

# FISCAL BEHAVIOUR OF THE ECONOMIC AGENT. FACTORS OF INFLUENCE

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## Abstract:

*Defining the behaviour appears to be a relatively easy initiative, in reality, however, the definition of this concept requires consideration of a variety of items. Coercive character of taxation and the opposition of taxpayers to comply with taxes generate their fiscal behaviour as a form of manifestation intended to hinder performance or application of tax laws or impose "conditions" in achieving its objective. Behaviour of taxpayers is similar to searching for an optimum situation in order to satisfy their necessities; this one, being subject of taxation, may represent the compliance to paying taxes or noncompliance on ethical, social, economic issues. Resistance to paying taxes can take various forms of manifestation: underground economy, fraud and tax evasion, tax abstinence.*

**Keywords:** *economic agent, tax burden, fiscal behaviour, factors of influence*

**JEL Classification:** H26, H32

## 1. Aspects regarding the taxation of the economic agent

Fiscality was and still is a major obstacle to the structural evolutions of the economic agent. Each enterprise is touched, in its structure and objectives, in a direct way, by the tax pressure, which produces a series of distortions in its behaviour. But influences are not exercised only by the administrative rules, and also by the burden of the financial tasks, which, without a relaxation of them, under the conditions of a generalized economic and financial blockage and of a sub-capitalization, can lead to the paralization of the activity of the present enterprises and to prohibition for the foundation of new commercial companies in fields needing important capital investments.

The tax payer's attitude embraces a psychological aspect, the tax effect depending on more variables:

- the real amount of the tax;
- the taxpayer's capacity to assess the real tax burden;
- his attitude towards state and towards fiscality;
- the capacity to use the administrative rules in favour of the taxpayer;
- the usage degree to the taxes charged.

The level of taxation is determined by several factors, such as economic performance, effectiveness of using public spending financed by taxes, ownership, public needs set by government policy, the degree of understanding by taxpayers for budgetary needs and adherence to government policy, efficiency and ability to collect tax debts to the state budget.

By its mere existence, the tax is able to change taxpayer's economic and social behaviour through its influence on consumption and saving degree. From this point of view it should also be considered the concept of marginal tax burden, resulting from the application of the tax rate on additional income and which is related to the existence of tax progressivity.

Increasing of fiscal pressure will determine the taxpayer to choose between the needs that he has to satisfy and will choose those that have the highest marginal utility. Tax incidence varies according to the nature of the tax. Income tax influences negatively both the ability to save and to consume intentions in different degrees depending on social categories.

Taxes collected by state from economic agents form a tax burden that is more pronounced as their share in the value added generated by the taxpayer is greater. Fiscal pressure is felt and amplified by indirect taxes (VAT and excise duties) which affect sales volume and their competitiveness through price.

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According to the present tax legislation profit and wages are the most taxed. Accordingly, the more a firm is more profitable, the tax burden borne by the economic agent is higher. In terms of financing the entity, profit, along with depreciation, represent the main element of self-financing. The gross profit is affected by the tax, the company's self-financing capacity is reduced. But the size of levies in gross profit to the budget does not only affect self-financing activity, but also the economic agent's ability to pay - payment of income tax is a negative cash flow.

Since the economic agent is interested not only in the magnitude of the added value, but in effective profit, fiscal pressure directly felt is given by profit tax rate. Also, as the economic agent's profitability and the absolute size of the profit increase, the tax burden of enterprise increases, this being due to the linear taxation of profit.

For Romanian enterprises, besides the burdensome taxation we also should mention that they are forced to cope with too high financing needs for their current activity as a result of widespread and disinvestment of incipient capital markets.

The present tax system comprises in its structure a plenty of taxes, charges and contributions which the enterprise must pay at certain due dates, in function of exigibilities, leading, often, to dysfunctionalities in its economic activity and in that of the treasury (cash flows).

The taxes owed by the taxpayer are in general: tax on profit/income, tax on dividends, VAT, excises, customs taxes, contributions to social securities, the unemployment fund, tax on buildings, taxes on the auto means, the stamp tax. To these there add also taxes specific for some activities (taxes on fortune games, tourism tax, advertising tax etc), as well as annual taxes for authorizations, licences, fees, penalties and increases(interests) for the delay of the due payment of taxes. The big number of taxes and charges which must be paid creates a high tax pressure upon the enterprise. Having in view the other factors which act upon the economic agent's activity: the level of demand and supply, competition, the sales level, the cashing term, the population's living standard, labour productivity, etc many taxpayers hardly cope with the tax pressure, leading to its bankruptcy or to practicing of the tax evasion in order to survive.

Defrauding taxes by some taxpayers creates unfair competition between producers. Given the competitive system of market economy and the living standards of the population, the price level is essential for carrying out the economic activity of an enterprise. In this case the firm that does not pay taxes to the state can sell with lower prices than those who pay their taxes.

