



Fiscal Fraud and Evasion: Social Responsibility Perspective

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Nota Introdutória

A Escola Superior de Tecnologia e Gestão (ESTG) do Instituto Politécnico da Guarda (IPG) congratula-se pelo facto do Professor Doutor *David Crowther*, da *London Metropolitan University*, Reino Unido ter aceite o convite para realizar uma visita de trabalho e investigação científica a decorrer entre os dias 9 a 15 de Novembro de 2002. Temos a certeza que com esta visita será possível desenvolver um debate privilegiado entre toda a comunidade Docente e Discente.

É igualmente um enorme privilégio dar início à série *Estudos e Documentos de Trabalho* com seis *papers* da autoria do Professor David Crowther. Esperemos que este seja o estímulo e o incentivo que falta para que, em particular a comunidade académica da ESTG, apresente trabalhos científicos que estimulem a discussão científica.

Não se poderá deixar de agradecer à Fundação para a Ciência e Tecnologia que, através do Fundo de Apoio à Comunidade Científica, generosamente aceitou a nossa candidatura, bem como todos aqueles que directa e indirectamente contribuíram para a sua concretização.

Constantino Rei

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FISCAL FRAUD AND EVASION: SOCIAL RESPONSIBILITY PERSPECTIVE

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ABSTRACT

In a society in which all firms and citizens want to be balanced and in which exists respect for others, it would be reasonable to suppose that firms, in general, and citizens, in particular, paid their respective taxes, more motivated by a conscience of civic duty and social responsibility perspective, than, properly, for fear of the sanction of a non-execution order.

Actually, fiscal fraud and evasion became a “current” practice for firms to decrease their payments to the State Budget in consequence of the no taxes payment. Fiscal fraud and evasion, usually, involves a deliberate act with the intention of obtaining an unauthorized benefit. Some examples of these actions in firms’ are: making or altering documents; purposely inaccurate financial reporting; improper handling or reporting of money transactions; authorizing or receiving compensation for goods not received or services not performed.

In this sense, directors and all levels of management are responsible for preventing and detecting situations of fiscal fraud and evasion. Also, for establishing and maintaining formal internal controls that, inside of a sphere of social responsibility and functional segregation, provide security for the resources of the firms. Thus, directors and managers of firms must recognise risks and exposures inherent in their responsibility area, and be, particularly, attentive of fiscal fraud and evasion indicators.

The authors defend that, it is urgently that the Governments reinforce the fight against fiscal fraud and evasion of the firms to provide the increase of their revenues through the implementation of formals internal preventative measures. This aim sets, on one hand, in the effectiveness of the combat measures of fraud and evasion. On other hand, it centres in the social responsibility of citizens and in generalization of its ethical behaviour.

The success of these measures on the taxes services depends on the level of modern information and communication technologies. In this context, the progressive computerisation of taxes services remains a priority for the Government, because low automation levels limit the efficiency of the execution of taxes payments, of tax audits and the fight against fiscal fraud and evasion.

Key Words: Fiscal fraud, Evasion, Social responsibility, Ethical behaviour.

JEL-Classification: H26-Tax evasion; M14-Social responsibility

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Introduction

The role of the State in the economy has been the object of debate. This happens because democracy and popular participation through free and fair elections oblige the Government of each country around the world to accomplishing a stable economic policy free from all the phenomenon of distortions and combating corruption, evasion and fraud while the appropriate legal and practical measures must be taken.

So, Governments try to develop and implement a taxation police that represents an efficient national instrument of solidarity of the society with the main objective of economic growth but in a sustainable way. But, these polices are directly linked to economic changes, technological improvements and social traditions.

In effect, there is no authentic and stable democratic system without social justice and where taxes are destined, initially, to obtained financial support for the satisfaction of citizens needs as a global society. But citizens, for their part, either individually or collectively, must be recognized, respected and furthered, together as a society. So they constitute, also, a fundamental vehicle for the redistribution of the wealth and the promotion of the equality between the citizens.

Also, the society demands that individual citizens, firms and intermediate organizations should be effectively protected by law whenever they have rights to be exercised or obligations to be fulfilled. Thus, it is unmorally that an individual citizen or a firm received the benefits of the State without paying taxes or worst promoting the use and abuse of evasion for not paying taxes. Unfortunately, fiscal fraud and evasion became a current practice for firms to decrease their payments to the State being caused by different factors which are more relevant:

- politicize (e.g. the rise of the burden of taxes and social security contributions; and the increase of regulation, especially of labour markets);
- economic (e.g. unemployment; and the decline of civic virtue and loyalty towards public institutions);
- psychological (e.g. forced reduction of weekly working time; and earlier retirement); and
- technical (e.g. uncheck system; and inefficient control).

Consequently, powerful institutions such as European Union (EU), United Nations (UN) and Organisation for Economic Co-Operation and Development (OECD) have an enormous potential at levels of public policy and push their approaches on social responsibility by using structures and human resources, legal and voluntary framework in accordance with the spirit and letter of the law and other regulations. Also, at a European Union (CE, 2006: 1), the basic idea is that institutions:

... therefore have the duty to guarantee the best use of their money and in particular to fight as effectively as possible against fraud. This is the reason for which the protection of the financial interests of the Community has become one of the major priorities for the European Institutions. This covers activities concerning the detection and monitoring of frauds in the customs field, misappropriation of subsidies and tax evasion, insofar as the Community budget is affected by it, as well as the fight against corruption and any other illegal activity harmful to the financial interests of the Community.

Indeed, the most controversial issue is the fiscal fraud and evasion as a reality that economists, managers and political-makers are confronted with and that come assuming a growing dimension and new and sophisticated forms (see Pereira, 2005)¹. All these dimensions and forms are combined with a declining of the tax morale and in addition there are some conceptual difficulties with this behaviour.

The struggle against fiscal fraud and evasion is, on one side, a true private obligation, because who practices fraud and evasion infringe the fundamental beginnings of the equality, the legality, the just division of the revenue and wealth, the loyal competition, the social responsibility and the fiscal responsibility. As Cooper (2004: 27) defends:

The social impact of organizations is very much influenced by the legal constraints on their activity. Incorporated organizations actually depend upon law for their very existence and all their dealings must take into account the laws ... These laws and regulations are socially constructed and therefore an important argument in the business and society field is to consider what role public policy or government regulation has to play.

