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Investigation of Tax Evasion Existence in IRAN: Case Study from Private Joint Stock Companies of Kermanshah

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ABSTRACT

Tax evasion is measured either through the adoption and use of information that have been collected for other purposes (such as measuring the tax information on personal and family expenses) or the deduction of tax evasion, through the use of observation in other economic variables, i.e. determining the total economic activities and then the fraction of revealed activities. The present study is an attempt to evaluate the tax evasion for the number of companies by the use of information contained in declarations of the private joint stock companies. For a long period in profitable companies, the distribution of benefits among stockholders is typical. In the other hand, partners account in private joint stock companies means removal and payment of partners to the company (except relevant items to the capital increase and profit distribution). If the account balance is credited (debited), it means seeking out of (liabilities to) the company. So in the long time, by the mean of gain, the relationship between the income and changes in partners account credited balance is completely direct. In this research, among active corporations in IRAN (Kermanshah) about 45 companies were chosen and examined in the period of five years as an example. The results show the tax evasion in these companies.
KEYWORDS: Tax evasion, Tax structure of IRAN, Measuring of tax evasion

INTRODUCTION

Most developed countries are characterized by a broad base for direct and indirect taxes with tax liability covering the vast majority of citizens and firms. Developing countries, in contrast, are confronted with social, political and administrative difficulties in establishing a sound public finance system. As a consequence, developing and emerging countries are particularly vulnerable to tax evasion and avoidance activities of individual taxpayers and corporations. This can be considered one of the primary reasons for large differences in the ability to mobilize own resources between developed and developing countries. Large amounts of potential tax revenue are lost annually as a result of tax planning, tax avoidance and tax evasion activities undertaken by the private sector, often actively supported by offshore jurisdictions that maintain artificially low regulatory and tax burdens. [6]

While tax revenues in OECD-countries amount to almost 36 per cent of gross national income in 2007, the share in selected developing regions amounts around 23% in Africa (in 2007) and 17,5% Latin America (in 2004). In 2005, the average tax revenue to GDP ratio in the developed world was approximately 35%. In the developing countries, it was approximately 15%, and in the poorest of these countries, the group of low income countries, tax revenue was just 12% of GDP. Tax systems in many developing countries are characterized by tax structures being not in line with international standards, by lack of tax policy management, low compliance levels and inappropriate capacities in tax administration. And although developing countries still realize some of their domestic revenues through international trade taxes and tariffs, they have declined over the last twenty years. Aside from these structural differences in the tax systems between developing and developed countries, it is important to recognize that tax losses that arise in the course of tax evasion and avoidance activities do largely contribute to the poor performance of state revenue mobilization in developing countries. [6]

As a complex phenomenon, tax compliance can be addressed from a variety of perspectives. Taxpayers' stance is influenced by many factors, including their disposition towards public institutions, the perceived fairness of the taxes, prevailing social norms, and the chances of noncompliance being detected and punished. Without questioning the relevance of ethical and sociological motivations, the economic analysis of tax compliance has focused mainly on how evasion can be deterred through detection and sanctions. The thesis is that the taxpayer's behavior can be fruitfully seen as the result of a rational calculus, a careful assessment of the costs and benefits of evasion. Since even in the simplest tax and enforcement systems the incentives to comply are far from obvious, this economic perspective offers precious insights that can be used to derive suitable policy measures. Yet, given the complexity of the economic set-up in which the taxpayer usually makes compliance decisions, no simple policy prescription should be expected. In fact, as we will see, to date

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theoretical and empirical research has managed to establish very few firm points. Nevertheless, the general picture of tax compliance is much clearer now than just a few decades ago. At least the literature has shown that evasion is a serious problem, too complex to be solved by simple policy adjustments, and that the set of instruments for controlling it is vast. [4]

