

TAX PROFILING AS A TOOL FOR TAXING THE SO-CALLED UNJUSTIFIED INCOME IN ROMANIA

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Abstract:

We were always told that George Orwell's 1984 is just a fiction book, not a manual of instructions. But more recent events seem to suggest the contrary. A decade ago, tax authorities paid good money for income information from Switzerland or Liechtenstein even if such information was obtained in a fraudulent manner. DAC 6 put professionals of the (tax) death row and the increased exchange of tax information facilitated access to most of taxpayers' sources of income. As a result, tax authorities are now able to profile their taxpayers by determining their usual sources of income, certain expenses, shopping habits or random people they share the lunch bill with via Revolut. This type of profiling has recently led Romanian tax authorities into a fight regarding the so-called "unjustified income". We therefore investigate whether the concept is defined by Romanian tax law, the boundaries of the constitutional and legal framework, the mechanics of the audits, the burden of proof and the genuine probatio diabolica required in certain procedures and, on the whole, the adequate solution and the perspectives of such profiling.

Keywords: *income taxation; unjustified income; tax information; tax audits; proportionality.*

JEL Classification: K340.

1. BRIEF INTRODUCTION TO THE TOPIC

In a few recent Romanian cases concerning the audit of natural persons' sources of income and associated taxes and social security contributions, national tax authorities have shown progress in using various types of tax profiling. In fact, the target of the tax inspectors has been the so-called "unjustified income" associated with certain individuals. With a variety of tax information exchange tools at hand and using data available online, teams of either the General Antifraud Direction (DRAF) or the National Tax Administration Agency (ANAF) seem to have become more innovative and keener on exploiting such information.

While profiling has been used for either security purposes (e.g. fighting terrorism) or as part of a national surveillance program, it is generally considered a dangerous tool for privacy rights. Maybe for that reason also, tax profiling has been usually associated with private audits carried out for preventive reasons (for

example, a dedicated auditor might circulate a questionnaire to assess what's the tax norm of an organization, how does it look at tax, including tax transparency or how is tax handled daily).

However, the interest in profiling tax and financial behavior with big data is genuine (Politou, Alepis and Patsakis, 2019). Even if the times of various "papers" (sensitive financial information leaked online) and dark alley purchases of tax havens data have passed, tax authorities are now collecting a huge amount of data from various sources. As both the Organization for Economic Development and Cooperation (OECD) and the European Union (EU) have been pushing for automatic and complete exchange of tax information, the constant upgrading of the EU Directive on Administrative Cooperation (Council Directive 2011/16/EU of 15 February 2011) led to serious concerns and even more serious legal battles (Tofan, 2023; Costaş, 2007). DAC 6 was particularly criticized for imposing on tax and legal professionals an obligation to contribute, in a broad sense, to profiling, for arrangements that had not been reported or intended to be reported (Castro Bosque, 2024).

In the past years, for example, Romanian Government gathered such information from banks, couriers (e.g. identity of buyers and sellers, package value, collected cash), national and local authorities; it also used DRAF force to investigate commercial patterns, select and copy documents, evaluate assets and financial data, collect data from social platforms posts; upon request or by automatic exchange of information similar data was collected from online economic platforms; last but not least, data and requests for further checks were sent to ANAF by the Romanian Court of Accounts. It is no wonder then if one day a tax inspector knocked on somebody's door and asked why the price of some wedding dresses regularly sold by a company had been paid to a personal account or if a certain Revolut or Wise payment was a gift or the equivalent of supplied services.

Scholars have already elaborated on defining profiling and explaining its various avatars (Ferraris *et al.*, 2013), which is not the purpose of this paper. We will only refer to a working definition these authors have put forward, explaining that *profiling* is a technique to automatically process personal and non-personal data, aimed at developing predictive knowledge from the data in the form of constructing profiles that can subsequently be applied as a basis for decision-making.