Following this, the struggle against fiscal fraud and evasion is, also, a public obligation, because causes distortion in the economic activity, limits the quality of the public services and the social dimension of the State and determines the increase of the tax burden supported by the taxpaying. In this sense, the combat to these flagellates requests an active and permanent actuation with an unlimited purpose of being effective and efficient (Antunes, 2005).

However, in a society in which firms and citizens want to promote the morality of the tax system, it is suppose that must be balanced, not overpay or underpay taxes for specific firms and citizens and by equal treatment respect each other. At the same time, it would be reasonable to suppose that firms, in general, and citizens, in particular, paid their respective taxes, more motivated by a conscience of civic duty and social responsibility perspective, than, properly, for fear of the sanction of a non-execution order.

During the research literature, it was hard to find comprehensive studies that deal with these subjects, methodologies to estimate the lost for the State Budget of these two main problems: fraud and evasion and empirical analysis about the nature of the fiscal fraud or the full evasion of taxpayer's.

Despite all of these, still exists several studies that analyzed, for example, the income tax evasion (e.g. Allingham & Sandmo, 1973; Friedland et al., 1978, Feinstein, 1991). Subsequently, the authors try in this research to test these models with Portuguese data, but it was not possible to reproduce it, because the some of variables used in the models are not available. The complexity and raising uncertainties inherent to this data not allowed to promote an empirical analysis.

For those reasons, in this research, the authors decided to present a case study about the Portuguese experience of fraud and evasion, because it demonstrate this particular point more effectively and they find that the prevention, exposure and investigation of this case study is one way to show a bad example that will not provide any basis of scientific

¹ Among the studies related with this thematic one, surpassing the fiscal area, see Schneider & Enste (2000).

generalization. Somehow, good behaviour of citizens and firms is not always easier to find in corporate financial reports.

The organization of this paper is as follows. In section 2 argues the concept of fraud and evasion. Section 3 presents the understanding of the role of ethics and, consequently, section 4 discusses the importance and effects of the code of ethics. The European and Portuguese fight against fraud and evasion is presented and argued, respectively, in section 5 and section 6. At last, the paper concludes that the research was undertaken to assess the level of fraud and evasion, as well as measures or precautions against fraud and evasion in the European and Portuguese topic.

The concept of Fraud and Evasion

This research presents dual theoretical frameworks for the analysis of fraud and evasion in fiscal perspective. The first theoretical framework is based in law, taxation, code of ethics, accounting and social responsibility theory and disclosure information, providing explanations for economic and social decisions (see Gray et al., 1994; Tilt, 1994). The second theoretical framework as is origins in organisational and sociological theory (see Rahaman et al., 2004) that will assure the link of social responsibility as a fundamental objective to influence fiscal fraud and evasion.

It is vital to ensure that the clearest possible definitions are used, because in the literature there are several concerns about the understanding of fiscal fraud and evasion. This research is about what the literature call aggressive international tax practices. They are significant and economic relevant problems that each State is facing.

Fiscal evasion, typically, involves deliberately ignoring a specific part of the law. For example, firms may follow under-report taxable receipts or claim expenses that are non-deductible or overstated when they participate in tax evasion. They might also attempt to evade taxes by wilfully refusing to comply with legislated reporting requirements.

Fiscal avoidance happens when procedures are adopted by firms to minimize tax, while within the letter of the law; those procedures contravene the object and spirit of the law. Another example is when fiscal planning reduces taxes in a way that is inconsistent with the overall spirit of the law.

Fiscal planning is designed to arrange an individual's and an firm's affairs in order to maximise after-tax returns and must be exercise in an atmosphere of integrity of procedures adopted, mutual trust and good ethical behaviour (Stainer et al., 1997). So, effective fiscal planning occurs when the results of these procedures are consistent with the letter of the law and reputation, principles and actions of the firm.

Several studies detail the tax haven that is described as a jurisdiction with no taxes or a very low rate of tax, a lack of transparency in the operation of its tax system, a lack of effective exchange of information with other countries and, usually, have strict bank secrecy laws and they often have little or no economic activity.

Thus, fiscal avoidance, fiscal evasion and fiscal planning procedures and schemes are controversial matters especially when they involve tax reduction arrangements that may meet the specificity of the law. Another aspect that must be noted is the abuse of tax havens as a growing concern for all countries participating in the global economy. However, standards and laws are different from country to country and in diverse languages that enlarge the complexity of its analyses.

By other perspective, the severest form of an irregularity is fraud. This definition is used in auditing standards. They refer as irregularities which incorporated fraudulent financial report presented by firms as well as accountancy and auditing department's embezzlement or defalcation. For example, Nieschwietz et al. (2000) provide a review of the empirical research on external auditors' detection of financial statement fraud.

Prosser (1971) describes the elements of fraud as follows:

- *false representation of a material fact;*
- *representation made with knowledge of its falsity;*
- *a person acts in the representation; and*
- *the person acting is damaged by his/her reliance.*

Related with the taxpayer's conduct, as Brackney (2005: 304) specifies the Courts look to certain "badges of fraud" such as:

1. *understatement of income;*
2. *inadequate records;*
3. *Failure to file tax returns;*
4. *Implausible or inconsistent explanation of behaviour;*
5. *Concealment of assets;*
6. *Failure of cooperate with tax authorities.*

Fraud and evasion are defined as an irregularity committed deliberately². Fiscal fraud and evasion involves a deliberate act with the intention of obtaining an unauthorized benefit. In a review literature, it has been presented several acts, but is not limited to them of fiscal fraud and evasion in firms' such as:

- making or altering documents;
- purposely inaccurate financial reporting;
- improper handling or reporting of money transactions; and
- authorizing or receiving compensation for goods not received or services not performed.

This happens because fiscal fraud and evasion is, indirectly, consented by the Governments when they systematically treated any information especially if it is fiscal as secret neither possible to scientific investigation. For example, bank secrecy is widely recognised as playing a legitimate role in protecting the confidentiality of the financial affairs of individuals and legal entities (OECD, 2000: 7). However, the law usually specifies that the information is originally regarded as secret, but it shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals

² See the definition in Article 1 of the Convention of 26 July 1995 on the protection of the Communities' financial interests, which came into force on 17 October 2002 (EC, 1995).

in relation to the taxes. The extent of tax evasion may be related to a country's economic and institutional development (Gërxhani, 2004).

