
TAX EVASION, SHADOW ECONOMY, AND TAXATION SYSTEM. JUDICIAL INSIGHTS AND ECONOMIC ASSESSMENTS

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(Received: January 2026; Accepted: March 2026; Published: May 2026)

Abstract: The shadow economy is a widespread phenomenon, with a major impact on public finances. It should not be viewed strictly as an economic problem, as it raises a number of ethical, social, and governance concerns. Combating the underground economy cannot be achieved only through increased controls and higher fines. It requires a multifaceted approach, targeting the root causes of informal economic activities. In order to discourage illicit activities, more efficient institutions, a simpler and more transparent fiscal system, and better regulation are needed. In this paper, we present the negative effects of the shadow economy and the need to combat it, and also address the main determinants of the underground economy, as well as the strategies needed to reduce it. Tax evasion represents the quid pro quo of the fiscal system, lato sensu, and taxation technique, stricto sensu. In this paper, both a quantitative and qualitative overview of the connections between tax evasion and the shadow economy in the context of the taxation system are presented. The practical case studies presented and analyzed were designed to reveal the judicial problem of tax evasion and the economic implications of the shadow economy. The empirical aspects analyzed in the paper focus on a more comprehensive approach to a more equitable taxation system. The conclusions of this study highlight the need for a more comprehensive fiscal system environment, both in Romania and at the European level, with a special orientation

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on equitable taxation, reducing the taxpayer burden, and a more flexible and transparent taxation system.

Keywords: Shadow economy; tax burden; taxation; informal economy; judicial case studies; high court.

1. Introduction

The underground economy encompasses a range of activities that take place outside of government regulation or supervision. We are talking about legal, but also illegal activities that are not reported and not taxed. The legal informal economy refers to undeclared business or unregistered work (e.g., unreported income from self-employment) or barter for hidden goods and services. In contrast, illegal transactions are explicitly against the law (e.g., drug trade, human trafficking, and smuggling). The black market represents the dangerous segment of the underground economy because it involves transactions of illegal goods and services, such as arms trafficking, counterfeit goods, and stolen items. All these unregulated and untaxed activities have a sufficiently large scope to constitute an economy of their own, even though it is illegal.

The underground economy poses significant challenges for governments in all countries, and these are due to the hidden nature of economic activities that escape taxation and regulation. There are difficulties in measuring the level and impact of the underground economy, because the activities in question are not reported. The underground economy raises numerous ethical concerns because it reflects deep-seated problems within society. It accentuates inequality between individuals, while also having a negative impact on marginalized communities. It can exacerbate social problems, because people in those communities have a low standard of living and reduced social protection. In addition, underground businesses create unfair competition for legitimate businesses.

In countries with corrupt governments and also with weak and discretionary administration of the law, there is fertile ground for the underground economy. This actually reflects broader economic and social failures, with individuals being motivated to engage in informal activities as an adaptation mechanism.

In order to have a more equitable and prosperous society, combating the phenomenon of the underground economy should be an important priority for governments in each country. Decision-makers should design effective strategies that contribute to the gradual reduction of informality. Such a policy aims to simplify tax codes, which could encourage individuals to participate more in the formal economy and give up underground activities. Then other measures refer to: reducing regulatory barriers by simplifying registration and regulatory requirements for new

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businesses, promoting financial inclusion, increasing individuals' trust in state institutions, digital reforms, and the use of mobile money. At the same time, equitable access to education, especially for marginalized communities, is very important to diminish the incentive to engage in underground economic activities.

The phenomenon of the shadow economy is widespread, being present in both advanced and developing economies, but to different degrees. However, legal activities carried out to avoid taxes are the fastest-growing component of the shadow economy. This is mainly due to the way tax systems are structured (Orsi et al., 2014). In this context, it is necessary to strengthen fiscal control actions, mainly at the level of indirect taxes, to develop a more efficient system of tax revenue collection (Brezeanu et al., 2011).

Since firms operating in the underground economy do not contribute to the tax base, governments will not have sufficient resources to provide basic services to individuals. Therefore, governments must adopt measures to discourage underground economic practices and to encourage individuals to operate within the legal framework. Therefore, reducing taxes combined with intensifying the monitoring process will lead to a decrease in the underground economy and an increase in tax revenues. This will be beneficial for society as a whole.

The main objective of this paper is to present and analyze a holistic approach to the relationship between the shadow economy and tax evasion, both from a judicial and an economic perspective. The scope of the research is to examine the judicial problems and their applications in the practical environment in order to test the legal problems and offer potential solutions. The research methods used in this research are oriented towards the following analyses, synthesis, judicial case understanding and interpretation, and empirical analysis of the economic data.

The paper is structured as follows: the first part analyzes the current state of the art by revealing the main trends and features in the judicial and economic literature regarding tax evasion, taxation system, shadow economy, and their implication; the second part is destined to debate actual important case studies and jurisprudence of the Romanian practical environment; the third part enables some important empirical features of shadow economy and their implications of the tax evasion mechanism; the final part bring forward the main considerations and conclusions regarding the strong connections between tax evasion and shadow economy in theory and practice.

2. Literature Review

Also called the underground economy, informal or parallel economy, the shadow economy includes not only illegal and dangerous activities, but also incomes from

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the legal production of goods and services that are deliberately hidden from public authorities, for several reasons. First, there is an attempt to avoid paying taxes and social contributions, then to meet the legal standards of the labor market (such as minimum wages and the maximum number of working hours) (Erdoğan, 2016).

The underground economy refers to all economic activities that would be taxable if reported to tax authorities. Illegal activities include: trade in stolen goods, drug trafficking and production, smuggling, fraud, and human trafficking. The illegal economy has significant challenges for law enforcement and public policy because it operates outside the established legal frameworks (Schneider & Enste, 2002).