2. THE NEED TO COLLECT AS MUCH AS POSSIBLE

Romania has long experimented a serious VAT gap and has had chronic difficulties in collecting taxes. One might stress that this is a result of no serious reform of the rules concerning taxation of natural persons in the past 30 years of an obsolete tax administration (I have been myself blessed with the same tax inspector for two decades) and of lack of specialized audit units. Indeed, while

economy is turning into a digital economy and certain items of income are the direct consequence of it, Romanian government did not show any interest in approaching taxation of individuals and re-writing the existing rules. Legal patches in isolated cases have had little effect in our opinion.

In the past years, justifying a series of reforms of its tax administration, Romania traded regular tax audits for the speedier "documentary checks" (*verificări documentare*). While a decade ago documentary checks were only performed in a limited number of cases and meant to clarify single issues (Costaş, 2016), in 2025 such tax checks seem to be the common manner of verifying taxpayers, both companies and individuals. However, doctrine pointed out a number of unsolved issues subject to widespread concern: documentary checks lead to the issue of tax decisions subject to review by another tax authority, legal certainty ignored; lack of detailed for this type of audit gives room to abuse and disrespect of taxpayers' rights; mechanisms and techniques of tax audits are disregarded under the pressure to collect in a timely manner and so on. In a nutshell, this is "the perfect legal uncertainty" (Costaş, 2023).

On one hand, it is true that checks performed revealed a number of cases where income had never been declared and taxed. Flying under the tax radar, individuals failed to account for significant amounts of cash received from influencing, musical performances at weddings and other events, online adult entertainment services (video chat), transactions with cryptocurrency, sale of make-up products, fashionable clothes, shoes, navigation systems, leather products, timber and even hay or fruit trees. On the other hand, there were epic fails, such as the illegal taxation of donations received by a veterinary for the pick-up, treatment and alleged "sale" of stray dogs or the taxation of income derived from the sale of waste (Costaş and Puț, 2023).

A change of perspective in criminal legislation – mainly article 10 of Law no. 241/2005 – allowed such taxpayers to avoid criminal responsibility for unpaid taxes of no more than 1 million euros whether taxes themselves, associated tax interest and a further 15% increase were to be cleared within 30 days from discovery (Costaş and Tofan, 2023). However, this was and still is a *take it or leave it* offer, as taxpayers cannot challenge the amounts determined by ANAF or DRAF, ask for an expert report on the matter or provide evidence to reduce the taxable base with deductible expenses.

As of 1 July 2024, a change made to article 117 of the Romanian Tax Code established a 70% tax rate for any "unjustified income" of natural persons to be discovered. A shady note to the new legislation provided that article 117 in its new form – the old legal norm referred to a 16% rate – shall be applied to "all tax decisions issued after 1 July 2024", raising serious concerns about the possible, yet unlawful (Puț, 2024) application of the 70% tax rate to income earned until 30 June 2024.

In this particular context, a series of documentary checks and tax audits have been performed with the sole aim of collecting as much as possible for a state budget with a 9.3% deficit in 2024. It is worth noting that as of 2020 tax inspectors with DRAF can also perform the check of the personal tax situation regulated by article 130 and the following of the Romanian Tax Procedure Code using the documentary check procedure. That translates into lengthy and complex procedures lasting 12 to 18 months exchanged for fast forward documentary checks and is subject to our analysis.

“I can resist anything except temptation”, Oscar Wilde once said. And it is (tax) temptation that pushed for a new witch hunt: the taxation of the so-called “unjustified income” at a 70% rate.

3. WHAT IS “UNJUSTIFIED INCOME”?

The Romanian legislator has never been keen on detailing direct tax (see High Court of Cassation and Justice – Administrative and Tax Section, decision no. 2826 of 23 May 2024, quoted by Văsonan, 2024) or indirect tax (Costaş, 2024) provisions so that they were thoroughly understood and applied in a unitary manner by taxpayers, courts and tax administration. On the contrary, in many cases legally undefined concepts are used by the Romanian tax authorities (Puț, 2018). The recent case of “unjustified income” makes no exception.