The authors have limited their focus to the concept of the fiscal fraud and the evasion, which relates primarily to intentional behaviour and misrepresentation of the laws and rules or omission from the role of ethics.

The Role of Ethics

The fiscal fraud and evasion, corruption, disrespect for the environment, are some of the ethical problems that they are placed in the society, as a consequence of the profound political, social and economics transformations. However, at the same time and paradoxically, the authors confirmed the increase of an ethic sense, that is to say that the society and the firms, as well the citizens, recognize each one more the importance and the value of ethical and socially responsible behaviours, as well as the risks and costs that the deviations as regards to ethics per times involve.

The process of ethical decision making requires that behaviours be assessed against standards or norms of acceptability. Velasquez et al. (1983) presented a schematic for ethical decision making that focuses on whether an action or decision meets three ethical criteria: utility, rights and justice. *Utility* judged behaviour in terms of its effects on the welfare of everyone. *Rights* express the requirements of ethics from the standpoint of the individuals, in other words ethical decisions must project the individual's legal and moral entitlements (Gatewood & Carroll, 1991). *Justice* is essentially a condition characterized by an equitable distribution of the benefits and burdens of working together requiring that all citizens be guided by fairness, equity, and impartiality.

These principles are proposed as the normative principles that should be used to anchor organizational and professional ethical standard setting. However, each of the criteria utilizes different moral concepts, and each one emphasizes aspects of ethical behaviour that are not emphasized by the others. The ethics influences the corporate social responsibility (CSR) assumed by the organizations, elevating the acceptable minimum previously above the fastened by the organizations' groups of interests. These values form part of the organizational culture and they should be incorporated in an explicit way in the corporate objectives through the definition of the corporate mission (Guerras, 2004).

Probably, the CSR has gained an important position due to the great impact in the society of numerous financial scandals played by important firms as Enron as well as WorldCom. Anecdotal evidence suggests that mailing firms may be motivated to engage in fraudulent financial reporting to conceal their distress (Rosner, 2003). These examples will have left an indelible impression among people that all is not well with the corporate world and that there are problems which need to be addressed (Crowther & Rayman-Bacchus, 2004). Indeed, this recent examples in the business world illustrate the magnitude of the impact that poor ethical behaviour can make in organizations. As Cleek & Leonard (1998) states:

... unethical decisions and activities frequently undermine the performance and abilities of many organizations.

However, the authors agree with Peñalva (2002) that defends that it is sometimes necessary that a great cataclysm happens for to alter the *status quo*.

The European Union and specific it's Commission, thought the *Green Paper - Promoting a European framework for corporate social responsibility* (COM, 2001: 8), understands the CSR as:

... a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. Being socially responsible means not only fulfilling legal expectations, but also going beyond compliance and investing 'more' into human capital, the environment and the relations with stakeholders.

Actually, many factors justify the evolution of the corporate social responsibility (COM, 2001): new concerns and expectations from citizens, consumers, public authorities and investors in the context of globalisation and large scale industrial change; social criteria are increasingly influencing the investment decisions of individuals and institutions both as consumers and as investors; increased concern about the damage caused by economic activity to the environment; and transparency of business activities brought about by the media and modern information and communication technologies, for example with view to fight against fiscal fraud and evasion.

The increase of informative transparency has been developing in consequence of the financial scandals that, from 2001, they the American and European finance markets (Bosón et al., 2004). Effectively, the transparency and the obligation of diffusing the true and fair view constitute a slope of the corporate social responsibility (Rivero, 2003). In this sense, the main objective of sustainable information is that the same allows evaluating the CSR behaviour, its commitment with the sustainable development and its effectiveness in the execution of its economic, social, and environmental functions, as well as the capacity of the firms to generate social externalities, that satisfy the needs of the different interested parts (AECA, 2005).

The CSR should be treated as an investment, not a cost. In the fight against fiscal fraud and evasion, the authors must encourage the development of innovative practices, to bring greater transparency and to increase the reliability of evaluation and validation of firms' practices. It suggests an approach based on the deepening of partnerships in which all actors have an active role to play. Thus, the true CSR is to stay in syntony with the local environment and with the context of the global economy (Montañés & Sánchez, 2004).

On January 31, 1999 the United Nations (UN) with Kofi Annan's Global Compact Initiative, analysed the CSR in a context of globalisation. This initiative of sustainable development would bring organizations together with UN agencies, labour and civil society to support universal environmental and social principles. The UN Global Compact is a purely voluntary initiative (designed to stimulate change and to promote good corporate citizenship and encourage innovative solutions and partnerships) with two objectives: mainstream the ten principles in business activities around the world (includes a tenth principle against corruption); catalyse actions in support of UN goals³. The Global Compact's ten principles in the areas of human rights (two principles), labour standards

³ Available online at 'www.unglobalcompact.org/AboutTheGC'.

(four principles), the environment (three principles) and anti-corruption (one principle) enjoy universal consensus.

Related with the transparency and anti-corruption, the principle 10: “Businesses should work against corruption in all its forms, including extortion and bribery” of the UN Global Compact demonstrated a new willingness in the business community to play its part in the fight against corruption, and specifically against fiscal fraud and evasion. Following this, in Portugal is necessary to increase the transparency, because in 2005 Portugal occupied the 26th place in the *Corruption Perceptions Index*, published by the Transparency International, above the Greece and the Italy, as well as of new European Members States.

The UN Global Compact argues that corruption⁴ is a major hindrance to sustainable development, with a disproportionate impact on poor communities and is corrosive on the very fabric of society. The impact on the private sector is also considerable, because it impedes economic growth, distorts competition and represents serious legal and reputational risks for firms (see UN, 2004). *Legal risks* because independently of what form a corrupt transaction may take, there are obvious legal risks involved. For that, is necessary the international enforcement of anti-corruption legislation. *Reputational risks* in the sense that it is of critical importance for an organization to be able to quickly quash any unfounded allegations by demonstrating that it acts in a transparent manner and has in place policies and procedures designed to prevent corruption. Proves of the relevance of the variable *reputation* is the disappearance of Arthur Andersen as mark en United States (Galán, 2002).