The expansion of the underground economy reduces government revenues, which in turn leads to a decline in the public goods and services provided by the state. Governments can respond by raising tax rates for individuals and firms. However, higher taxation, combined with the perceived deterioration in the quality of public goods and public administration, creates an incentive for firms and workers to move more towards the underground economy (Schneider & Enste, 2002).

The informal economy destabilizes economic and social balances, harming macroeconomic indicators and monetary and fiscal policies. Workers in the informal economy earn lower wages and do not benefit from social protection. Communities may face increased social tension because individuals with low incomes have a low standard of living (Erdoğan, 2016). The shadow economy creates unfair competition among firms and also generates additional social costs, since the tax burden is shared among a smaller number of citizens (Orsi et al., 2014).

Sanchez et al. (2023) highlight the detrimental effects of the shadow economy on society: losses of tax revenues, reduced productivity, lack of employee protection, distortion of economic indicators, undermining trust in institutions, and increased criminal activity. Combating the underground economy is essential for governments that wish to maintain transparency, accountability, and public trust, while also promoting equitable economic growth.

Approaching the phenomenon of the shadow economy involves profound ethical, social, and governance concerns. Combating it is not an easy task; it is often associated with systemic governance failures, corruption issues, and a lack of trust in public institutions. Individuals and firms are motivated to migrate toward the informal economy as a result of skepticism about how public money is spent. The underground economy is seen as a poorly conceived and shortsighted strategy. In fact, it is the explicit or tacit recognition of an economic, political, social, human, and ethical failure (Argandoña, 2010).

The high tax burden, labor market regulations, and the low quality of public goods and services act as strong incentives for firms and employees to operate

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clandestinely. Thus, the larger the tax wedge (the difference between the total cost of labor and the net wage), the greater the temptation to participate in the underground economy, thereby deliberately avoiding taxes.

Most authors identify the main determinants of the informal economy as: tax burden, the quality of public goods and services, labor market regulation, inefficient legal framework, and low fiscal morality (Remeikienė et al., 2022).

Schneider and Enste (2002) argue that the principal driving forces behind the growth of the shadow economy are the ever-increasing burden of taxes and social contributions, combined with tightening restrictions in the labor market. In addition, weak and arbitrary enforcement of laws and regulations encourages the informal economy. Consequently, countries with lower tax rates, fewer laws and regulations, and a robust legal system generally tend to have smaller underground economies. Similarly, Alfoul et al. (2002) reveal that the quality of institutions is the most important factor influencing the size of the underground economy.

Singh (2012) shows that it is not higher taxes that lead to the growth of the underground economy, but weak institutions and the rule of law. Thus, often poorly run institutions and excessive regulations push individuals and firms to enter the informal economy to evade regulations and the administrative burden. Also, Haggard and Tiede (2011) suggest that a functional legal framework can limit the expansion of the informal economy. However, increasing corruption will implicitly lead to the growth of the underground economy. Sanchez et al. (2023) identify the main factors that can foster the underground economy: economic development, the quality of institutions, fiscal pressure versus moral taxes, the strength of deterrence, and the extent of regulations.

The underground economy, characterized by untaxed and unregulated economic activities, poses a number of challenges for stability and social welfare. Its clandestine nature and scale require a prompt and multi-faceted policy response that addresses the root causes of informal economic activity (Nguyen, 2024). There is a need for interventions that promote compliance and foster economic resilience. Combating the underground economy is necessary for several reasons.

First of all, the shadow economy has a significant economic impact, potentially leading to substantial losses of revenue for the state budget and a deterioration in the quality of public goods and services provided. In countries where the level of the underground economy is high, tax revenues are lower, and there is a tendency for tax rates to rise. This pushes even more individuals toward tax evasion. Singh (2012) argues that when the state tries to increase tax revenues through higher taxation, this leads to a growth of the informal economy, further eroding the state's capacity. A

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vicious circle emerges that can prolong the negative balance of weak institutions and the limited development of the formal sector.

Besides the economic implications, the shadow economy reflects broad social problems and ethical concerns. It generally appears when state institutions are weak, and the level of corruption is high. Individuals are tempted to evade taxes due to a lack of trust in the government, being skeptical about how the state uses their contributions. The increase in corruption and a weaker legal framework are associated with higher levels of the informal economy. Therefore, the rule of law is vital for combating corruption and the underground economy.

Reducing the underground economy is important for overall economic development. Thus, countries with lower GDP per capita exhibit higher levels of the shadow economy, as well as higher rates of poverty and income inequality. Governments can act by adopting measures to reduce the shadow economy.

The underground economy presents new areas and opportunities for growth, with governments having to constantly seek effective strategies to reduce its effects. Its unpredictable nature brings significant challenges for states, which should implement updated policies to combat it (Ștefoni et al., 2024).

Schneider and Enste (2002) identify several efficient ways to stop the shadow economy. Thus, more frequent tax audits and tougher sanctions can reduce the underground economy. At the same time, implementing measures to improve the business environment, simpler tax systems, fewer laws and regulations, and lower tax rates can be effective. Governments must emphasize the rule of law and the strict enforcement of a minimal set of regulations. Similarly, Singh (2012) highlights that to reduce the underground economy, governments should pursue the consolidation of the rule of law, the strict application of only the minimum necessary regulations, and the creation of access to the formal economy.

Policymakers should ensure a more transparent and efficient legal framework by simplifying regulations and improving law enforcement. Strengthening the legal framework will contribute to reducing underground economic activities (Ștefoni et al., 2024). On the other hand, Sanchez et al. (2023) believe that the underground economy cannot be completely eradicated. However, by promoting economic stability, consolidating transparent and accountable institutions, and alleviating overly strict regulations, this phenomenon can be diminished.

The main sources of the shadow economy are very different in developing countries, compared to high-income countries. Thus, in low-income countries, the most important drivers of the underground economy are problems related to government effectiveness, in terms of the quality of public goods and implemented policies. On the other hand, the underground economy in high-income countries is largely due to

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relatively high tax rates, which lead taxpayers to hide their income to obtain financial benefits (Rozkrut et al., 2025).

