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## STRATEGIES FOR USE OF TAX CLAIMS TRANSFER DURING ECONOMIC CRISIS

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### **Abstract:**

*Although the provisions of the Code of Fiscal Procedure give the image of some norms that must be observed word by word, behind the legislative text there are hidden a series of options which can be taken, or some optimal strategies. The identification of the options expressed implicitly within the Code of Fiscal Procedure, as for example the option of carrying out the procedure of assignment of a claim but also its modelling by using the theory of games and the theory of the options which are subject of this study can have as a result the reduction of arrears, the increase of collections and the elimination of other consequences of the liquidity crisis.*

**Keywords:** tax administration, insolvency risk, games theory, assignment of claim, payment.

**JEL Classification:** G10, G28, H21,

### **Introduction**

Due to lack of liquidity there is a large number of debtor companies, some of them being able to extinct the claim quickly since it has been a temporary lack of liquidity, and others not, and get in bankruptcy. One of the problems that may be discussed in terms of the rapidity of the reaction of the tax administration is which is the decision that can be taken concerning the opportunity of assigning a claim for the companies situated in a potential state of insolvency.

It can be taken in consideration for example (but the fiscal claims are not the object of this study) the provisions of art. 1751 within the Code of Fiscal Procedure by which the National Agency of Fiscal Administration can assign the claims which it manages, as they are individualized, by enforceable title. Within this article it is stipulated that there can assigned the main claims and the accessories. Pursuant to this procedure, the assignee of the claim takes over as a consequence of the assignment of claim all the assignor's rights, including its guarantees.

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### **Modelling the exercise of the option of assigning the claims**

The nominal value of the claims which are to be assigned represents the value of the claims which are to be assigned as they are individualized in enforceable titles.

We shall analyze the case where the claims can be assigned by starting with an initial price which is equal to the nominal value, but in order to determine the opportunity of this type of procedures, there shall also be carried out a theoretic study where the fiscal claims can be assigned to a price lower than the nominal value.

Taking into consideration the existent legal framework there can also be taken into consideration the information asymmetry, being the situation where the creditor holds fewer information than the assignee, namely the creditor does not know all the borrower's characteristics. In other words, the value of the claim can present for the assignee another function of utility that the creditor does not know.

According to the assignee's aversion in report with the risk, there is also the possibility that the latter should acquire the claim even at the nominal value stipulated by law.

Thus, it is optimal for the fiscal creditor to appeal to this procedure for all the fiscal claims, following to be expected an assignee who holds additional information or who has another function of utility.

Hereinafter for the development of a theoretic model there shall be analyzed the case when the initial price of the procedure can be even lower than the nominal value.

The question to ask is which would be the cases where there can be realized a benefit from this operation.

This option can be taken within the context of the analysis and the determining of the measures of enforcement, so that the realization of the claim should be done with the best advantages, but also by the followed borrower's rights and liabilities

"Which is the immediate interest?" is actually the dilemma. To increase revenues through the immediate collection of the amounts or to minimize losses due to non-payment of arrears. If the debtor is solvent, it is better that the claim should not be assigned, one receiving also overdue amounts and the delay interests.

If the state of solvency is precarious, it can then be discussed whether it is better to assign the claim, thereby limiting the losses from tax arrears.

To assess the impact of this decision it is sufficient to ask us the following question: what amount was registered on the order panel of creditors and what amount was recovered pursuant to the insolvency procedures?

Under these conditions it would have been more appropriate that the claim should have been "sold" before? At what price? When?

The result of this measure would practically create a market that would have an effect in compensation of the lack of liquidity, which would lead to the increase of encumbrances and to the decrease of arrears. During the period of economic crisis the use of these levers can be important.

The current value and future value are the principles that lead to a correction of synthesis documents and accounting reporting.

For the case in which the price of the title on the market may not be used, two situations that can occur should be taken into consideration: either the enterprise continues to manufacture and achieve profits, or it only brings losses and therefore should be liquidated.

These two positions really express the optics of evaluation. The winding-up value of an enterprise is determined by the flow of liquidity that can be obtained in case of cessation of trading and selling each asset considered individually, piece by piece.