So, the organizations must focus on anti-corruption measures as part of their mechanisms to protect their reputations and the interests of their shareholders. The reality that laws making corrupt practices criminal may not always be enforced is no justification for accepting corrupt practices (see UN, 2004). Corruption undermining the world’s social, economic and environmental development, for that the corporate community can and should play its part in making corruption unacceptable once the corruption diverts resources from their proper use and distorts competition and creates gross inefficiencies in the public and private sectors.

Following this, the fiscal fraud and evasion is seen as a violation against the accepted moral norms and values for social, financial and administrative behaviour. The moral nature of these values refers to what is judged as right, just, or good (conduct), because ethics absence implies corruption. Thus, the corporate code of ethics increased importantly, as strategic management nowadays needs more and more business ethics in order to compete in a global market (Jesus, 2004).

The Code of Ethics

Ethics governance programs, including codes of ethics, ostensibly are developed as tools for bringing some degree of uniformity and propriety to peoples’ performance of organizational roles (see Gatewood & Carroll, 1991)⁵. For Weaver (1995), codes

⁴ The UN (2004: 5) defined corruption as: *the abuse of entrusted power for private gain*.

⁵ The study of Weaver (1995) contributes to understanding codes of ethics by focusing on the relationship between code of ethics design and recipients’ responses.

symbolized to employees an organization's values or ideology, and it that symbolic role affect peoples' perceptions of and responses to firms and institutions. In this sense, business ethics research appears to conceptualize the codes of ethics as distinct and formal documents specifying self-consciously ethical constraints on the conduct of organizational life (Weaver, 1993; Schwartz, 2001). Research in this domain is characterized by several terms of among which stands out the influence of codes of ethics on employee behaviour in organizations.

In this approach, Weller (1988) said that a code of ethics is a statement of rules to guide present and future action. Subsequently, Weaver (1995: 368) considers that codes of ethics:
... explicitly set standards for the quality of relationships among organization members, and between the organization as whole and specific members. Codes assign responsibilities, benefits, and burdens in organizations, and often establish procedural rules for the evaluation of members' actions.

The code of ethics (or code of conduct, code of practice, corporate credos, mission statements, or values statements)⁶ is an organization's policy statement and defines ethical standards for sound corporate governance. This code not only establishes the organization's values, but also spells out essential practices, behaviour, ethics, and business standards for all employees' firms. Employees are the most important stakeholders in the perspective of the Resource-Based View (Barney, 1991; 2001a; 2001b). According with this perspective, the firms can obtain competitive advantages (sustainable)⁷ face to the competitors if they have, simultaneously, four topics: valuable, rare, imperfectly imitable, and non-substitutable resource of a firm (Barney, 1991). With a *valuable* and same time *rare* item, as well as *imperfectly imitable* and *non-substitutable resource* of firms, we have the ethics.

The authors agree with Schwartz's (2004) opinion that firms should be required to expensed resources to develop and implement a code of ethics in order to reduce the chance of improper conduct by their members. The code of ethics intends to be an instrument that facilitates the recognition and the eventual resolution of ethical problems, and each firm adopts rules in agreement with its own characteristics (activity, objectives and environment). Somers (2001) argues that:

... there were clear differences between firms which and without ethical codes on three dimensions: a focus on profitability, use of discretionary funds for charitable contributions and the importance of behaving morally and ethically. In all three cases, employees of firms with ethical codes of conduct felt that these three value-based objectives were more important than did employees in firms without ethical codes.

Looking at the codes of ethics, Langlois & Schlegelmilch (1990) consider that three basic formats can be distinguished. Firstly, there are regulatory documents giving staff specific

⁶ The Green Paper defined 'code of conduct' as: a formal statement of the values and business practices of a firm and sometimes its suppliers. A code is a statement of minimum standards together with a pledge by the company to observe them and to require its contractors, subcontractors, suppliers and licensees to observe them. It may be a sophisticated document, which requires compliance with articulated standards and have a complicated enforcement mechanism.

⁷ Barney (1991: 102) states that: *a firm is said to have a sustained competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors and when these other firms are unable to duplicate the benefits of this strategy.*

advice on behaviour and conduct which include sanctions (termination of employment and/or reimbursement of damages). Secondly, there are short and more widely phrased creeds including statements of aims, objectives, philosophy or values. Specific guidance on employee behaviour or sanctions is not stated in these types of documents. Thirdly, there are elaborate corporate codes of ethics covering social responsibility to a set of stakeholders and a wide range of other topics.

Brooks (1989) states that is a heightened interest in corporate social performance which is evidenced in six factors, specifically:

- the crisis of confidence about corporate activity;
- the increasing emphasis on quality of life – our health, our leisure time, our working conditions, our fresh air and water, are all in jeopardy from acid rain, radiation and other forms of pollution;
- the growing expectation that, if caught, a corporation and its executives will be penalized heavily rather than let off lightly;
- the growing power of special interest groups (stakeholders);
- the increasing level of publicity of non ethical behaviours; and
- the change in the objectives which control business, according tend to de-emphasize the maximization of short-term profit as the only goal.

Considering all these aspects, a code of ethics to be effective, to be more than a simple written document, it should be inherent to the practices and behaviours of the members' organizations, mainly of its managers, in addition to it should correspond to a widespread sense of the duty of everybody in a global society. To summarize, Cleek & Leonard (1998: 620) consider that:

... the interactionist model of ethical behaviour consist on (1) individual factors, (2) ethical philosophy, (3) ethical decision ideologies, (4) external factors, and (5) organizational factors. When these sections are combined into an interactionist model they describe those factors that impact upon ethical decision-making behaviour in organizations.

Also Ford & Richardson (1994) agree that ethical behaviour can be influenced by *individual* factors, such as gender, nationality/culture, age, religion, type of education, type of employment, years of employment, and personality, beliefs and values, as well as *situational* factors, such as peer group influence, top management influence, rewards and sanctions, type of ethical decision, organization size, and industry type.

According to this, Watson (2003: 41) argues that:

However, the idea that some people view fraud differently may not be a simple case of "ignorance of the law is no excuse". Rather, it may be the result of something ingrained in the social nature of human interaction, particularly when cultural heritage is introduced into the equation.