The underground economy presents a number of negative consequences for society, among which we can mention: reductions in government revenue, distorted competition, a decrease in the quantity and quality of public goods, deterioration of institutions and social attitudes, and a slowdown in investment and economic growth.

Enste (2018) highlights that the underground economy should not be seen only as an economic problem, which can be solved by higher fines and tougher controls. To reduce it, better regulation, a fair and transparent tax system, and more efficient institutions are needed. However, corruption, illegal work, and organized crime need to be combated through stricter controls and laws. According to Fleming et al. (2000), the growth of the underground economy shows that current policies may be wrong, often fiscal or regulatory policies being oppressive or burdensome.

Tax evasion refers to those actions by which taxpayers illegally evade payment of taxes and contributions owed to the state. It is a component of the underground economy, constitutes a crime, and is punishable (regulated in Romania by Law 241/2005).

Tax evasion has several underlying causes. Excessive tax burden, the complexity of legislation, and volatility of fiscal norms lead to a decline in voluntary compliance. Frequent legislative changes also create an atmosphere of uncertainty that fosters evasion trends (Alm & Torgler, 2006). Another factor for evasion is people's mistrust of institutions. The tendency not to comply with tax obligations will increase when individuals perceive mismanagement of public funds, a lack of transparency in state spending, or a high level of corruption. Additionally, the limited effectiveness of control authorities amplifies tax evasion.

Tax evasion presents multiple forms of manifestation, some sophisticated and hard to detect. Among the most common practices are underreporting income, failing to register commercial activities, using shell companies, recording fictitious expenses, and falsifying accounting documents. Within the underground economy, tax evasion appears as a systematic practice, with firms operating completely outside the legal framework.

The impact of tax evasion is profound. First, it reduces government revenues, which can affect economic growth and competitiveness. It also erodes citizens' trust in state institutions, creating a vicious cycle in which fiscal morality declines.

Tax evasion discourages honest taxpayers from paying taxes, because they have to bear a higher tax burden than normal. It diminishes individuals' confidence in the

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government's ability to allocate resources efficiently and, at the same time, compromises the overall fairness of the tax system (Femi-Ayegbo & Omodero, 2025).

To reduce tax evasion, coercive measures are needed, but structural reforms as well. Deterring illegal practices requires modernizing tax-control systems, using electronic payments, and promptly applying sanctions. On the other hand, voluntary compliance can be increased by reducing the tax burden, simplifying legislation, and increasing transparency in the use of public funds. Therefore, fighting tax evasion can be achieved through a strong legal framework, as well as by strengthening the relationship between the state and taxpayers. Preventive and coercive measures are needed to help create a healthy fiscal climate based on equity and fairness.

Governments have been collecting taxes from citizens for thousands of years. Taxation methods have been diverse and very creative, yet citizens, often driven by self-interest, typically do not refrain from anything to hide their income from the tax authority. However, the decision to pay taxes in accordance with the law is complex, and it is recognized that taxpayer behavior cannot be explained solely by purely economic considerations (Alm et al., 2012).

Tax authorities should adopt as a dominant strategy the goal of enhancing tax compliance among taxpayers, while also having the option to resort to sanctions if this strategy fails. Citizens are willing to honestly declare their income as long as the political process is perceived as fair and legitimate. Additionally, friendly treatment of taxpayers during audit processes can increase tax compliance (Feld & Frey, 2007). Dumiter (2023) reveals some important features linking tax evasion with double taxation conventions and tax compliance for a more comprehensive approach regarding direct taxation in the OECD country group. Todor et al. (2019) analyze the taxpayers' behavior in South and East Europe, taking into account some interesting features such as corruption, underground economy, taxation rates, and government effectiveness. Muresan et al. (2014) highlight the importance of the VAT evaluation and assessment from the perspective of a more comprehensible indirect taxation environment for the practical specialists.

Other studies reveal the importance of transfer pricing in improving the soundness of the taxation system by analyzing several important jurisprudential case studies from the Romanian level (Dumiter & Jimon, 2020). Another interesting study highlights the complex problem of non-residence taxation and its international implications by practical case study analysis and jurisprudential interpretation (Dumiter & Jimon, 2015).

Summarizing, the current state of the art regarding the connections manifested between tax evasion, shadow economy, and taxation system brings forward an

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interesting and complex mechanism of taxation, fiscal transparency, tax authorities' implication and awareness, and also international cooperation, further development, and improvement.

3. Practical assessments of tax evasion and its implications on the shadow economy and taxation system

In this section, a collection of practical and jurisprudential case studies from the Romanian High Court of Cassation and Justice is presented to evaluate and assess the judicial and legal implications of tax evasion on the shadow economy in the context of the practical environment in Romania, with a special focus on the economic and legal analysis of the taxpayer behavior agenda.

3.1. Case study 1: Tax evasion problem for a criminal group with two similar entities. Decision no. 218/2025 of the High Court of Cassation and Justice

In a first case, pending before the High Court of Cassation and Justice, decision no. 218/2025, the appeal of the appellant company – plaintiff was upheld against the judgment handed down by the Timișoara Court of Appeal, concerning the action brought by the against the defendants Arad County Public Finance Administration and the Ministry of Finance – General Directorate for the Settlement of Appeals, a judgment which the claimant challenged, requesting the annulment of the decision and the admission of the claim for the following reasons.

The main grounds for the case are a disproportionate restriction of the claimant company's right to a fair trial, which cannot be compensated for by the analysis of the court of judicial review.

With regard to the circumstances of the case brought before the court of first instance, it was based on the administrative act (decision) issued by the Ministry of Public Finance - General Directorate for the Settlement of Appeals, which upheld the tax assessment decision, by which the Galați County Public Finance Administration established a series of debts owed by the claimant company, with the amount of 12,449,549 lei being subject to appeal, of which 8,262,836 lei was VAT and 4,186,713 lei was VAT-related accessories.