## **2. The tax pressure, a determinative of the economic agent behaviour**

The main factor which influences upon the fiscal behaviour of the economic agent represents the multitude of tax prelevations of the economic agent, more concretely, the tax pressure.

Fiscal pressure is felt directly by taxpayers, ie the payers of taxes. The tax represents for honest taxpayer a "necessary evil" and agrees to pay it.

But what happens when taxes exceed tolerable limits, inhibit the initiative or even determine tax revolts? Then taxpayers feel tax burden which paralyzes their normal behaviour in the economy and society.

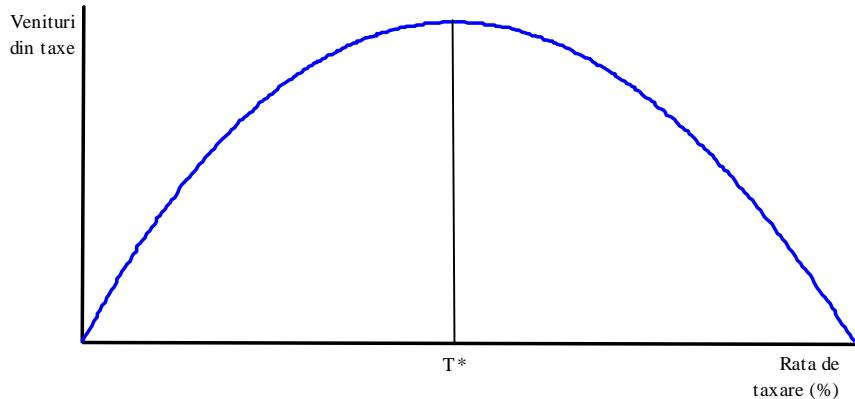
Honest taxpayer complies with taxes, but, at one time, when taxes exceed certain limits of endurance, events occur that bring serious disadvantages in ability of state to collect these revenues. Taxpayer's behaviour becomes abnormal by trying in every way to evade taxes, hoping for a decreased of tax burden that becomes sometimes suffocating.

The desire of taxpayers to ensure their income before increasing tax pressure without extra effort contributes to the development of shadow economy, which gradually replaces the real economy-official activities, making room to the underground economy. The consequences of this are fewer taxpayers, the reduction of both tax base and inadequate macroeconomic policies in the area.

Economist Arthur Laffer implements graphically "Laffer curve" in 1980, an idea experienced by Adam Smith, according to which tax rates that are too high destroy basis on which taxation activates.

Arthur Laffer gave one of the most convincing explanation of the relationship between tax rate the government imposes and revenues collected from it. "Laffer curve" shows graphically the relationship between the tax rate and income from taxation.

**Fig. no.1 Laffer Curve**



Laffer curve shows that income from tax increases more pronounced at low levels of taxation. As the tax rate increases, income increases at a decreasing rate, up to a point  $T^*$  where authorities collect the maximum possible revenue - after this point, any increase in the tax rate causes less work, increased of tax evasion, thus reducing income. At a tax rate of 100%, as authorities collect all that taxpayers gain, work will not be encouraged anymore.

Laffer curve also shows that the government can achieve the same level of income in two ways:

- by collecting taxes and duties from a small number of taxpayers (a tax or levy with a higher level corresponding to a narrow base),
- by imposing lower taxes on a larger segment of taxpayers (a small fee to a large base).

We believe that tax reduction should be done on the basis of a tax reform which, especially for less developed countries, as our country, should aim at increasing the tax base while reducing tax rates without affecting the revenues to budget State.

Therefore, an effective tax reform can be accomplished in two ways:

- On the one hand, if the current tax rate is higher than the optimal  $T^*$ , lowering the tax rate would increase revenue by increasing the tax base.

- On the other hand, if the tax rate is lower than the optimal  $T^*$ , the growth of rate would increase the income tax.

If there is a limit to the tax burden, the main issue is knowing if the normal tax threshold is surpassed or not. If taxation is excessive, the only way to reduce this level is that of giving up on tax obligations (to varying degrees). Increasing the tax burden represents a source of conflict but not a normal motivation for work.

Regarding the fiscal pressure on the firm, it can be calculated using the formula:  

$$\text{Firm's tax burden} = \text{taxes paid by firm} / \text{Total value of the firm}$$

Enterprise's tax burden depends on share of each type of levy in total of levies as well as the added value and the rate size of each type of levy .

### **3. Factors that influence the fiscal behaviour of the economic agent**

Coercive character of taxation and the opposition of taxpayers to taxes generate their fiscal behaviour as a form of manifestation intended to hinder the implementation of tax laws or impose certain "conditions" in achieving its objective.