Similar parallelism was made by Glover & Aono (1995: 8) that defend:

... the premises that corporate culture and industry traits significantly influence the likelihood for fraud to occur.⁸

⁸ Abbott et al. (2000) examine whether two key audit committee characteristics, activity and independence, in combination, reduce the likelihood of fraudulent or aggressive financial statements actions. Following this, Kneer et al. (1996) consider that the auditor needs to be mindful of appearances, *ex-post*.

This method cannot ensure 100 per cent detection of all fraud, but it offers an advantage over traditional risks models since it focuses on the underlying causes for fraud, which should assist the auditor in both prevention and detection of fraud by identifying early warning signs (Glover & Aono, 1995).

The European Fight against Fraud and Evasion

The fight against fiscal fraud and evasion is important to increase the fiscal justness, to increase the fiscal revenue and simultaneously to decrease the tax burden, to eliminate a distortion factor in terms of managerial competitiveness and to avoid the dilapidation of the patrimony of the State. As Hillison et al. (1999) states, no industry was immune to fraud losses. For this, the fiscal administration should have the necessary powers to obtain the elements that can base its decisions relatively to a taxpaying citizen (Sanches, 2000). In any case, there is considerable evidence that taxpayers misreport some sources of income more intensively than others (Patterson & Noel, 2003; and Martinez-Vazquez & Rider, 2005). The taxpayers expect to benefit from the misrepresentation, and exploit loopholes in their roles in order to present a deliberately misleading (normally, flattering) impression of a firm's financial position or results (Alexander & Archer, 2001).

Studying fiscal fraud and evasion creates an opportunity to discuss the decision-making process related with the 'shadow economy'. This concept refers to a broad phenomenon that, usually, includes tax evasion, activities against government regulation, illegal activities, and hidden employment. As Schneider (2005: 598) concludes:

The average size of the shadow economy as a proportion of official GDP in 1999–2000 in developing countries was 41%, in transition countries 38%, and in OECD countries 17%. An increasing burden of taxation and social security contributions underlies the shadow economy. If the shadow economy increases by 1%, the growth rate of the "official" GDP of developing countries decreases by 0.6%.

In order to reduce the shadow economy, it was necessary for the Governments and Intermediate Institutions to intensify the action against the fiscal fraud and evasion. For example, the EU in 1999 decided to take all possible actions, because it was the "horrifying year" in the history of the EU. This classification is related with the mass resignation of the Santer Commission, following a series of scandals (culminating in a nepotism row involving the former French prime minister and then EU Commissioner, Edith Cresson). So, the new Commission European acted quickly to created the European Anti-Fraud Office that as adopted its French acronym – Office de Lute Antifraude (OLAF) – this new independent European Anti-Fraud Office, succeeding after 1988 the Unit for the Co-ordination of Fraud Protection (UCLAF).

This organism reinforces the fight against fraud, corruption and any other illegal activity affecting the financial interests of the European Community. According to the European Commission (CE, 2006: 5), the OLAF:

... is rather the legal instrument for administrative investigation with which the European Union has been equipped by the Commission, to guarantee better protection of Community interests and compliance with the law against attacks from organised crime and fraudsters.

In the last five years, to satisfy the objectives of a global strategy in a longer term context, the Community and the Member States have acted with determination and planned their efforts in a multi-annual strategy (2001 to 2005) around four challenges (CE, 2000: 6):

- *an overall legislative anti-fraud policy (the development of the regulatory system towards more effectiveness and coherence);*
- *a new culture of operational cooperation (full participation and concerted commitment of the national and Community authorities on the ground);*
- *an inter-institutional approach to prevent and combat corruption (the strengthening of the credibility of the European institutions);*
- *enhancement of the penal judicial dimension (adaptation of national criminal prosecutions to the new obligations of the Treaty).*

In agreement with the OLAF, for a **new legislative anti-fraud policy** is necessary to develop a culture that include prevention, detection and cooperation by integrating all the sectors where fraud and corruption may take place. So:

- *Prevention* denotes the quality of acting in accordance with on clear legislation, easily applicable and including provisions likely to strengthen sound financial management and effective control of Community and national policies.
- *Detection* presupposes a sound application of Community and national principles, values and norms as well as sound management of Community policies and funds.
- *Cooperation* is related with the progressive developed of administrative cooperation rules between the European Commission and the national authorities which allow for a better application of economic and financial rules.

However, imports to have in minded that there may be gaps in the rules and places where the rules are vague or even incomplete. Of equal, if not greater significance is the fact that taxpayers may develop schemes which fulfil the letter of the rules, but undermine their spirit (Shah, 1996). Taking advantages of gaps or ambiguities in rules or specifically in accounting standards to present a biased picture of financial performance can be understood as creative accounting (Shah, 1998). The authors reinforce that it does not breach the letter of the law, but may be breach in its spirit.

In relationship to the **new culture of operational cooperation**, the European Commission and the national authorities intended to bring the resources together to encourage a more proactive orientation of action on the ground. Effective action against fraud and evasion inside several countries presupposes the best possible knowledge of their social, economic and criminal environment. In this since, the technology and the technical means for gathering, storing and exploiting information must moreover be developed in the light of best social practice.

Additionally, an **inter-institutional approach to prevent and combat corruption** is need⁹. The OLAF will have to cooperate closely and regularly with the Community institutions, bodies and agencies and contribute to training actions. Furthermore, it must encourage transparency and the duty to communicate. The European Commission will

⁹ For a critical perspective of professional associations, governmental agencies, and international accounting and auditing bodies in promulgating standards to deter and detect fraud, domestically and abroad see Vanasco (1998).

develop norms and rules¹⁰ on ethics and conflicts of interests oriented for transparency and security to avoid Community decisions being affected by irregular influences. As the Commission of the European Communities states (CE, 2000: 15):

The objective is to have a working environment where every official at every level is in a position to be aware of his responsibilities, in particular with regard to the obligation of loyalty to the institutions and the obligation to cooperate to prevent irregularities.

The fourth, and last, challenge is related with **the enhancement of the penal judicial dimension**. The inclusion in the Treaty of Amsterdam of Article 280¹¹, the regulations adopted in May 1999 under the co-decision procedure, the inter-institutional agreement and the establishment of the OLAF brings about in a tangible manner the integration of the national judicial dimension in the fight against fraud and corruption (see CE, 2000).