In its defense, the claimant company mainly argued that the contested tax acts were unlawful, invoking the Order to discontinue criminal proceedings, whereby D.I.C.O.T.-Arad Territorial Office ordered the discontinuation of criminal proceedings against the claimant and administrator B, finding that they could not be charged with the crime of tax evasion and of initiating/forming an organized criminal group, or of supporting/joining such a criminal group in their relations with two other commercial companies. At the same time, in the alternative, the claimant argued that

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she was entitled to deduct value added tax, given that she had acted in good faith by checking whether the companies were registered with the National Trade Register Office, who the partners and administrators were, and whether they were listed in the register of taxable persons whose VAT registration had been canceled, or whether they were listed in the register of inactive economic agents mentioned on the ANAF website.

However, the court of first instance dismissed the claim as unfounded, citing, on the one hand, the prosecutor's order to dismiss the case because the preliminary chamber judge had found that the initial decision to discontinue criminal proceedings was *res judicata*, and, on the other hand, considering as another reason for rejecting the claim the existence of circumstances based on which it found that the claimant company had acted in bad faith, participating in fraudulent, fictitious operations, so that it would not be entitled to deduct VAT.

The High Court of Cassation and Justice, in its analysis of the grounds for cassation, argues that the first instance court misapplied the principle of *res judicata* by failing to note that the reason for the dismissal of the criminal proceedings was not strictly procedural, but was based on *res judicata*, since the criminal investigation authorities had already checked the accounting records, the legality, and the reality of the commercial operations carried out by the claimant company, and the innocence of the claimant and the company's administrator had been definitively established due to the lack of an objective element of the offense.

At the same time, the court of appeal considers that the court of first instance conducted a superficial investigation of the case, which led to uncertainty regarding the facts, noting the lack of vigilance on the part of the judge of first instance who, on the one hand, failed to notice that the prosecutor's order, on which he based all his conclusions, did not directly concern the situation of the claimant or its administrator, but rather other participants in the commission of the offences, considering that the procedural act in question was not capable of establishing that the company's administrator was the perpetrator of the offence of tax evasion, and, on the other hand, ignored the fact that, during the criminal proceedings, several procedural acts of significance for establishing the facts had been issued and did not order the administration of this evidence, even though this was necessary for a fair clarification of the facts, more precisely the effects of the circumstances established during the criminal proceedings on the tax situation under consideration.

The court of appeal also considers that the administration of evidence was necessary to establish whether there was any similarity between the facts for which the criminal investigation was discontinued and those on which the refusal to recognize the right to deduct VAT was based, and whether the facts retained in the criminal proceedings,

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which formed the basis for the decision to discontinue criminal proceedings, could be subject to reassessment in the tax proceedings.

For these reasons, the High Court of Cassation and Justice upheld the appeal lodged by the appellant-claimant, quashed the contested judgment, and referred the case back to the same court for retrial.

3.2. Case study 2: Tax evasion problem for an insolvency company in the context of *legem fraudando*. Decision no. 3688/2024 of the High Court of Cassation and Justice

In another case, the Administrative and Fiscal Litigation Section of the High Court of Cassation and Justice, as an appeal court, rejected the appeal filed by the appellant-plaintiff against the civil sentence as unfounded.

The reasons for the decision show that, through the application for summons, the plaintiff requested the trial court to annul the administrative-tax acts, namely the Decision to impose joint and several liability in the event of joint and several liability according to art. 25 para. (1) let. a), para. (2) let. c) and let. d) of Law no. 207/2015 regarding the Fiscal Procedure Code, Decision on the resolution of the appeal, and considering the procedural fault of the defendants - General Directorate of Public Finance, Galați and County Administration of Public Finance, Constanța - Collection and Enforcement Service for Legal Entities, obliging the guilty party to bear the legal costs occasioned by this litigation.

Following the decline of jurisdiction by the Constanța Court of Appeal to the Administrative and Fiscal Litigation Section of the Constanța Court of Appeal, the court partially admitted the plaintiff's request to be summoned to court in opposition to the defendants and partially annulled the Decision on the resolution of the appeal issued by the defendant, the Regional General Directorate of Public Finances of Galați, regarding the measure of suspending the procedure for resolving the appeal until the final resolution of the criminal case, and rejected, as unfounded, the request to annul the Decision on joint and several liability issued by the defendant, the County Administration of Public Finances of Constanța.

The Court of Appeal's judgment was appealed by the plaintiff, citing several reasons, on which occasion he requested the admission of the appeal, the partial annulment of the appealed decision and, through retrial, the annulment in its entirety of the Decision on the annulment of the appeal and the annulment of the Decision on the imposition of joint and several liability issued by the defendant.

In relation to the factual situation, the plaintiff-appellant and a certain natural person transferred their shares held in the insolvent company to two other natural persons, a fact correctly assessed by the first instance as a simple presumption of intervention

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to defraud the law, to evade control, and declare tax obligations to the competent tax authority. The assessment of the first instance regarding the existence of bad faith of the appellant-appellant, who held the capacity of administrator of the debtor company, is also reinforced by the aspects communicated during the verifications to issue the decision to engage joint and several liability, the plaintiff stating that he no longer holds the capacity of administrator, respectively of associate, transferring his shares. Subsequently, the decision to engage joint and several liability was issued both in the name of the appellant-appellant and the natural persons who subsequently acquired the capacity of associates and administrators to date.

From the examination of the contested sentence, the Court of Appeal thinks that, legally, the first instance found the cumulative fulfillment of the conditions provided for in the article. 25 paragraph 2 letter d) of the Fiscal Procedure Code, in the sense of the existence of bad faith of the plaintiff as administrator and associate regarding the non-payment of the tax obligations of the insolvent debtor when due, a fact proven by the documents that were the basis for issuing the decision to impose joint and several liability. The first instance correctly interpreted and applied the legal provisions, establishing on the one hand that the hypotheses for imposing joint and several liability are alternative and not cumulative, and starting from this premise, it correctly found the cumulative fulfillment of the conditions for incurring tortious civil liability on the plaintiff, plaintiff under art. 25 paragraph 2 of the Fiscal Procedure Code.