Fiscal behavior is generated by two main factors:

- Natural factor, derived from the free rider instinct of taxpayers; here are distinguished education, traditions, training, income source, mentality and access to information;
- Institutional factor, derived from regulations, trust, stability.

Taxpayers behaviour under coercive taxation may be of compliance or noncompliance to taxes, based on ethical, social or economic issues. Resistance to paying taxes can take various forms of manifestation: underground economy, fraud and tax evasion, fiscal abstinence etc.

We believe fiscal behavior is influenced by internal and external factors of firm.

#### **3.1. Internal factors influencing fiscal behaviour**

These factors, with indirect impact, might be:

- High costs required by firm activities compared to the financial resources;
- Limited material resources. This can be an impediment if there is no proper management;
- Lack of access to new technologies;
- Lower demand for services;
- Lack of experience of business owners and external factors on which they have no control (new competitors, lack of suppliers or personnel fluctuation).

All these factors have a negative influence on the enterprise. When the tax burden is overwhelming, adding the difficulties mentioned above, the inclination to tax evasion increases. Therefore, we believe that an essential role in the degree of tax compliance of the firm is its "health", more precisely, the level of its profitability to be satisfactory.

#### **3.2. External factors influencing fiscal behaviour**

Here we refer to economic agent's size (micro, small, medium-sized enterprise), seasonality (its activity is ongoing, seasonal - winter, summer, occasionally), the region in which the entity activates, its area of activity (according to NACE code).

In this respect, we consider  $\beta$  a coefficient expressing the impact of the influence factor (those listed above) on the fiscal behaviour of the firm, with positive values between 0 and 1 (or 0% -100%),  $\beta \in [0, 1]$ . We have:

**$\beta=0$** , the firm is not affected, the behaviour is correct

**$\beta=x$** - value when that factor has an impact on the company. The closer  $\beta$  is set to 1, the more vulnerable is the firm to the factor and aims to incorrect, escapist behaviour,

**$\beta=1$** - escapist behaviour, factor has a major impact on the firm

We propose the following: We note  $Y = Cf / Fi$  an impact report indicating the extent that fiscal behaviour is influenced by these factors of influence; Cf - fiscal behaviour of the operator, Fi- influence factor (external).

$\beta \in [0;1]$ , broken down into ranges  $[0;0,4];[0,5; 0,7];[0,8;1]$ .

Also  $\Sigma x_i$  is the multitude of economic agents falling within that sample.

Should be noted that assigned values based on intervals are generated by the statistics provided by the White Paper (2010 edition - CNIPMMR), meaning turnover, the economic performances of firms by region, size, etc.

*Y represents:*

$Y \in [0;0,4]$  the fiscal behaviour is not affected by the factor

$Y \in [0,5;0,7]$  the behaviour is influenced at a reasonable level

$Y \in [0,8;1]$  the factor has a strong negative influence

**a) F1= entity's dimension**

**Tabel no.1 Fiscal behaviour depending on firm's dimension**

<b>Y=Cf/dimension</b>	<b>[0;0,4]</b>	<b>[0,5;0,7]</b>	<b>[0,8;1]</b>
<b>Micro</b>	-	-	$\sum xi$
<b>Small enterprise</b>	-	$\sum xi$	-
<b>Middle enterprise</b>	$\sum xi$	-	-

According to estimates, micro enterprises have the lowest level of compliance; on the opposite side are the medium ones, which are often subject to fiscal controls.

**b) F2= seasonality**

**Tabel no. 2 Fiscal behaviour depending on firm's seasonality**

<b>Y=Cf/ seasonality</b>	<b>[0;0,4]</b>	<b>[0,5;0,7]</b>	<b>[0,8;1]</b>
<b>Ongoing activity</b>	$\sum xi$	-	-
<b>Seazonal activity<sup>1</sup></b>	-	$\sum xi$	-
<b>Occasional activity<sup>2</sup></b>	-	-	$\sum xi$

We believe that firms with permanent activity are honest, they comply with taxes, one reason is that they are contained in a record at official level and fiscal control can be performed any time.

Instead, in terms of seasonal work is well-known that during the holiday season and holidays, most firms do not pay their fiscal obligations to the state. Also agents with occasional activities have a reduced level of tax compliance, most often tax evasion realizing to VAT, labor taxes.

**c) F3 = region in which the firm activates**

**Tabel no. 3 Fiscal behaviour depending on firm's region**

<b>Y=Cf/ region</b>	<b>[0;0,4]</b>	<b>[0,5;0,7]</b>	<b>[0,8;1]</b>
<b>N-E</b>	-	-	$\sum xi$
<b>S-E</b>	-	$\sum xi$	-
<b>S</b>	-	$\sum xi$	-
<b>S-V</b>	-	-	$\sum xi$
<b>W</b>	-	-	$\sum xi$
<b>N-W</b>	-	$\sum xi$	-
<b>Center</b>	-	$\sum xi$	-
<b>Bucharest-IIfov</b>	$\sum xi$	-	-

We believe that honest behaviour have firms from Bucharest-IIfov region, followed by the North-West. Those with an average fiscal behaviour are regions of South-East, South, Central. The rest (Northeast, Southwest, West), being areas that are not economically developed, escape taxation.