Tax structure in IRAN

Parameters of the tax system in IRAN such as low share of taxes from GDP and sources of funding, tax pressure on companies in indirect taxes shows that the tax system in IRAN doesn't have a desirable structure. The comparison between corporation tax and income tax shows imbalance, injustice and inefficiency in collecting income tax. That should include the all earnings in the economy. Despite the high-income that they have, don't pay their taxes as it be and tax evasion is wide spread and common in earning money. [12]

Samimi and Hamzeie have found that weakness of the monetary system and weakness of tax information system and complexity of tax laws have been the most important reason for tax evasion in jewelers guide in IRAN. [7]

Zaayer (2009) believes that tax system in IRAN is not desirable, and one of the most important of its completed challenges is complexity of tax structure. He believes that because of specific attention on self-expressing and voluntary participation of taxpayers in paying tax voluntarily, undoubtedly beside culture and information, effectiveness and efficiency of this approach depends on ability and willingness of taxpayers understanding and participating in their legal responsibilities and obligations and also ability of tax administrations in interpretation and enforcing the tax laws fairness most of those who directly or indirectly involve in tax system acknowledge on complexity of tax system in country, and they believe that tax simplification is necessary and vital to ensure the declarative application increase the efficiency of the tax system. [13]

The most important causes of tax evasion can call absence of tax culture in the community, absence of full exchange of information and lack of monitoring and follow-up system on taxation, ascending recognition and being weakness in its implementation, the absence of willingness in submission of tax returns and weak performance guarantees in this case, delays in receipt of tax, the lack of understanding and documenting of taxpayers' income, being broad and varied exemptions, corruption of tax officials, increasing the tax burden and complexity of laws and regulations, increase in transfer payments, record in real income and rising unemployment, rise of self-employment, demographic changes, administrative bureaucracy, government fiscal policy, delay in issuing the executive regulation commanded by the executive branch, weak informative systems, lack of trust in government, income inequality choosing how to earn money by people effective social deficits. Income tax in most countries in the world is based on tree major basis, individual incomes (tax on total income), corporate tax, and payroll tax. In countries surveyed in a conducted study by Pajhuyan and Darvishi (2010), the share tax revenue of the total annual fund resources is between 81% and 25.92% , it means that in the surveyed countries, governments provide funds of budgeted through taxes that the worst is 81% and the best is 25.92%. In IRANs' economy, the share of taxes from sources of funding in the best status has been 40% and the worst status 17% (between 2007-1981). On the other hand, import tax that makes 30% of tax revenues of the country is highly dependent on oil revenues. [12]

In recent years despite of emphasis on reforming in tax system and reduce the economy's dependence on oil, we observe the reduction on share of income tax from total revenues, so the share of post-tax income from total revenues and its share of direct taxes has decreases 50% in 1979-1981. Low share of post-tax income of state tax revenue shows the malfunction in the structure of the tax base. [12]

According to official figures released by the tax system in IRAN, there is approximately 25% tax evasion.

Tax Evasion

Tax evasion is usually associated with the commission of a criminal offense. It can be considered to consist of willful and conscious non-compliance with the laws of a taxing jurisdiction which can include a deliberate concealment of facts from Revenue authorities. (Committee of Experts on International Cooperation in Tax Matters Seventh session)

Tax evasion is said to occur when individuals deliberately fail to comply with their tax obligations. The resulting tax revenue loss may cause serious damage to the proper functioning of the public sector, threatening its capacity to finance its basic expenses. By distancing effective payments from statutory taxes, tax evasion defines a specific revenue deficiency, known as the 'tax gap'. (Luigi Alberto Franzoni)

Tax evasion has specific features that distinguish it from other crimes. First of all, the tax evasion is kind of cheating that particularly takes place against a government economic entity. Here the government determines the structure and level of taxes and considers the control and necessary mechanism to receive it. Second, tax evasion derives from the involvement major elements in underground economy. These elements can be called tax evaders, inspectors, and government. And third, there is a special relation between tax evasion and central

concerns of public sector economy. (Bureau of economic research) Asadaabaadi and Shaahhoseini have mentioned 26 factors as emerging fields of tax evasion.