Article 117 of the Romanian Tax Code, in force as of 1 July 2024, reads as follows: “*Article 117. Defining and taxing income whose source has not been identified. Any income found by the tax authorities, under the terms of the Fiscal Procedure Code, whose source has not been identified, is taxed at a rate of 70%*”. This article was modified by Law no. 296/2023, to the sense that the tax rate was increased from 16% to 70%. Moreover, according to art. VII par. (1) b) of Law no. 296/2023 the increased tax rate “applies to tax decisions issued by the tax authorities as of 1 July 2024”. This article is not new to Romanian legislation, as the previous article 79¹ of the old Tax Code was in force since 1 January 2011. The previous version of the law, however, referred to an adjusted taxable base that should have been determined using indirect methods of reconstitution for both taxpayers’ income and expenses (in accordance with Order of ANAF President no. 3733/2015 regarding the approval of indirect methods for the determination of income).

Following the entry into force of the 70% tax rate, intrusive documentary checks and the qualification of certain amounts as “unjustified income” made social networks, such as Tik-Tok, spread viral posts regarding taxation of such income. Doctrine should therefore pay equal attention to the matter.

In an effort to determine what “unjustified income” is, one should first consider the provisions of article 117 itself of the Romanian Tax Code. However, contrary to the provisions of Law no. 24/2000 regarding the norms of legislative technique, this article says nothing. An elliptical construction only clarifies the

existence of a 70% tax rate and definitely not what “unjustified income” might be. Of course, there is a reference to “any income”, which broadens the spectrum of possible taxable items of income, but the text is immensely shy of any legal certainty. Should an individual who received a bank transfer made using phone numbers as payer’s and beneficiary’s identificatory be subject to a documentary check in order to assess the “justified” or “unjustified” nature of payment? What does it take to “justify” income: a job, a generous bank account, regular updating of personal identification data? Do friendship, love, relationship, work relations or context “justify” payments from one account to another? Are there any patterns applied in order to rule what’s “justified” or what’s “unjustified”?

However, on a different note, an experienced observer can explain that the correct remedy whenever there is income and the source of that income is not traceable would be to apply articles 106–107 of the Tax Procedure Code, namely establishing the tax base by estimation (Costaş, 2016). Such a procedure relies on the fact that, in any given case where the taxpayer did not declare the source of income, ANAF must be able to identify the source of income (ex. income from wages, income from independent activities) and, if this is not possible, it must use the estimation procedure in order to tax.

Bottom line, we do not know what “unjustified income” is. Might that be since individuals, as a rule, do not have an obligation to justify income on a regular basis?

4. ARE ROMANIAN TAXPAYERS UNDER A GENERAL DUTY TO REPORT INCOME AND FORTUNE?

We argue that in Romania there is no general obligation to declare all income or to point out all goods that might generate income. Therefore, if somebody finds a painting by Nicolae Grigorescu (1838–1907, a great Romanian impressionist painter) in his/her grand grandmother’s attic or a valuable vintage car that is no longer in circulation in his/her grand grandfather’s old garage, he/she is under no obligation to declare such goods. As a result, income arising from the sale of such goods and various other sources has “a source that has not been identified”.

To further explain this, we will use other relevant examples from the Romanian Tax Code (Costaş and Puț, 2023). First, according to article 62 p) Tax Code, gifts received at weddings, baptisms and similar events, which are very common in Romania, are not taxable and the taxpayer is under no obligation to monitor, identify, document and declare such nontaxable income (except the case where such gifts exceed the value of 25,000 lei – some 5,000 euros – when the Civil Code requires an authentic donation contract). Second, as a rule, the sale of movable and immovable goods from the private patrimony of an individual are not taxable, in accordance with article 62 m) Tax Code (except for investments’ income arising from the sale of shares and certain real estate transactions described in article 111 Tax Code). Third, any income from dependent activities

(wages) obtained abroad is not taxable in Romania, no matter the tax treatment in the other state, according to article 76 paragraph (4) o) Tax Code. And, in yet another example, according to Romanian Civil Code presumptive heirs can freely use the movable goods that were found after someone passed away (e.g., a huge amount of cash, other movable goods) if the other heirs do not object to that.

Such examples reinforce the conclusion that the Romanian legislator did not intend those taxpayers keep a detailed track of the income they gain from various operations and, except for the cases specifically provided for in the Romanian Tax Code (e.g., income from independent activities, intellectual property, rentals, agriculture or investments), such income does not have to be included in the annual tax return. Furthermore, Romania does not tax gifts and successions (with the rare exception of real estate, if the succession has not been cleared two years after *de cuius* passed away) and there is no tax on fortune or the increase of fortune throughout the year (Tofan, 2024).

