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Creative Accounting, Earnings Management And Falsification – Evidence Of Tax Avoidance In Greek Taxation.

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Abstract: *Nowadays, after a decade of continuously economic and healthy crisis, many companies all over the world face serious problems of sustainability and are forced to tax avoidance. The way of tax evasion varies. Companies can use earning management, creative accounting or falsification. Presenting different ways of reducing profits, this paper focus on evidence of tax avoidance using legal way according to Greek tax law. An example is presented in how a company, following the Greek taxation, can reduce their profits and equally the amount of annual tax.*

Key Words: *Earnings Management, Creative Accounting, Falsification, Tax-evasion, Tax Fraud, Tax Audit, Accounting, Taxation,*

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H21, H26, K22, K34, M42, M41, M48,

I. Introduction

The World Community today is faced with severe economic problems and businesses, to cope, are usually led to tax evasion. Tax evasion is varied either it can resort to issuing and accepting false documents or it can resort to accounting manipulations as sometimes legal restrictions sometimes not, which are popularly known as creative accounting.

Today, tax evasion is one of the most important problems of the Greek economy, according to statements by the Ministry of Finance. The government's goal is to deal with tax evasion and to immediately increase public revenues. Tax is a Compulsory contribution paid by the citizen, without special consideration and collected by the state to deal with public expenses such as Expenditures for Administration, Defense, Justice, Health, Education etc. To meet all these needs, the state therefore imposes, as we have said, taxes by formal law.

Taxes are divided into direct and indirect. Direct taxes are levied directly on the taxable income of citizens, such as Income Tax. Indirect or Consumption taxes which are imposed on transactions, mainly VAT but also other consumption taxes. The relationship between direct and indirect taxes is a big problem for any government because usually higher direct taxes indicate a higher level of development, while the opposite happens for higher indirect taxes which indicate developing or underdeveloped states.

However, avoiding the appearance of taxes, or otherwise managing profits with the aim of showing reduced profits and thus yielding reduced taxes, is a clear management decision. According to Abdelghany (2005) when the change of management of a company is about to take place, downward earnings management is a frequent phenomenon.

II. Earnings Management

Earnings management should not be confused with illegal activities that will manipulate financial statements and results and produce results that do not reflect economic reality.

According to Beneish (2001), academics have not been able to agree on a definition of earnings management. In other words, it has not been possible to date to cite a definition of earnings management commonly accepted by all academics. Earning Management can be defined as "the logical and legal management, decision making and reporting intended to achieve stable and predictable financial results".

Shipper (1989) argues that earnings management is "the purposeful intervention in the disclosure process of a firm's financial statements for private gain". Also, Healy and Wahlen (1999) argue that it is "the management's discretion to present the company's financial statements in such a way that, without violating accounting rules and standards, and misleading stakeholders about the true effectiveness of the business". According to Levit (1998) earnings management is defined as a gray area where accounting is distorted, and earnings reports reflect the wishes of management rather than the actual financial performance of the business.

Several phrases have been used to describe earnings management activities such as Income smoothing, Financial statement management, The numbers game, Banking income for the future.

According to Scott, (2009) earnings management is defined as the manager's choice of accounting policies, or actions that affect earnings, so that earnings are achieved. As this definition shows, earnings management can be viewed from two perspectives: from one perspective we have the effort to make earnings favorable to management, through the choice or change of accounting procedures "(accounting handling of policies) and on the other hand " is the effort to control profits by changing its real elements.

Research on earnings management shows that this is a widespread phenomenon. According to Burgstahler and Dichev (1997). to achieve profits. In other words, many companies use earnings management, either to maintain steady earnings growth or to avoid losses.

One of the main forms of earnings management is income smoothing, which aims to show a steady increase in the company's earnings and reduce their "volatility". A basic condition for the application of income smoothing is the achievement of large enough profits so that the financial results are above average for a long period of time. Other things being equal, management usually aims to smooth out earnings. This is because stable earnings are desirable in capital markets.

Consequently, when earnings are expected to fall below or exceed target, managers may be expected to pursue earnings management in order to increase or decrease them.

III. Creative Accounting

Baralexis (2003) support that creative accounting is " the exploitation of the weaknesses of the accounting rules and laws or even the violation of them, with the ultimate goal of presenting the accounting statements not as they should normally be, but as it is convenient for the company each time to appear".

According to Amat, Blance and Dowds (1999) creative accounting is defined as a process where accountants use their knowledge of accounting rules to manipulate the figures that appear in a company's accounts. Also, Gowthorpe and Amat (2005) argue that Creative Accounting refers to the intentional distortion of communication between businesses and shareholders by those who prepare financial statements and seek to change the content of the messages being communicated.

In general, creative accounting has created a negative image since its purpose is the preparation of financial statements that will meet the requirements of managers regarding the financial position and performance of the economic unit.