Therefore, the Court finds that the first instance conducted a correct and legal analysis of the existence of the condition for engaging tortious civil liability, considering as proven the bad faith of the appellant-plaintiff who did not pay the tax obligations owed to the state budget, individualized in the uncontested tax decision, for the company and in the Decision to engage joint and several liability.

Also, in the Court's opinion, the first instance considered that the issuance of a dismissal order for the criminal act notified - the act of tax evasion is not of a nature to prove the absence of bad faith in relation to the provisions of art. 25 paragraph 2 of the Fiscal Procedure Code, because the conditions for engaging the tortious civil liability of the appellant-plaintiff are met under the conditions of art. 25 paragraph 2 letter d) of the Fiscal Procedure Code, liability which is distinct from criminal liability, respectively from the proof of the intent of criminal fraud from the perspective of the existence of the constitutive elements of the crime of tax evasion, provided for by art. 9 paragraph 1 letter c) of Law no. 241/2005.

Therefore, the lack of criminal liability does not remove the civil-administrative liability of the appellant-plaintiff under art. 25 paragraph 2 letter c) and d) of the

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Fiscal Procedure Code, in this case, the cumulative conditions provided for in art. 25 paragraph 2 letter d) of the Fiscal Procedure Code was met.

Also, the aspects of illegality regarding the legality of the issuance of the Taxation Decision for the company's tax obligations were considered unfounded, a taxation decision not contested by the company, respectively by the appellant as administrator during the period covered by the tax audit, having as its object unpaid tax obligations, it being assessed that the first instance correctly verified the legality of the decision to impose joint and several liability issued for the appellant-plaintiff under the conditions of art. 25 paragraph 2 letter d) of the Fiscal Procedure Code, respectively, for the bad faith non-payment of tax obligations by the insolvent debtor, the appellant having the capacity of administrator of the company.

3.3. Case study 3: Tax evasion problem regarding the deduction of the VAT system. Decision no. 3687/2024 of the High Court of Cassation and Justice

The High Court admitted the appeal of the appellant-complainant company, citing the misinterpretation and application of the substantive law provisions, namely the provisions of Article. 145 para. (2) letter a), art. 146 para. (1) fit. b), art. 155 para. (9) of Law no. 571/2003 on the Fiscal Code, which regulates, in national legislation, the right to deduct VAT, the specific provisions of the VAT Directive [1], as well as the case law of the Court of Justice of the European Union on the matter.

In light of the facts, the plaintiff company concluded contracts with Company B for general management services, services provided and invoiced, to be subsequently re-invoiced in favour of companies that purchased the investment projects in office buildings started by the plaintiff company. At the same time, the plaintiff company had concluded with company B., as a provider, the contract for the same general management services provided for the company under review. By subsequently contracting with company B. for the same general management services for which the plaintiff had concluded a previous contract with company B, it doubled the expenses for general management services.

Considering these aspects, in accordance with the legal provisions in the matter, as well as the fact that the services contracted with the two affiliated persons coincide, being detailed in the activity reports issued by both companies providing these services, the tax inspection bodies did not grant the right to deduct VAT related to the expenses recorded in the accounts and which were not re-invoiced, related to the contracts concluded with B., establishing that the company cannot prove the necessity of performing the services for the purpose of carrying out the economic activity, given that the same services were already provided by company B.

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The plaintiff company was subject to a tax inspection, as a result of which administrative documents were drawn up, namely the Tax Inspection Report on the additional tax payment obligations established for the plaintiff company, which established the non-grant of VAT deductibility, the Taxation Decision on the additional tax payment obligations established for the plaintiff company, the Decision on the resolution of the appeal, documents issued by the National Agency for Fiscal Administration, ANAF - General Directorate for Solving Appeals, General Directorate for the Administration of Large Taxpayers, General Directorate for the Administration of Large Taxpayers, Appeals Resolution Service.

For these reasons, the plaintiff company contested the administrative documents at the competent court of first instance, which dismissed the action as unfounded, which is why the plaintiff company appealed to the High Court of Cassation and Justice.

The appeal court held that the trial court based its decision to dismiss the action on legal reasoning inconsistent with the specific VAT rules, impermissibly extending the criteria and conditions in the field of profit tax to the field of VAT, qualifying the situation as abusive, motivating the failure to comply with the criteria established by case law by the European Court of Justice.

On the one hand, the court of appeal found the illegality of the retention by the first instance of the "positive effect of the res judicata" from a previous dispute concerning profit tax, showing that, to operate the positive effect of the res judicata, the essential legal issue previously resolved must be the same issue that must be resolved in the subsequent dispute, which presupposes the applicability of the same relevant legal rules. However, in the case at hand, distinct legal rules applied to VAT, namely art. 145–146 of the Fiscal Code and the provisions of Directive 2006/112/EC, and the solution given to the issue of profit tax was based on other rules and conditions, respectively, the deductibility of expenses, including requirements of "necessity" within the meaning of the rules on profit.

At the same time, the High Court held that the lower court and the tax authorities imposed additional conditions for the deduction of VAT, practically requiring the demonstration of a "real, concrete, necessary economic benefit", a fact qualified by the appeal court as a confusion of the rules on the deductibility of expenses to profit with the rules on the right to deduct VAT. It was emphasized that the right to deduct VAT is governed by certain substantive and formal conditions, and the "subsumption" of the condition that the acquisition be for taxable transactions to a broader requirement of "necessity" distorts the VAT regime and risks violating the principle of VAT neutrality, as reflected in the VAT Directive and in the case law of the CJEU.

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The High Court also validated the appellant's argument regarding the principle of non-interference in the management of the company, holding that it is within the company's margin of appreciation to request multiple opinions or services that it considers useful, without the tax authority having the power to censor the appropriateness of management decisions through the filter of VAT deduction requirements, reasoning that supports the conclusion that VAT deduction cannot be refused through an assessment of opportunity/"necessity" transformed into a legal condition.