Reduce the likelihood of detecting tax evasion and increase the tax compliance costs both cause the increased willingness to the tax evasion gradually cause the tendency toward tax evasion. Also, division and injustice in the economy cause the increasing dissatisfaction with traditional payers, and finally it will be the increase tax compliance costs for them. In addition, if reach payers realize unequivalent between tax pressure and services provided by the public sector, the opportunity cost of compliance will be increased for them.

In economic terms, evasion problems originate in the fact that the variables that define the tax base (incomes, sales, revenues, wealth, and so on) are often not 'observable'. That is, an external observer cannot usually see the actual magnitude of an individual's tax base, and hence cannot know his true tax liability. Sometimes this knowledge can be obtained by means of costly audits, in which case we say that the tax base is verifiable (at a cost). In other cases, as when it is related to cash payments, the tax base cannot be verified at all. Taxpayers can take advantage of the imperfect information about their liability and elude taxation. Another problem with the measurement of tax evasion relates to its proper delimitation within the broader set of the informal economy. No taxes are generally levied on transactions in the home and criminal sectors, which are usually beyond the reach of authorities and official statistics. Hence, proper determination of the boundaries of evasion is a formidable task, in that evasion is often inextricable from other illegal and unrecorded activities. [4]

Tax Avoidance

Avoidance is typically accomplished by structuring transactions so as to minimize tax liability. In some cases, avoidance is encouraged by legislation granting favorable tax treatment to specific activities in contrast to general taxation principles. From a legal standpoint, evasion differs from avoidance in being unlawful, and hence punishable (at least in theory). As far as economic function is concerned, however, evasion and avoidance obviously have very strong similarities; sometimes, indeed, they can hardly be distinguished. This adds to the difficulty of interpreting the real implications of the tax gap. [4]

For reasons such as being special privilege in tax treatment, special activities of the general principles of taxation and shortcomings in tax law and regulations can provide the opportunity use of legal solutions for reducing or non-performance of tax obligations for payers. In some cases, tax avoidance encourages people to the allowed and special procedure instead of usual trading as tax law for some activities. In terms of the economic behavior of taxpayers, tax evasion and tax avoidance have a lot of similarity to the extent that they are difficult to distinguish. Anyway, tax evasion and tax avoidance both take place as avoiding of paying tax. But the main difference is that tax avoidance is legal by mean that economic factors using tax law pores and revision in economic decisions try to decrease their tax liabilities, while the tax evasion is illegal. [11]

That means that entrepreneurs using tax law pores and their reload economic decisions try to decrease their tax liabilities.

Many countries make a distinction between acceptable tax avoidance and unacceptable tax avoidance. Unacceptable tax avoidance is achieved by transactions that are genuine and legal but involves deceit or presence or sham structures; it is an indirect violation or an improper use of the tax laws or treaties. Acceptable tax avoidance methods or tax planning however reduces tax liability through transaction or other activities that are intended by legislation. Courts in most countries have consistently recognized the right of taxpayers to avoid taxes by means that are within the law. However, courts in many countries have also found that the tax laws should be interpreted so as to prevent their avoidance by the use of transactions that have no business purpose, although there is considerable variety in the approaches of courts in different countries.

How to Evade

As it said, generally, tax evasion refers to wrongful failure to pay all or part of the tax. It can be done as set financial account, providing false financial information or concealing information. In addition, tax evasion relates on extent of the informal economy such as home vage deals and illegal activities like criminal and delinquency activities that the tax is not received from these kinds of activities because of the lack of data. [11]

The easiest way to decide in tax evasion considers it as a speculative. If the payers declare their income less than their real income (or declare their expenses more than their real expenses), there will an opportunity for them to escape from paying tax without being detected.