In doing this, the four strategic guidelines will allocate the Community to improve in a significant way the level of protection of the Communities' financial interests. The implementation of these strategic orientations will allow the control provisions and the audit capacity of the Commission departments to be strengthened overall with a triple aim of effectiveness, transparency and ethical behaviour. The institutions and Member States must adopt the measures necessary to ensure an equivalent high level of protection of financial interests throughout the Community and to fight fraud and evasion unrelentingly and with the utmost vigour.

In this since, the Member States adopted very wide ranging measures aimed at improving the protection against fraud, as, among other, measures to counter money laundering or corruption, national anti-fraud strategies, improvements in financial controls or procedures for the processing of data held on computers. For example, in Portugal external audits should be conducted henceforth at least once every eight years on the expenses of bodies that manage public expenditure (in particular European funds). The audits must assess the body's function and aims and whether its expenses meet criteria of economy, efficiency and effectiveness (see CE, 2005).

Table 1 shows results for the overall index of globalization for the period 1975–2000 as well as the three sub-indices: economic, political and social integration in 2000. The index was developed in Dreher (2003)¹² for 123 countries and is based on 23 variables that relate to different dimensions of globalization.

¹⁰ The findings of Wenzel' (2004) study are overall consistent with the theoretical predictions concerning the relevance of norms for the deterring effects of legal sanctions against tax evasion.

¹¹ See EC (2002). The article 280 of the European Community (EC) Treaty sets an objective of effective and equivalent protection throughout the Community. It requires all the responsible authorities in the Member States to organise close and regular cooperation with the Commission. It introduces a new legal base to allow the European Parliament and the Council to adopt by co-decision procedure the measures to prevent and combat attacks on the Communities' financial interests. Article 280 of the EC Treaty calls finally for a policy of permanent evaluation and transparency which must be implemented on the basis of the Commission's annual report drawn up in cooperation with the Member States (see CE, 2000).

¹² In Dreher (2003). *Does globalization affect growth? Empirical evidence from a new index*. Unpublished paper, University of Mannheim.

Table 1: Globalization Index of the EU 15 Countries

Country	Globalization (index year)						Political	Social	Economic
	1975	1980	1985	1990	1995	2000	2000	2000	2000
Austria	4,44	4,54	4,15	4,31	4,47	5,10	6,75	3,61	5,39
Belgium	6,30	5,33	5,40	5,43	5,24	5,48	7,33	3,49	6,18
Denmark	5,28	4,63	4,38	4,23	4,55	5,69	7,26	4,60	5,63
Finland	4,32	4,25	4,15	4,12	4,75	5,71	6,79	4,97	5,67
France	4,24	4,15	4,15	4,14	4,61	5,36	8,58	3,17	5,19
Germany	4,26	4,04	4,57	4,27	4,36	5,20	6,99	3,70	5,38
Greece	3,01	2,90	2,69	2,73	2,90	3,70	4,30	2,27	4,76
Ireland	3,59	3,63	3,62	3,85	4,04	4,95	4,92	3,30	6,75
Italy	4,14	3,83	3,82	3,80	3,90	4,50	7,05	2,05	5,11
Luxembourg	5,45	4,97	5,46	5,34	5,37	5,61	2,21	5,10	8,84
Netherlands	5,31	4,69	4,47	4,42	4,77	5,31	5,52	4,08	6,46
Portugal	2,23	2,49	2,30	2,63	3,10	4,10	4,88	2,12	5,61
Spain	2,85	2,85	2,84	3,13	3,65	3,95	5,31	1,96	5,01
Sweden	5,18	4,53	4,56	5,00	5,36	6,00	7,85	5,00	5,62
UK	5,04	4,73	4,68	4,74	4,64	5,44	7,04	3,73	6,01

Source: Dreher (2006: 182).

In another perspective, Belgium in 1975, 1980 and 1990, Luxembourg in 1985 and 1995 and Sweden in 2000 get the bigger values of globalization index. In other perspective, Portugal gets the lowest value of the globalization index during the period of 1975 till 1990, but this value increases. These probably encourage to review the Portuguese behaviour and in the year of 1995 and 2000 generates a surprising higher value of the globalization index more significant than Spain and Greece although smaller than other countries. As Dreher (2006: 183) concludes:

... globalization increased average effective tax rates on capital and did not influence the other policy instruments analyzed in this study. When adjusted statutory tax rates on capital are employed, the results show that increasing globalization reduces taxes.

There was widespread concern that fraud increase dramatically after EU enlargement in 2004, but that impression of malpractice undermines public support for the EU and the relations between the Member States. However, the EU itself cannot bear all of the blame for fraud, evasion and corruption of the EU budget, because each Member State adopts and specific programme approved by the European Commission and spent the budget in accordance to that.

The Portuguese Fight against Fraud and Evasion

The fiscal fraud and evasion can be combated through the use of preventive measures and fiscal politics, for the raising of the bank secret, the flexibility of the professional secret, the change and crossing of information between the several institutions of the tributary administration and the sedimentation of the tributary laws and the velocity of its application (see Antunes, 2005). Brackney (2005: 307) considers that:

To ameliorate the tax consequences of their criminal activity, taxpayers should attempt to negotiate an order of restitution instead of an order to forfeiture or voluntarily make restitutions before sentencing.

Some times firms with core restatements have higher frequencies of intentional misstatements (fraud) and subsequently bankruptcy or delisting (Palmrose & Scholz,

2004). Other times the fiscal fraud and evasion be connecting with accounting manipulation. For Feinstein (1995: 53):

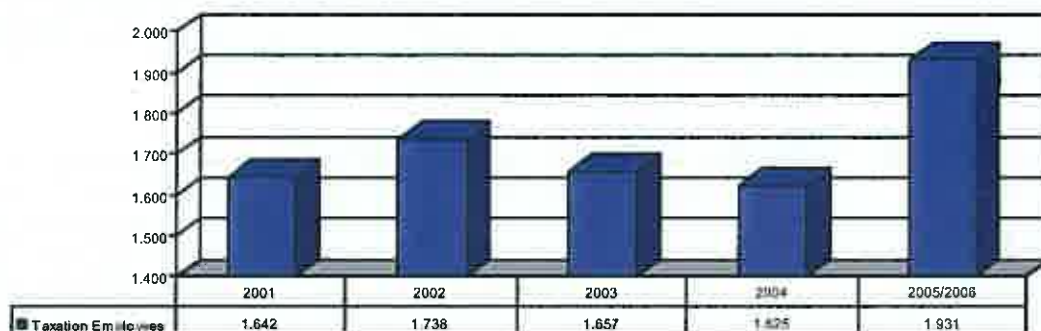
An accounting manipulation arises when a firm shifts line-item entries in its accounting statements to misrepresent the relative contributions of different activities to overall profits.