There can be identified several possible values: the value of cassation, the proper winding-up value, the liquidative value.

The value of cassation can be considered as the smallest value of winding up; it is the case of the assets which are totally worn or which are strictly specific to the company and that are no longer of interest to any possible purchaser.

In this case, liquidity flows correspond to the amount of the sale price of the component parts.

The winding-up value is itself an assessment of the companies at loss. In estimating the flow of liquidity, the amount of liquidities obtained by selling of assets as such shall be considered as the starting point, but for the sake of caution also the hypothesis of forced sale of assets.

The liquidative value is a value of winding-up calculated less severe. It is estimated in terms of further activity, the calculations have as a starting point the flows of collections and the progressive sale of company assets under the market conditions.

The value of further activity is determined by the updated amount of future cash flows generated by the activity of the enterprises.

Within the study there shall be considered the risk of insolvency for a limited liability company using the model Merton for the evaluation of the corporate debentures<sup>1</sup>, and it is estimated for the simplification of the model that in case of bankruptcy there shall be used the value of cassation and that within enforcement there shall be used the liquidative value.

If the company which is with a limited liability is insolvent at maturity, it shall be declared by the creditors as being bankrupt.

In this situation the creditors should receive the value capitalized by the operation of bankruptcy that is, the cassation value (L) and in case of enforcement there shall be collected a liquidative value ( $b \times L$ ).

$L$  = cassation value

$b$  = coefficient which determines the value of sale of the assets at the value of winding-up

Winding-up Val =  $b \times$  cassation value

The problem specified above practically makes us face the following game:

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<sup>1</sup> Altar, Moisa, Financial Engineering, part I - version 3, January 2002

If the company does not exercise the procedure and assigns the claim and the company cannot recover itself by reorganization (insolvent) it can win a percent from the value of the claims ( $z \times F$ ) where  $z$  is the percent from the claim where the auction for claims assignment can start.

If the administration exercises the procedure and assigns the claim and the company recovers itself by reorganization, the state can reclaim a part of the claim, but it loses the difference up to the value of the claims.

If the claim is not assigned and the company cannot recover itself by reorganization, (insolvent) the state wins until the end the value of winding-up  $L$ .

If the administration does not close the procedure of assignment and the company recovers itself by reorganization, the state shall reclaim the claim so the state wins  $bL$ .

	<b>P</b>	<b>1- P</b>
	<b>Insolvency</b>	<b>No insolvency</b>
<b>Start Procedure</b>	$z \times F$	$z \times F$
<b>Do not start Procedure</b>	$L$	$bL$

•  $z \times F$  = the value where there assigned the claims ( $z$ =percent of assignement)

•  $F$  = claim value

•  $V1$  = Expected Value at starting the procedure =  $(z \times F) \times p + Z \times F \times (1-p)$

•  $V2$  = Expected Value if the assignment is not started =  $L \times p + b \times L \times (1-p)$

$V1 > V2$  implies :

$$(z \times F) \times p + (z \times F) \times (1-p) > L \times p + b \times L \times (1-p)$$

$$p = \frac{zF - bL}{L - bL}$$

The adequate option is to initiate a procedure of assignment of claim when the probability of bankruptcy (calculated for example according to the model Merton) in is larger than  $p$  calculated above. ( $p_f > p$ )

$$p_f = 1 - N(d2) =; \quad p_f > p$$

At balance  $p_f = p$

$$z = L/F (p_f - p_f b + b)$$

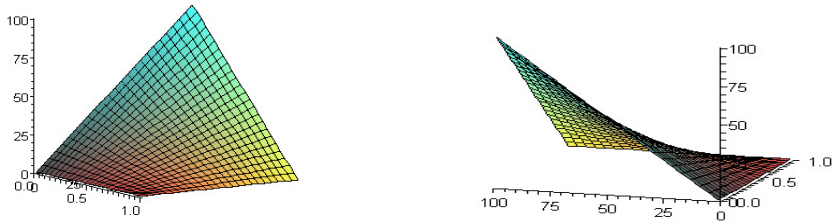
The condition  $Z < 1$  means that it is appropriate to exercise the option of assignment when  $L < F (p - pb + b)$  that is, when the value of winding-up is less than one percent of the claim.