The High Court expressly censured the way in which the first instance retained the "abuse" and "artificial nature" of the operations to justify the refusal to deduct VAT, holding that this finding was not made according to the criteria derived from the CJEU case law to which the decision refers, in the sense that one cannot operate with presumptions of fraud or abuse, and the refusal of deduction requires a rigorous demonstration, based on objective elements, including the existence of a purely artificial arrangement and the taxpayer's conduct. It was held that in this case, the artificial nature with purely fiscal purposes of the transactions was not established by certain evidence and that the "alleged duplication" cannot be judiciously equated with fraud, tax evasion, or abusive exercise of the right to deduct VAT.

Based on these considerations, the High Court admitted the main appeal of the appellant company, quashed the sentence, and, re-examining, partially admitted the action against the defendant General Directorate for the Administration of Large Taxpayers - Appeals Resolution Service, annulling the contested tax acts and ordering refunds, according to the operative part.

3.4. Case study 4: Tax evasion problem regarding the tax authorities' inspection report in the matter of the VAT system. Decision no. 2429/2024 of the High Court of Cassation and Justice

In another case, the Administrative and Fiscal Litigation Section of the High Court of Cassation and Justice, as an appeal court, rejected the appeals filed by the National Agency for Fiscal Administration and the Timișoara County Administration of Public Finances against the civil sentence as unfounded, the decision being particularly interesting in that it protects the economic operator who had fulfilled the evidentiary obligations provided for by national tax legislation, in the absence of concrete indications of complicity in fraud.

In fact, the plaintiff issued a number of 105 invoices to companies in the European Union, treating the operations as intra-community deliveries and applying the VAT exemption. In the CMR transport documents related to these deliveries, in the section regarding the receipt of goods, logistics warehouses in Italy and Hungary were listed,

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warehouses that the tax authorities consider operating in a self-service mode, the goods being picked up by other persons, not by the customers/beneficiaries indicated in the invoices and CMRs.

From this state of affairs, following the tax inspection, the plaintiff company was charged with a payment obligation related to VAT in a certain amount, because the conditions for applying the VAT exemption for intra-community supplies were not met, citing that the customer beneficiaries listed on the invoices were not identified as final recipients, the receipt of the goods and their registration in the accounting records of the beneficiaries were not ascertained, and some companies were not found at the declared premises, so that the traceability of the goods could not be verified, so the tax authority refused the exemption and imposed the collection of VAT for the supplies in question.

The tax decision was maintained administratively by the Decision of the General Directorate for Solving Complaints within ANAF, which is why the plaintiff company filed an administrative tax dispute with the court of first instance, requesting the annulment of the administrative-tax acts issued by the General Directorate for Solving Complaints within ANAF and the Timiș County Administration of Public Finance, respectively the Tax Decision based on the tax inspection report and the Decision to resolve the VAT appeal.

The Court of Appeal as the court of first instance partially admitted the plaintiff company's action, partially annulling the Tax Decision regarding the VAT obligation for 101 of the 105 invoices, holding that the plaintiff proved the transport of the goods and did not collaborate in a fraud, which is why the National Agency for Fiscal Administration, and the Timișoara County Administration of Public Finance filed an appeal.

From the examination of the contested sentence, the court of appeal considers the appeals of the tax institutions as unfounded, confirming the reasoned assessment of the trial court, which, examining the legality of the establishment of tax obligations, showed that in the matter of VAT, compliance with the principle of priority of community law over national law is required, given that this tax was regulated by European Union legislation, especially since the case concerned legal acts performed during the period 2017-2020, therefore acts issued after 1.01.2007, when Romania joined the European Union.

Referring also to European case law, the High Court recalls that Member States are also obliged to apply the principles of proportionality and protection of legitimate expectations, holding that the mere impossibility of the authorities of destination to find the recipients at the time of the control does not automatically remove the exemption if the supplier has provided evidence, which attests to the normality of

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the economic operations. Once the transport of the goods across the border is proven, the legal nature of the operation is evident as an intra-Community supply for which the applicant - as seller - was not obliged to calculate VAT, and the establishment of VAT is the responsibility of the tax authorities of the country of destination, where the consumption of the goods takes place, the exception being the participation of the seller in fraud (as was the case in the Judgment of 7 December 2010, delivered in the case R., C-285/09) a situation that is not found in the case.

Thus, the court of first instance partially admitted the action and ordered the annulment of the contested acts regarding VAT, holding that these acts are illegal only in terms of establishing the burden of the plaintiff company of the obligation regarding VAT related to intra-community deliveries for which the court held that the plaintiff had proven the delivery of the goods by transporting them to another EU member state and handing over the goods to the buyers according to their instructions, which is equivalent to the transfer of ownership of these goods.

For the reasons stated, the High Court rejected the appellants' appeal and considered that the contested sentence is legal in relation to the grounds for annulment invoked.

4. Empirical underpinnings regarding the connections between tax evasion and the shadow economy

In this section, an empirical overview of the connections between the shadow economy and tax evasion is provided, including some empirical aspects at the international level. The data analyzed and compiled by the authors are designed to provide an overview of the shadow economy framework at the international level, which is connected with the tax evasion phenomenon.

Figure 1 shows the level of the shadow economy in OECD countries, as a percentage of GDP, for the year 2023. Thus, we observe from Figure 1 that the highest level of the shadow economy is in Colombia (20.9%) and Mexico (17.9%), and the lowest level is in Ireland (5.1%), Switzerland (5.1%), and the USA (5%). In Romania, the value was (13.1%), and the OECD average was (8.2%).

Therefore, we can see that in less developed countries the level of the shadow economy is higher, while in developed countries its level is lower.