The manipulation of accounting statements by their preparers can be designated by creative accounting. The authors understand that the concept does not have a full definition, but each one expresses several important aspects as fraudulent financial reporting with intentional misstatements or omissions of amounts or disclosures (Abreu & David, 2002). In the point of view of Naser (1993), the creative accounting can be identified as the process of manipulating accounting figures by taking advantage of the loopholes in accounting rules and the choices of measurement and disclosure practices in them, to transform financial statements from what they should be to what preparers would prefer to see reported.

On its side Mulford & Comiskey (2002: 3) say that creative accounting is any and all steps used to play the financial numbers game, including the aggressive choice (done in an effort to achieve desired results) and application of accounting principles, fraudulent financial reporting (intentional misstatements or omissions of amounts or disclosures), and any steps taken toward earnings management (the active manipulation of earnings toward a predetermined target) or income smoothing (a form of earnings management design to remove peaks and troughs from a normal series). However, other authors, as Archer (1996), argue that the concept of creative accounting is used to describe a widespread and accepted practice and is neither illegal nor a breach of accounting standards.

Accounting standards are based in the same common principles of taxation, such as equal firms should be treated equally providing this rules some guidance on issues of fairness. So, the increase, for example, of Portuguese taxation employees presented in Figure 1 is connected with reduction of fiscal fraud and evasion and is indirectly linked with large budget deficits and the need of increase revenues. The Portuguese Government promotes the fiscal policy by investing on physical inventory (e.g. new buildings, offices), assets acquisition (e.g. computers, software) and new employees in the Ministry of Finance. This tendency shows progress and promotes the fairness treatment of all the Portuguese taxpayers.

Figure 1: Taxation Employees in Portugal (number)



Source: MFAP (2006).

The success of these measures on the taxation services depends on the level of modern information and communication technologies. In this context, the progressive computerisation of taxes services remains a priority for the Government, because low automation levels limit the efficiency of the execution of taxes payments, of tax audits and the fight against fiscal fraud and evasion.

In presence of fiscal fraud and evasion is always on the responsibility of the administrative authorities, the police and other preliminary investigation authorities such as in the Portuguese case: *Ministério Público or Policia Judiciária*. The prevention of fraud is primarily effected by the law and regulation adopted by the Government.

Portugal may obtain bank information only if a criminal proceeding is pending or if an enforcement order is issued by a court at the request of the tax administration and also in cases where fiscal benefits are provided through bank accounts (e.g. special treatment of retirement savings). Several countries (e.g. Czech Republic, Denmark, Finland, France, Italy, Norway, and Spain) can obtain bank information for tax administration purposes without limitation (OCDE, 2000).

The level of information and documentation required to open accounts other than anonymous and numbered accounts varies from country to country. Most countries require banks to verify the name and address of the client by some type of official documentation (e.g. passport, identity card, driver's license) and others require also tax identification numbers (TINs) to open an account, but only ten countries (e.g. Denmark, Finland, Iceland, Norway, Poland, Portugal, Spain, and Sweden) require the customer to provide documentary evidence of the TIN (OCDE, 2000).

In Portugal to obtain information from a Bank about a third person is require only in criminal cases where a judge can decree the lifting of bank secrecy neither information that belongs to a family member of the person about whom the request is made. Most countries can obtain information from a bank that is not suspected of tax fraud but who has had economic transactions with a specified person suspected of tax fraud (OCDE, 2000: 36). In addition, in Portugal as in others countries, banks obtain information about the account holder's economic situation and business activities for creditability purposes.

In Portugal, in other analysis based in the *Report of the Fight Fiscal Fraud and Evasion* produced by the Minister of Finance allows to conclude that the mechanism of raising the bank secret increased significantly in the period 2003-2005 (more 769% of processes). Table 2 shows the high percentage of the taxpaying citizens' voluntary authorizations in the last three years (71.6% in 2003, 57.8% in 2004 and 60.7% in 2005) and the low number of the judicial participations (6.8% in 2003, 2.6% in 2004 and 7.9% in 2005).

Table 2: Processes of raising the bank secret in Portugal

Situation	2003	variation		2004	variation		2005	Total
		value	%		value	%		
Established processes	74	464	627,0	538	105	19,5	643	1,255
Technical analysis	16	197	1231,3	213	-11	-5,2	202	431
Voluntary resolution	53	258	486,8	311	79	25,4	390	754
Judicial participations	5	9	180,0	14	37	264,3	51	70

Source: MFAP (2006).

Particularizing, the previous evidence of a Portuguese case study that is the *Banco Espirito Santo* (BES). The authors present the evolution between 2002 till 2004 in Table 3 of the fraud processes and in Table 4 of the money laundering process in BES.

Table 3: Processes of fraud in the BES

Fraud	2002	variation		2003	variation		2004	Total
		value	%		value	%		
Technical analysis	61	36	59,0	97	-31	-32,0	66	224
Judicial participations	21	-9	-42,9	12	15	125,0	27	60
Inquired processes	43	-5	-11,6	38	-11	-28,9	27	108

Source: BES (2005).

This research shows the surprising increased of the processes related with the money laundering, mainly in 2004 (more 145,000 technical analyses relatively to 2002). This reality confirms the reflections of Schneider & Enste (2000) that the evasion is a fact of life around the world, and that are strong indications that it is increasing¹³.

Table 4: Processes of money laundering in the BES

Money laundering	2002	variation		2003	variation		2004	Total
		value	%		value	%		
Technical analysis	222	46.917	21.133,8	47,139	98.247	208,4	145.386	192,747
Judicial participations	10	46	460,0	56	48	85,7	104	170
Inquired processes	0	0	-	0	0	-	0	0

Source: BES (2005).