If we look at this from the perspective of the burden proof – of the “justified” or “unjustified” character of such income – one must first pay attention to the provisions of article 44 par. (8) of the Romanian Constitution, which states that “*Licently acquired property cannot be confiscated. The licit nature of the acquisition is presumed*”. In principle, in Romania, the demonstration that property has been acquired illicitly must be carried on in a criminal trial (e.g., income arising from the sale of drugs shall ultimately be confiscated) or in an administrative procedure carried on in accordance with Law no. 115/1996 for the declaration and control of the assets of dignitaries, magistrates, persons with management and control positions and public servants.

We can easily argue that the introduction of a 70% tax rate is actually a “criminal sanction” in accordance with the criteria set by the European Court of Human Rights in cases such as *Bendenoun and others v. France* (Costaş and Puț, 2023). The only difference is that such a sanction is applied in the absence of any trial, based on a summary analysis and using legally undefined concepts such as “taxation of unjustified income”.

In terms of evidence, according to article 73 paragraph (2) Romanian Tax Procedure Code, the burden of proof stays with the tax administration. Indeed, according to article 73 paragraph (1) of the same Code, taxpayers are only obliged to prove acts and facts that support their tax declarations and requests for the tax authorities (Costaş, 2016). They are not compelled to prove the source of all their income. It is an important point since in many tax audits and particularly during the intrusive documentary checks tax inspectors tend to reverse the burden of proof and ask taxpayers to show proof that they have licitly acquired property or income.

5. PROFILING FOR TAX PURPOSES

We have approached this topic from the point of view of tax profiling because practical experience shows such profiling is carried on extensively. In a significant number of cases, beneficiaries of payments in cases of nationalized goods, lawyers that carry out other activities apart from the legal business (e.g., rentals, sale of timber) individuals that use significant funds, shareholders of companies or housewives that sell various things on economic platforms have been asked to show proof of their income or be taxed at 70% for “unjustified income” if they failed to do so. Some of these requests were sent in the context of the constant monitoring of social media and social platforms (e.g., notifications sent to performers that have reached a certain number of visualizations on YouTube). Others are the direct effect of shady profiling made by the Court of Accounts, which monitors payments made by national authorities in the case of nationalized goods or money lend to companies by their own shareholders and then asks tax authorities to step in and perform documentary checks.

As documentary checks have undefined legal boundaries (Costaş, 2023), profiling has gone even further. In many cases, even if taxpayer’s X income and fortune is under scrutiny, tax inspectors state in their decisions that they have performed internal checks with taxpayers A, B, C or D (the taxpayer’s grandmother, his/her significant other, the high school best friend or the business partner) and that these taxpayers did not possess the financial means to make payments to taxpayer A (e.g. in the case of a wedding gift, a personal loan or a price for a sold good that taxpayer A indicated as sources of his/her income). It is understood that taxpayers A, B, C and D are not audited themselves, but they had definitely been profiled with regard to their financial status, banking accounts and money flowing through such accounts, movable and immovable property, dependent or independent activity carried on, shareholder status in various companies, financial results of such companies and so on.

The “informal” nature of such audits carried out with taxpayers A, B, C and D is definitely contrary to Romanian law, as such taxpayers are not verified themselves (at least not in a public audit or documentary check performed in accordance with the provisions of the Romanian Tax Procedure Code). As a result, one can seriously doubt the licit nature of evidence collected in that manner and taxpayers can obviously claim such evidence is not used against them in the main audit procedure.

It is to be added to this that taxpayers A, B, C and D are under no obligation themselves to evaluate or declare, at a certain moment in time, their non-taxable income or non-taxable fortune. Therefore, if they are asked to declare and prove the amount of cash they had on 1 January 2018, they can’t simply do that because they kept no evidence whatsoever (of course, they can estimate, but then again this is not accurate information and failure to provide accurate information might be used both against them and against taxpayer X).