Deciding to escape the taxpayers should notice to its costs and benefits and calculate the interest rates that accrues as a result of tax evasion and also loss rates that they have to pay as a result of their stuck in the fall as a penalty and even the possible of rate of their declarants.

A simple arithmetic expression of decision to tax evasion by the taxpayers is as follow:

It is supposed that taxpayers have the Y level of income that they are aware of that, but tax agents are unaware. Income declared by taxpayers is equal X, and their income tax is based on fixed rate t. in this way, if taxpayers escape from paying tax, the rate of declared incomes by them is $Y-X$ that is always bigger and equal zero, and not received tax is $(Y-X)t$.

Some common examples of tax evasion include:

- The failure to notify the taxing authorities of one's presence in the country if he is carrying on taxable activities;
- The failure to report the full amount of income;
- Deductions of claims for false expenses;
- Falsely claiming relief that is not due;
- The failure to pay over the proper amount of tax due;
- Departing from a country without paying a tax due with no intention of paying them;
- The failure to report items or sources of taxable income, profits or gains where there is an obligation to provide such information or if the taxing authorities have made a request for such information. [3]

Tax evasion can be happened by showing the higher expense than normal or by cheating on financial accounts through hiding the income. According to the tax rules in IRAN, part of service companies' income should be paid to the tax affairs organization into account by legal entities. It also becomes more difficult to hide the incomes according to setting value-added tax in recent years (since 1998) and obligation to report all payments and receives by the companies. Although it is not also difficult to provide fraudulent billing fee in showing unrealistic costs through making fraudulent billing fee is one of the easiest way for tax evasion specially for small companies in IRAN.

Measuring of Tax Evasion

Detecting tax evasion and estimating how it responds to tax and enforcement policy have traditionally been difficult since those engaging in evasion wish to keep this behavior concealed. Furthermore, disentangling the effects of tax rates and audit intensity from other unobserved factors is not straightforward. Audit intensity is likely to be endogenously related to the propensity to evade, as auditors focus collection resources toward groups of taxpayers likely to evade. Also, variation in tax rates across individuals or firms is often correlated with evasion opportunities. For instance, higher income individuals face a higher marginal tax rate and at the same time may have more income from sources that are easier to conceal. The value of providing empirical evidence regarding these questions is high, as even theoretically the response of evasion to tax rates is not clear. [9]

Although the topic of tax evasion and tax avoidance represents a problem for developed and developing countries, literature and data concerning this topic are still scarce. This is partly due to the fact that the extent of tax evasion and avoidance is hard to estimate as the phenomena are difficult to observe and precise data is, thus, lacking. Hence, there are no reliable empirical findings which provide a clear picture of size of the problem or the relative importance of different kinds of tax evasion and avoidance.

A fundamental difficulty in analyzing tax evasion is the lack of reliable information on taxpayer compliance. After all, tax evasion is illegal, and individuals have strong incentives to conceal their cheating, given financial and other penalties that are imposed on individuals who are found cheating on their taxes. There have been many approaches to measurement, which JamesAlm broadly classifies as ***Traditional*** and ***Modern***:

Traditional Approaches:

Among traditional approaches, the most accurate source of information on individual compliance is based on "direct" measurement of evasion via actual audits of individual returns. For example, from 1965 to 1988, the U.S. Internal Revenue Service (IRS) conducted detailed line-by-line audits of a stratified random sample of roughly 50,000 individual tax returns on a 3-year cycle via its Taxpayer Compliance Measurement Program (TCMP).

More "indirect" methods look for traces of evasion behavior that are left in various indicators that can be identified, so that evasion is not measured directly but rather indirectly via these measureable traces. There are several indicators that have often been used. One approach estimates evasion via some "gap" that can be estimated, such as the gap between income reported on tax returns and income in the national income accounts, between income and expenditures in the national income accounts, or between official and actual labor forces.

