcement of the Tax Code) are relevant for the power conferred through our Tax code to the tax authorities and the exercise of the right of assessment, and such provisions stipulate that:

(1) When establishing the amount of a tax or of a fee for the purpose of this code, the tax authorities may not take into consideration a transaction having no economic purpose or may reclassify the form of a transaction so that it would reflect the economic content of the transaction.

(1¹) Tax authorities may not take into consideration a transaction carried out by a taxpayer that was declared inactive by order of the President of the National Agency for Tax Administration.

(1²) Also, the tax authorities shall not take into consideration transactions carried out with a taxpayer that was declared inactive by order of the President of the National Agency for Tax Administration. The procedure of declaring taxpayers inactive shall be established by an order. The list of taxpayers declared inactive shall be published on the website of the Ministry of Public Finance – the portal of the National Agency for Tax Administration and shall be made public in compliance with the requirements established by order of the President of the National Agency for Tax Administration.

(2) In a transaction carried out between affiliates, the tax authorities may adjust the amount of the income or expenditure of any of the persons, as the case may be, so that it would reflect the market price of the goods or services provided under the transaction. When

establishing the market price of the transactions carried out between affiliates, the most adequate of the following methods shall be used:

a) the method of comparing prices, by which the market price is established based on the prices paid to other persons selling comparable goods or services to independent persons;

b) the cost-plus method, by which the market price is established based on the costs of the good or the service provided under the transaction, which is increased by the corresponding profit margin;

c) the resale price method, by which the market price is established based on the resale price of the good or the service sold to an independent person, which is decreased by the expenses with the selling, other expenses of the taxpayer and a profit margin;

d) any other method acknowledged in the guidelines regarding transfer prices issued by the Organization for Economic Cooperation and Development.

5. Taxation of income obtained from illicit activities

The state does not seem to be interested in morals when it comes to its revenue, a reason for which the income obtained from illicit activities is taxable. Of course, the tax on the income obtained from illicit activities shall be owed when the illicit income is not taken over by the state as an effect of special seizure, for instance.

However, the taxation of income from illicit activities is also justified from the point of view of the principle of equality before the law and the authorities: since all income received in a professional context is taxed, how could the income received from illicit activities remain untaxed? Yet, if we admit that the income from illicit activities is taxable in the same way as the income received in a legal professional context, then we have to admit that the expenses made for receiving such (illicit) income are deductible.

In our law, there is no Tax Code provision regarding the taxation of income received from illicit activities. However, budgetary laws contain applications of this rule when they stipulate that such income is taxable and even forecast the amounts to be collected in this category. For instance, Law no. 11/2010 regarding the state budget for 2010, in Appendix no. 1 (detailing no. 1), estimates the state income from the taxation of illicit business activities to the amount of 129 thousand lei, but the budgetary laws for the previous years contain similar provisions as well.

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