We denote that  $L/F = \alpha$  = the report between the value of winding-up and the value of the claim.

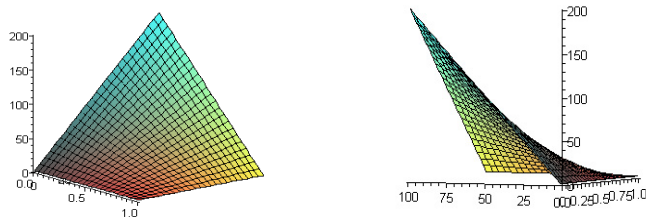
$$z = \alpha (p - pb + b)$$

This way it can be represented graphically  $z = f(p_f - p_f b + b)$ , with  $p$  comprised between 0 and 1 and  $b$  comprised 1 and 100, fact which expresses the variation of  $z$  according to  $p$  and  $b$

**Study with three-dimensional graphic .**

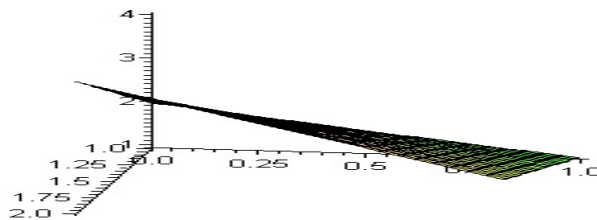


**Graphic 1.** We shall consider  $\alpha=1$  that is, we shall consider Winding-up Val= cassation value.

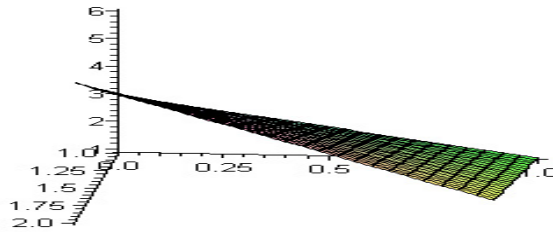


**Graphic 2.** We shall consider  $\alpha =2$  that is, we shall consider Winding-up Val= 2 \* cassation value

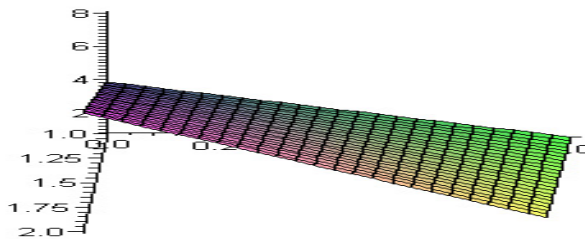
To illustrate an evolution graphic in various concrete cases we develop analysis for the following examples:  $b = 2, b = 3, b = 4$



**Graphic 3. :**  $b =2$  liquidate val = 2\* cassation value.  $z = L/F (p_f - p_f 2 + 2) = (2 - p_f) L/F = \alpha * (2 - p_f)$



**Graphic 4.**  $b = 3$  liquidate val = 3\* cassation value.  $z = L/F (p_f - p_f 3 + 3) = (3 - 2p_f) L/F = \alpha * (3 - 2p_f)$



**Graphic 5.**  $b = 4$  liquidate val = 4\* cassation value.  $z = L/F (p_f - p_f 4 + 4) = (4 - 3p_f) L/F = \alpha * (4 - 3p_f)$

### Conclusion

The fundamenting of the decision of assignment is based on the value of the assets, on the volatility of the assets, on the value of the claim, on the interest rate but also on the difference between the value of winding-up and the value of cassation.

Note that the graphic analysis of the measure increases the coefficient  $b$   $z$  is diminishing, and how  $\alpha$  increase the value of  $z$  also increases proportionately.

Graphic from the study observed that there are areas where the auction can begin even from scratch (when  $L / F$  is zero). It also notes areas admissible ( $z < 1$ ).

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