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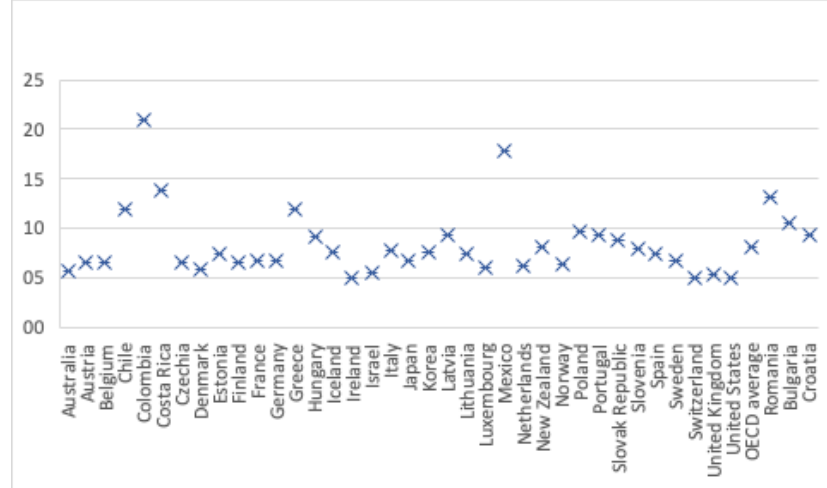


Figure 1. Shadow economy as percentage of GDP, OECD countries, 2023

Source: Own compilation (based on data of Rozkrut, M., Kowalczyk, M., Dybka, P., Karska, M., 2025). Shadow economy exposed. Estimates for the world and policy paths, <https://skilky-skilky.info/wp-content/uploads/2025/07/Ernst-Young-Global-Shadow-Economy-Report-2025.pdf>

In the following, we point out a few aspects of the tax audit activity. We present the results obtained by ANAF (the National Tax Administration Agency of Romania) for the year 2024, regarding the tax inspection activity carried out and the tax anti-fraud activity.

In order to increase taxpayer compliance with tax declarations, ANAF carries out two types of activities: issuing compliance notifications and performing documentary verification actions.

Thus, to increase voluntary compliance, the tax inspection authority carried out the following activities (according to the 2024 ANAF Performance Report):

- Issued 15,432 compliance notifications for estimated tax risks, in the amount of 4.64 billion lei.
- Conducted 29,321 documentary verifications of corporate and individual taxpayers, and as a result, additional amounts totaling 862.03 million lei were established.

Taxpayers who did not correct their tax risks as a result of compliance notifications were subjected to tax inspection actions. Thus, 21,387 tax inspections were carried out, establishing additional amounts totaling 5.56 billion lei. Then, 134

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precautionary measures were instituted in the amount of 165.43 million lei, and 1,449 fines were imposed in the amount of 9.27 million lei. A total of 356 referrals were submitted to the criminal investigation authorities, for a total damage of 4.96 billion lei. The tax loss was reduced by the amount of 4.43 billion lei. To identify potential tax risks, in 2024, 11,513 unannounced on-site inspections were carried out (ANAF 2024 Performance Report).

Regarding the anti-tax fraud activity, in terms of discovering and combating tax evasion, in 2024, inspectors quantified fiscal implications (representing VAT, taxes, social contributions, and other receivables) in a total amount of 2.18 billion lei. Therefore, 334 notification acts were submitted to the criminal investigation authorities, for damages totaling 930.16 million lei; 133 precautionary measures were instituted in the amount of 213.14 million lei. In order to prevent tax evasion, 14,659 main contravention sanctions were applied, the total value of the fines amounting to 143.95 million lei (ANAF 2024 Performance Report).

Next, we present some aspects regarding the collection of budgetary revenues in Romania in 2024. Figures 2 and 3 highlight the main taxes and contributions by budgets and within the state budget, collected by ANAF (the National Tax Administration Agency of Romania).

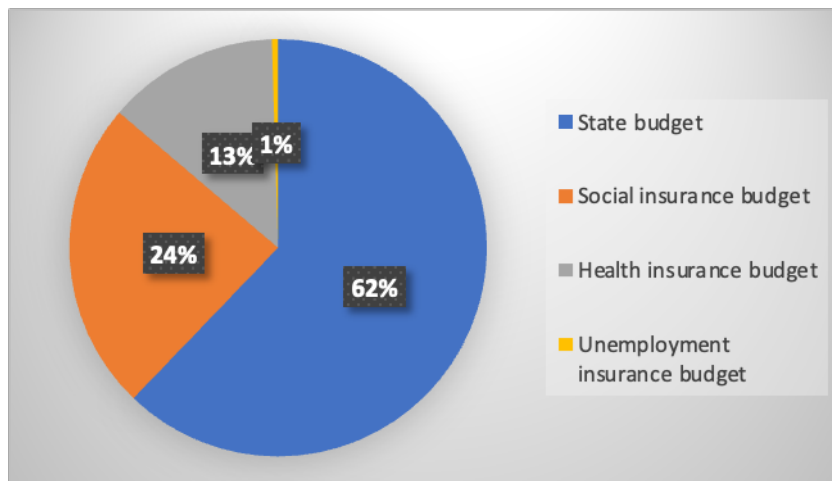


Figure 2. Total revenues collected by ANAF, by budgets, 2024

Source: Own compilation (based on data of ANAF 2024 Performance Report)