Some times, the aim of the fiscal fraud and evasion is to transfer the capital obtained with her to tax havens. The high-taxing Governments wrap themselves up in a cloak of morality, but the fact is that they are suppliers of services, enjoying local monopolies, and financed by their taxpayers under compulsion (Fildes, 2002). Thus, the Governments should change its approach to taxation law to avoid that the taxpayer's fell back upon the fiscal evasion. The European process of automatic information exchange comes in this sense, which should be extended internationally. Portugal have as fiscal paradise the Madeira International Business Centre (that is subdivided into the Industrial Free Trade, International Service Centre, Offshore Financial Centre and International Shipping Registry)¹⁴, in which the firms there located are exempt from corporate taxation (see David & Abreu, 2005).

Following this, it is urgently need legislative restrictions. Effectively, on March 27, 2004 it was published in Portugal the new prevention and repression regime relatively to the money laundering through the *Lei* n° 11/2004 (see AR, 2004) that transposed for the internal juridical order the Directive 2001/97/EC (see EC, 2001) on prevention of the use

¹³ Obtaining precise statistics about the allocation of a country's resources in the shadow economy is important for making effective economic policy decisions (Schneider & Enste, 2000) with the objective of fight against fraud and evasion.

¹⁴ The Madeira International Business Centre was legal created by *Decreto-Lei* n° 500/80 of October 20 (see MFP, 1980), *Decreto-Lei* n° 165/86 of June 26 (see MF, 1986), *Decreto-Lei* n° 215/89 of July 1 (see MF, 1989a), as amended by *Decreto-Lei* n° 198/2001 of July 3 (see MF, 2001). And other legislation about fiscal benefits as: *Decreto-Lei* n° 84/93 of March 18 (see MF, 1993), *Decreto-Lei* n° 37/94 of February 8 (see MF, 1994), *Decreto-Lei* n° 25/98 of February 10 (see MF, 1998a) and *Lei* n° 30-F/2000 of December 29 (see AR, 2000b).

of the financial system for the purpose of money laundering. However, the Directive 2001/97/EC (EC, 2001: 76) express that it:

... should not only reflect best international practice in this area but should also continue to set a high standard in protecting the financial sector and other vulnerable activities from the harmful effects of the proceeds of crime.

This new legal regime should be contemplated in the internal regulation control of firms and institutions public and private. For Haugen & Selin (1999) an internal control system has four broad objectives:

- to safeguard assets on the firm;
- to ensure the accuracy and reliability of accounting records and information;
- to promote efficiency in the firm's operations; and
- to measure compliance with management's prescribed policies and procedures.

The emphasis on the internal control systems and the internal audit functions result of the globalization of business, the technological advancements, the increasing business failures, and the widely publicized fraud (Rezaee, 1995).

Directors and all levels of management are responsible for preventing and detecting situations of fiscal fraud and evasion and for establishing and maintaining formal internal controls that, inside of a sphere of social responsibility and functional segregation, provide security for the resources of the firms. Thus, directors and management must recognise risks and exposures inherent in their responsibility area, and be, particularly, attentive of fiscal fraud and evasion indicators.

Discussion

News methodologies are needed to measure fiscal fraud and evasion and connect them with economic changes, technological improvements and social traditions as dimensions of social responsibility and more specifically with the financial performance. Thus, the requirements so that firms are sustainable connected with successive positive actions, with correct, fair and good behaviour, as well as with ethical behaviours that slow down the development of the shadow economy.

Indeed, global businesses should promote the sustainable development and Governments must be constantly vigilant to avoid being associated with corrupt practices. For example, the Enron business model was unsustainable as a model and this leading directly to the demise of Enron Corp (Baker, 2003). This firm had reported rapidly growing revenues, with a corresponding increase in stock prices. Unfortunately, this picture of growth was inaccurate. Instead, this firm was found to have applied generally accepted accounting principles (GAAP) inappropriately, resulting in a massive overstatement of income (Makkawi & Schick, 2003). In this case as in others, the firm did not understand the limitations of the options allowed by GAAP and made misinterpretations with very important effects of sanction severity.

It is urgently that the Governments reinforce the fight against fiscal fraud and evasion of the firms to provide the increase of their revenues through the implementation of formals internal preventative measures. This aim sets, on one side, in the effectiveness of the

struggle measures of fiscal fraud and evasion and, on the other side, in the social responsibility perspective of the citizens and the generalization of their ethical behaviour. Also, the auditors are important researchers in the discovery of fraudulent financial reporting, for that they should be sensitive enough (see Moyes & Hasan, 1996; Abdolmohammadi & Owghoso, 2000; Jayalakshmy et al., 2005; and McKee, 2006). Smith (1998) recognises differences between auditors, relative to their tolerance of accounting manipulations with an income impact. However, as Humphrey et al. (1993) states, it may be that development in auditors' responsibilities for the detection of fraud will only be forthcoming through further legislation.

Unfortunately, Portugal attempt to control the fraud and evasion through various punitive measures, rather than through reforms of the tax and social security systems which could improve the dynamics of the official economy.

The authors' proposals in the struggle against fiscal fraud and evasion are concentrating in bigger access to bank information for tax purposes. At the same time, the Ministry of Finance must implements and promotes for all taxpayer's a transparency information policy and establish an effective exchange of information mechanisms allowing the open system to be controlled for each one that pay tax.

International bodies such as IASB, FASB and IFAC may provide new standards that promote the principles of transparency, equality and effective exchange of information between all firms that must follow these regulations.

Governments must recognise the importance of permitting scientific investigations promoted by researchers that will access to fiscal information generated from certain law enforcement purposes. So, more and more progress, partnership, collaboration and teamwork between the Government through Ministry of Finance and Researchers will allow in the future to develop new perspectives of taxation and to face new fights related to fraud and evasion in the Portuguese reality.

In summary, the social responsibility is an essential need of the society and full, open and disclosure information that yields to better fiscal policy to be promoted by political-makers. The fraud and evasion should be fight with all weapons as tools, actions and procedures for everybody that used them to decrease the range and power of human bad behaviour...

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