<sup>1</sup> Activity for firms in agriculture and tourism

<sup>2</sup> When an event occurs : football game, competitions at international level, concerts etc

**d) F4= activity field ( NACE code)**

**Tabel no. 4 Fiscal behaviour depending on firm's activity field**

<i>Y=Cf/ activity field</i>	[0;0,4]	[0,5;0,7]	[0,8;1]
<b>Agriculture, forestry and fishing</b>	-	-	$\Sigma xi$
<b>mining industry</b>	-	-	$\Sigma xi$
<b>manufacturing</b>	-	$\Sigma xi$	-
<b>Production and supply of electricity, gas, hot water</b>	-	-	$\Sigma xi$
<b>Water supply and sanitation</b>	-	$\Sigma xi$	-
<b>Construction</b>	-	-	$\Sigma xi$
<b>Trade</b>	-	-	$\Sigma xi$
<b>Transport and storage</b>	-	$\Sigma xi$	-
<b>Hotels and restaurants</b>	-	-	$\Sigma xi$
<b>Information and communication</b>	-	$\Sigma xi$	-
<b>Financial intermediation and insurance</b>	-	$\Sigma xi$	-
<b>Real estate</b>	-	-	$\Sigma xi$
<b>Professional, scientific, technical activities</b>	-	$\Sigma xi$	-
<b>Public administration and defense</b>	-	$\Sigma xi$	-
<b>Education</b>	-	$\Sigma xi$	-
<b>Health and social care</b>	-	$\Sigma xi$	-
<b>Arts, cultural, recreational activities</b>	-	$\Sigma xi$	-
<b>Households</b>	-	-	$\Sigma xi$

According to recent reports (NAFA Performance Report, Public Report for 2010, Court of Accounts of Romania, Bucharest, 2011), economic agents that have incorrect behaviour are in agriculture (cereals, vegetables, fruits), those who operate with products that are subject to excise duties (tobacco, alcohol, energy products), real estate, hotels and restaurants, food industry, construction, trade.

Tax evasion is performed mostly to VAT (especially in construction, hotels and restaurants when, for example, employees receive their salaries in "envelope"), not declaring fair number of tourists (tourism) etc.

In conclusion, we can say that incorrect fiscal behaviour is made by small firms, operating in regions not very economically developed (South-West, North-East), their work is not permanent, and their field activity might be agriculture, trade, construction, or might belong to private household sector.

According to researches, the main obstacles for the enterprise are:

- Decrease in domestic demand;
- Excessive taxation, bureaucracy;
- Delays in paying bills from private firms;
- High borrowing costs;
- Inflation, the relative instability of the national currency;
- Difficult access to credit;
- Developments in the legislative, political changes, etc.

To avoid a reduced tax compliance of firms, we believe that:

- A reduction of social securities may be a significant incentive to transfer a significant part of the informal economy into the formal one;
- Improvement of legislation, its adaptation and strict implementation to those applied in the EU area. In this regard, will be pursued on one hand, the efficiency of the system of controls and record keeping in labor and taxation fields, as well as strictly application of penalties and sanctions for detecting informal activities;

- Simplification of taxes, while reducing bureaucracy;
- Reducing certain taxes that hinder the work in the formal sector, investments and private initiative, while increasing others that are currently undersized in Romania, as well as tax on wealth, capital or earth;
- Introduction in the fiscal basis a complex system of deductions and incentives and its efficient application, according to the model of Western countries.

#### **4. Conclusions**

We believe that the fiscal behaviour of the economic agent is influenced by many factors which act in such a manner that they determine them to comply with taxes or to escape by practicing tax evasion.

The determinants of fiscal behaviour are:

- the real amount of the tax;
- the taxpayer's capacity to assess the real tax burden;
- his attitude towards state and towards fiscality;
- the capacity to use the administrative rules in favour of the taxpayer;
- the usage degree to the taxes charged.

The main factor which influences upon the fiscal behaviour of the economic agent represents the multitude of tax prelevations of the economic agent, more concretely, the tax pressure. Fiscal pressure decreases according to the level of taxation, deductible expenses and the method of calculating the taxable income, all aggregated; fiscal burden also depends on the variety of taxes.

Also, in determining the fiscal behaviour of economic agent we should consider both internal and external factors of the enterprise. According to our research, the incorrect fiscal behaviour is performed by small firms, operating in regions not very well economically developed (South-West, North-East), their work is not permanent, and their field activity might be agriculture, trade, construction, or might belong to private household sector.

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