IV. Accounting Treatments to Improve Results

According to Rezaee (2002) and Spathis (2002), the most frequent accounting manipulations of beautifying the results refer to provisions for bad debts and personnel compensation, depreciation, the characterization of expenses related to fixed assets at their acquisition cost, the valuation of inventories as well as in wrongly used income/expense entries. Some other practices that result in the falsification of financial statements are the intervention, conversion and management of important financial documents, transactions as well as the relevant documents that accompany them. In addition, the deliberate omission or misrepresentation of facts, transactions, accounts or other material information necessary for the preparation of financial statements as well as the deliberate non-application of accounting rules, principles, policies and standards that are tools for measuring, recognizing, recording and disclosure of financial events and transactions, are techniques that distort the true picture of the business unit that the financial statements aim to convey.

Various research studies have examined the issue of motivations that drive creative accounting. Half a century ago, Hepworth (1953) identified several incentives including the existence of income tax contributions, shareholder and employee confidence in management being able to report consistent profits and psychological expectations which are related to increases or decreases in expected income.

The manipulation of the results is observed when the executives of a company use their judgment, during the preparation of the financial statements, to change the results and disorient the investors regarding the profitability and the general image of the company (Healy, Wahlenl, 1999).

V. Ways-Techniques of altering the accounting results.

When one company sells unused fixed assets to another, while at the same time entering into purchase agreements for the same or similar fixed assets at approximately the same price, then we have the so-called "round-tripping". As the Tax Cut increases, the gap between a domestic investor's tax and a foreign investor's tax increases, the more beneficial it becomes for the host country's domestic investor to avoid tax. As the tax cut increases, the host domestic investor sends more capital to the shell company in a tax haven source country, which in turn returns to the host country as a foreign portfolio investment (Kemme et al, 2020)

"Back-to-back" is roughly the same process, with the difference that there is also a slight time delay, meaning that the sell and buy transactions are not scheduled to occur at the same time. The technique of "swaps" (exchanges) occurs when two companies sell to each other essentially the same fixed assets, with the purpose of recognizing income from the whole process. All these practices artificially inflate the income of both buyer and seller (Kokoszka, 2003). Another technique that is often used to reduce profits, is the option for increased depreciation. More specifically, to show higher expenses, the company chooses as asset depreciation rates, the highest within the acceptable limits defined by accounting science or other national laws.

VI. Increased Depreciations – An example of creative accounting According to Greek Tax Legislation

Increased depreciation is an option for fixed asset-intensive businesses that invest frequently and repeatedly in fixed assets (furniture - utensils - other equipment - electronic Computers, etc.). These companies choose between 2 depreciation rates, the larger one, provided by generally accepted accounting principles or national jurisprudence, so that in the presence of increased depreciation, the final result (Profit) will be reduced.

According to the Greek Legislation (N.4172/2013), the depreciation rates are defined in the specific law in article 24. In the same article, (paragraph 7) it is defined that "if the depreciable value of an asset of the business is less than one thousand five hundred (1,500) euros, the item in question can be fully depreciated within the tax year in which the asset was acquired."

So, for example, a hotel unit chooses to renovate 100 rooms, with the installation of new furniture (bed - bedside tables - wardrobe). So, 100 beds, 200 bedside tables and 100 wardrobes are procured, with a total asset value of €300,000. The unit value of each type does not exceed €1,500 and even if each fixed item is €1,000.

Therefore, the company, making use of the provision of the tax law, instead of showing depreciation of the specific fixed assets at the rate corresponding to the furniture, i.e. 10%, therefore depreciation of €30,000 (€300,000 x 10%) due to the fact that the value of each asset does not exceeds €1,500, it can show depreciation worth €300,000, reducing the taxable income and thus the tax paid.

For the above case to be applicable, the company should be fixed capital intensive and be able to renew its fixed equipment frequently and in fact it should not be plots of land (which are not depreciated) nor buildings, the value of which is certainly greater than €1,500 and their one-off repayment is not foreseen. However, in the cases where the company can treat, a corresponding accounting treatment of its fixed assets, will show significantly reduced profits and will yield a significantly reduced tax.

VII. Conclusions

Creative accounting is responsible for distorting the financial statements of businesses in order to serve the interests of each business and its stakeholders. One manifestation of creative accounting is the management-manipulation of profits. Many definitions have been given for earnings management. Common to all of these is the distortion of the true image of the business to present an image that best serves its interests.

The motivations for a business to falsify its financial statements may come from forces that are external or internal to the business. Many times, these motivations come from the need for the viability of the business, even if the business proceeds with tax evasion. However, there are also cases of creative accounting and legal tax avoidance, where - under specific conditions - companies can take advantage of tax and other legal provisions, with the aim of reducing their profits or beautifying the image of their financial statements.

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