Furthermore, profiling for tax purposes, followed by a documentary check and a taxpayers' notice as to the amounts he/she has to pay has another aim as well. Changes to Romanian criminal legislation in the past few years have made it possible that, under article 10 paragraph (1) of Law no. 241/2005, taxpayers pay evaded tax debt and a 15% penalty in order to avoid any criminal responsibility whatsoever (for tax debts up to 1 million euros), since the results of tax profiling are not even sent to the Prosecutor's Office. Consequently, the results of tax profiling are formally exhibited during a documentary check and the taxpayer is warned: he/she either pays the tax debt which has been determined during profiling or he/she faces the possibility that amounts owed increase. Indeed, according to the same article 10 of Law no. 241/2005, if payment is done later, the value of penalties increases to 25% during criminal investigations, to 50% during first instance criminal trial and to 100% during appeal criminal trial. From a procedural point of view, it is a *take it or leave it* offer, since at the end of the documentary check, if the taxpayer paid, no tax decision is issued. So, even if the taxpayer paid, he/she can no longer challenge the results of tax profiling, as they had not been mentioned in an official tax decision and the lack of a tax decision prevents taxpayers from going to court.

To sum up, by using data gathered from various sources, processed with extensive use of artificial intelligence, Romanian tax authorities have come to the point where:

- (a) an individual's tax profile and his/her associated tax obligations are determined in a rather mechanical manner, based on various patterns and not necessarily on the evidence available both in favor and against the taxpayer.
- (b) for taxpayers, access to the tax file behind the conclusions of tax inspectors is difficult or close to impossible, particularly when a tax decision is not issued and the procedure closes (e.g., in the case where taxpayers match the alleged tax debt in order to avoid criminal prosecution).
- (c) although determination of taxes should be as accurate as possible and artificial intelligence should help, current results are pretty much different: in many cases the facts of tax cases are misunderstood, tax debt is determined considering solely income and not also expenses, key evidence is ignored and, in the end, tax obligations determined are annulled by tax courts in significant proportions; that is simply far away from "smart taxation".
- (d) the main concerns regard taxpayers' rights, as both audited taxpayers and "informally audited" connections of such taxpayers are unable to effectively defend in current tax audit procedures.

It is therefore our view that tax profiling should be kept to a minimum or eliminated, in order to secure both the coherence of tax audits and taxpayers'

rights. Moreover, given the significant number of tax cases that actually go to tax courts, we also believe that a proper use of such tools in connection with existing evidence and not instead of evidence should be considered. To use just one case as an example, a veterinarian was audited using existing data that showed she had sold to Romanian and European clients more than 600 stray dogs for consideration. Therefore, a tax decision was issued for the whole amount of consideration, as calculated from adding up payments made to the veterinarian's private bank accounts. However, a final decision of the Timișoara Court of Appeal portrayed a totally different perspective: the veterinarian did not exercise an "economic activity", she simply picked up stray dogs from the streets, treated them in her clinic, paid for their medication and advertised them for adoption (a fine tuning of facts that AI did not pick up); stray dogs had been registered as the "property" of the veterinarian since the IT system required an individual as the owner of the dog; all consideration received consisted of donations for the support of her voluntary activity or amounts meant to cover administrative and transport costs (e.g. passport and airplane ticket for a Romanian stray dog adopted by a Scottish family); most of such consideration was spent on medication, food and care of such dogs.

6. CONCLUSIONS

With more and more AI tools available and the desire of the Romanian tax authorities to make "easy money", there is a significant use of tax profiling. However, such profiling has shown to have raised major issues, stretching from serious breaches to taxpayers' fundamental rights to totally wrong tax conclusions. Overlapping with a debatable structure of national tax audits and insufficiently cleared legal concepts, the situation allowed that various items of income had been considered taxable or "unjustified income" subject to a 70% tax rate. It is our view that such an approach, together with the structure of the tax authorities or the proper writing of tax rules, should be under serious review. We challenge the possibility of taxing "unjustified income" itself since the legal concept is not defined by tax law and tax authorities are under a legal obligation to determine the nature and the source of any income in order to tax, showing evidence to the fact that such income is taxable.

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