Another indirect approach looks for traces of evasion in transactions financed by currency, on the assumption that the "true" level of economic activity can be estimated via a Fisherian relationship between money and its velocity. The gap between this predicted level of economic activity and the official national accounts level gives a measure of the so-called "shadow economy", which can then use as a proxy for the amount of tax evasion. A related and more commonly used method is the currency demand approach, which estimates the demand for currency as a function of conventional factors and also as a function of factors that are assumed to motivate individuals to engage in evasion activities. Any "excess" in currency demand, or the amount unexplained by the explanatory variables, is then attributed to the shadow economy and, by extension, the amount of tax evasion. [2]

Another related indirect approach assumes that there is a constant relationship between some physical input like electricity consumption and "true" economic activity; by measuring the gap between the official

output and the predicted "true" economic activity from the physical input, the amount of tax evasion can again be estimated.

Modern Approaches:

More recent approaches use a variety of novel methods. Some researchers have used measures of reported income from individual tax returns as a proxy for evasion, on the assumption that one's total income must be divided between reported income and unreported (or evaded) income(e.g., Dubin, Graetz, and Wilde, 1990; Gruber and Saez, 2002). Other researchers have conducted controlled field experiments (Slemrod, Blumenthal, and Christian, 2001; Iyer, Reckers, and Sanders 2010; Kleven et al., 2010). Some have used consumption based (Pissardes and Weber, 1989) or tax deduction-based (Feldman and Slemrod, 2007) measures as an indicator of tax evasion.

The Allingham and Sandmo "portfolio" model

The basic theoretical model used in nearly all research on tax compliance begins with the economics-of-crime model, first applied to tax compliance by Allingham and Sandmo (1972).

The individual's income *IC* if caught underreporting equals $IC=I-tR-f[t(I-R)]$, or income less taxes paid on reported income less penalties on unreported taxes; if underreporting is not caught, income *IN* is $IN=I-tR$, or income less taxes paid on reported income.

Where t is

The individual pays taxes at rate *t* on every dollar *R* of income that is reported, while no taxes are paid on underreported income. However, the individual may be audited with a fixed probability *p*; if audited, then all underreported income is discovered, and the individual must pay a penalty at rate *f* on each dollar that he or she was supposed to pay in taxes but did not pay.

The individual is assumed to choose reported income to maximize expected utility, or $EU(I)=pU(IC)+(1-p)U(IN)$, where *E* is the expectation operator and utility $U(I)$ is a function only of income.

Generally, estimate of underground economy and tax evasion in IRAN doesn't have so much precedent. The attempts in this regard refers to khal'atbari (1990), Taaherfar (1997), Garmaaroudi (1998), Ashrafzadeh (1378), Arabmaazaar (2000), Saadeghi and Shakibaaei (2001) and … that each one has discussed the usual method to estimate the size of the underground economy.

Unlike the previous studies that attempted for measuring the tax evasion for the whole economy, in the upcoming research it is afforded to measure occurrence of tax evasion by using given information in statements of private joint stock companies for the numbers of companies.

METHODOLOGY

According to the classification of research methods, the present study is a realistic target application that from the terms of the type contained analysis which studies the rate of correlation and relation between the variables.

Sample and Data Collection

In this research, we use the historical and realistic data gathered through tax affair organization in Kermanshah and statements offered by various companies. Variables needed to this study is measured by proper software (EXCEL) and is used its results as usable data in software (SPSS), and statistical analysis was performed to look for relationships between random variables. (Table 1 and 2)

Statistical society of this study includes all active companies in Kermanshah from early 2006 to late 2011. In this study the index of tax evasion is measured by using data from 2006 to 2010. The conditions of choosing sample are as follows:

1- Companies have presented tax statements from the beginning of 2006;

2- Their activity has not been cut. It means that the companies with one year cutting operations are deleted from the sample;

3- End date of financial annual of companies should not have been changed;

4- Chosen companies should be registered as Private Joint Stock Company, it is because it is only in these companies that partners account is by nature of the claim or debt, 45 companies are selected as sample in this regard.