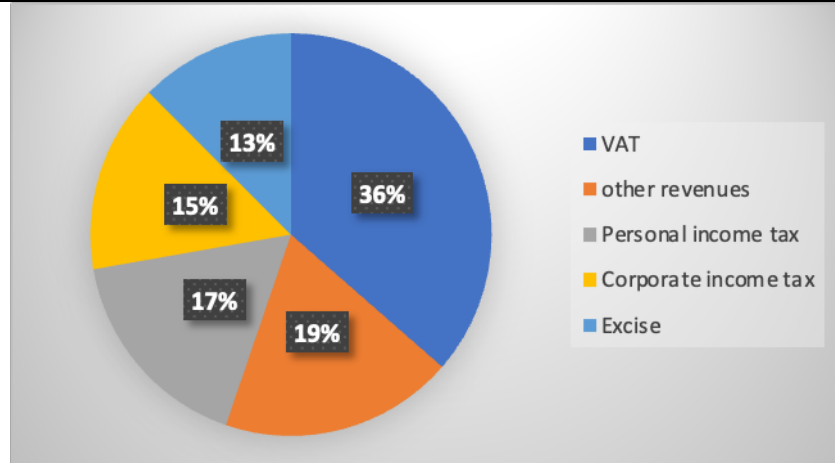


Figure 3. Revenues attracted to the State Budget, by tax types, 2024

Source: Own compilation (based on data of ANAF 2024 Performance Report)

Figure 2 shows that the largest share in the total consolidated general budget had the state budget (with 62%), in 2nd place was the social insurance budget (with 24%), and in 3rd place the health insurance budget (with 13%).

Figure 3 shows that the largest share in the state budget had VAT (36%), followed by other revenues (19%), and on the 3rd place we find the personal income tax (with 17%). We note that corporate income tax is only in 4th place, reaching 15% of the total. In last place, we find excise receipts (13%).

The empirical data presented in this section have shown that the shadow economy (Figure 1) has some interesting levels across the globe, because the situation in each country is different and the judicial and taxation systems differ from one country to another. Moreover, in Figures 2 and 3, the Romanian tax authorities have engaged in recent years in several reforms oriented towards a new taxation environment that reduces the shadow economy and the tax evasion phenomenon, and also to strengthen the taxpayers' compliance and fiscal culture.

Conclusions and policy recommendations

Tax evasion represents one of the most challenging phenomena in the judicial framework, having several implications both for doctrinal aspects and for the practical specialists. It is a complex and complete mechanism that currently has no single solution or correction, but there are several established underlying tactics and techniques in order to decrease its impact and the negative consequences.

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The shadow economy, on the other hand, represents a widespread phenomenon that is found in every state in larger or smaller amounts, depending on the state's development, financial structure, and current development of the state framework. Although several developed states have decreased the effects of the shadow economy considerably, in other developing and emerging states, the effects have been manifested completely.

The taxation system represents one of the more complex mechanisms and structures of an economy, especially being the primary tool for fiscal policy. Hence, with the creation of the fiscal space at the worldwide level, and especially at the European Union level, the taxation systems gain more complex and developed mechanisms in order to combine the national aspects with the international and European tax matters.

The empirical part of this paper highlights that the data collected and used suggest that there is still room to maneuver for the tax authorities in order to strengthen the fiscal policy and taxation mechanism, in order to reduce the shadow economy effects and decrease the tax evasion levels both at the national and international levels.

The policy recommendation for tax authorities is to continue to develop the fiscal space at European and international levels, increasing the cooperation and work between tax authorities, the exchange of best practices, and common activities for supervision and audits in the context of tax transparency, fairness, and positive communication with the taxpayers.

The practical judicial cases presented in this study reveal the importance of the tax system application in the practical environment, taking into account the legislative matters and the problems faced by the Romanian High Court of Justice in terms of tax evasion, profit shifting, shadow economy, and the different misinterpretations of the tax code and tax procedure code. Moreover, the construction of the fiscal space at the European Union level will lead to better integration of the national tax codes into the European fiscal policy and fiscal instruments.

Although Romania is making significant efforts to significantly reduce tax evasion, including by eradicating the underground economy, a fact materialized by launching and developing a broad reform based on digitalization, strengthening control capacity and improving voluntary compliance, this objective remains a complex challenge, requiring perseverance and continuous adaptation, coupled with the uniform application of legal provisions in the matter by both tax authorities, courts and legal practitioners, not infrequently noticing non-uniform or controversial interpretations of the same legal texts.

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In order to prevent such divergent interpretations and to support the standardization of judicial practice within lower courts, the role of the Panel for resolving legal issues in criminal matters within the High Court of Cassation and Justice is a defining one. With special reference to disputes concerning tax evasion, we present Decision no. 430/2025, by which the complaint formulated by the Bucharest Court of Appeal – Criminal Section I, in file no. 46964/3/2024/a1, establishing the following in the minutes of the decision: "In the interpretation of art. 10 of Law no. 241/2005, as amended by Law no. 126/2024 published in the Official Gazette no. 437 of May 13, 2024, the failure to draw up the specialized expert report determines the irregularity of the act of notification to the court, which entails the return of the case to the prosecutor" [1].

The general conclusions of this study are the need for an ongoing process for creating the fiscal space at the European Union level, especially in the direct taxation matters, increasing the connections between taxpayers and tax authorities, and creating a more transparent and sustainable tax environment, decreasing the tax burden and creating the proper framework for a high degree of tax compliance, tax effectiveness and equitable taxation levels.

Acknowledgments

The authors thank the anonymous reviewers and editor for their valuable contributions.

Funding

This research received no specific grant from any funding agency in the public, commercial, or not-for-profit sectors.

Author Contributions

FCD has been the project management coordinator and has constructed the plan of the article and managed each section of the paper. CFR has been responsible for the literature review and empirical data assessment. GVS has been responsible for the practical case study analysis and interpretations. All authors have worked on the introduction and conclusions. All authors have approved the final version of the article.

Disclosure Statement

The authors have not any competing financial, professional, or personal interests from other parties.

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Notes:

[1] Directive 2006/112/EC on the common system of value-added tax was transposed into Romanian national legislation by Law no. 227/2015 on the Fiscal Code. Title VII of Law no. 227/2015 is dedicated to “Value Added Tax” and contains provisions establishing the national legal framework for VAT.

[2] Î.C.C.J. – Panel for resolving a question of law in criminal matters - Decision no. 430 delivered at the meeting of December 15, 2025 (unpublished), accessible online at <https://www.iccj.ro/2025/12/15/minuta-deciziei-nr-430-din-15-decembrie-2025/>.