Research hypothesis

Corporate shareholder wealth in increased either through increasing their stock prices or distributing of their cash dividends. Most of companies are established and controlled as limited companies and usually as family in IRAN. Because of this legal structure and management method, transferring share is rarely done in these kinds of companies. It means that the only source of increasing wealth is distributing cash or non-cash

benefits in this case. By reaching profit in a company, the expected distribution of benefits among stockholders is imperative. Although in a short time, a company may have not distributed remarkable cash benefit to develop the company or perform a special project, but during a long time, distributing the benefits is certain by its case. On the other hand, the current account of partners in private joint stock companies means payments and withdrawals of partners (except cases based on increasing the capital and distribution the dividends). If the account balance is credited (debited), it means seeking out of (liability to) the company.

If a company had operated profit, reduce the credit balance or increase in the debt of partners would have been expected. But if by the same profit and no division between the partners, we face with increase in creditor or reduce the debit, it can be said that the corporate income tax declarations are untrue, its profit is reported lower than actual, and tax evasion has been happened. In this case, it is used from the current account of partners to show the untrue costs in company's declaration. This means that the costs of debt and the payments for it isn't true, this may be creditors of partners. It means that if partners have paid this amount. Research hypothesis is based on follow:

"By receiving profit, a relationship that there is between variables of profit and variables of changes in the credit balance is effective as desired operating on continuous variable."

Research Model

According to what has described changes in the current partners, which has been presented as dependent variable and profit, has put as independent variable in this research, and ANOVA method is used to measure the tax evasion.

The variable of profit is a Dummy variable, and its amount is 1 if there is any profit otherwise it is zero.

The results of hypothesis testing

As it shown in table 1, at the level of significance of 5%, variable profit has the significant effects on change in current partners. So, there is a significant difference between variable average in partners' account in the case of profit, and according to the variable average amount in partners' account that have presented in table 1 and 2, the amount of variable average in partners' current in the case of loss, and it means that there is tax evasion.

Table 1: ANOVA table

Dependent Variable: Change in Partners' Account					
Source of change	**Sum of squared**	**Degree of freedom**	**The mean squared**	**fisher statistics**	**Level of significance**
Profit	0.9731	1	0.973	5.26	0.023
Intergroup Error	26.681	144	0.185		
Total Error	0.65425	145			

Table 2: Change in Partners' Account

Source of Changes	Mean	Number
Loss	0.1162	21
Profit	0.5325	125

Conclusion

Tax evasion has been shown as a serious problem in developing countries such as IRAN in most of state and professional declarations. Although tax evasion is inevitable, the main question is how to prevent it. Two groups of solutions are named in this case: First: base on moral and religious values. Second: through pressure on taxpayers and establishing penalties and compensations that attempt to prevent the tax evasion. In this way, undoubtedly, the calculation of tax evasion of taxpayers provides the way to reach the prevention goal or penalizing violators. Calculating the tax evasion for a real or legal person is required to the searching on belongings and costs of person or family. In this study it is tried to calculate tax evasion through tax evasion survey in financial statements and provided declarations by private joint stock companies.The result of study implies the existence of tax evasion among selected companies through exponential over fees, thus it can be said that partners' account in private joint stock companies is used to hide untrue costs in these kinds of companies. It seems that one of the main factors of tax evasion is lack of a coherent system for following the expenses and bills by this method. It means that taxpayer may make fake bills without calculating these bills for its issuer. On the other hand, simple use of partners' account and lack of legal limitation in use of this account may make this action for taxpayers without the risk of capturing. Whatever is said here is the weakness of tax rules in controlling the tax evasion and of course lack of tax correct culture in IRAN.In general tax authorities and officials can control tax evasion by exponential over fees through imposing legal limitations in use of partners' account and making a coherent system to follow issued bills by different taxpayers.

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