

# INVESTIGATION INTO THE CAUSES OF TAX EVASION

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## INTRODUCTION

Money laundering, allegorically, 'cleaning of money' with respect to appearances in law, is the act of participating in explicit monetary exchanges to cover the personality, source and objective of money and is a principal activity of underground economy. There are different definitions accessible which portray the expression 'Money Laundering'. Article I of the draft European Communities (EC)<sup>1</sup> Mandate of March 1990 characterizes it as the change or move of property, realizing that such property is inferred t1'om genuine wrongdoing; for the motivation behind covering or camouflaging the unlawful source. As another definition goes, "Money laundering is the cycle by which huge measures of illicitly got money is given the presence of having started from a real source.

Tax evasion has always been a grey area for the government over the period of several decades and it has always bene an area of concern which is often ignored by various govt due to the absence of the Adequate resources to look into the matter. It is quite a shock as to how countries still struggle with tax crimes despite of being developed and progressive. The concept of tax has been as old as time and has been steadily progressing to match the everchanging global trends, with around a dozen of definitions one can turn to when it comes to defining taxes but one of the most relevant definitions that will help us lay the foundation for this paper is coined by Omotoso (2001) wherein he defines taxes as a compulsory charge imposed by a public authority on the income of individuals and companies as stipulated by the government decrees, acts or cases laws irrespective of the exact amount of services rendered to the payer in return. This definition is the perfect example of how modern taxes function and through the concept of modern taxes emerges the need to find the loopholes in the same and make sure to secure them so as to protect the government from being robbed out of millions of dollars every year which sadly, is one of the biggest issues the government of almost every country faces. Through

this paper we aim to investigate into just how is it that tax evasion is one of the fastest growing economic crimes and continues to be a nuisance that government faces every year.

## **RESEARCH PROBLEM**

The paper analyses the general trend in the developed world and in the developing world towards privatization, where even high-level politics are gradually conducted by or outsourced to NGOs. This is true for foreign policy as well as defense policy, like war, where agents such as paramilitary groups, militias and private army companies (PMCs) are increasingly utilized by States (as principal). This particular case of PMCs is thoroughly analyzed to promote a common legalization and regulation that opens up opportunities, not least in Africa, for military missions such as humanitarian interventions which would not otherwise be undertaken.

## **RESEARCH QUESTIONS**

- What is Tax Evasion?
- Why is Tax Evasion a bane for developing countries?
- What is the effect of Tax Evasion on the Indian economy and what are the ways to curb it?

## **RESEARCH OBJECTIVES**

- To promote a better understanding of the phenomenon of the privatization of war
- To clarify the status of PMC/PSC employees under international humanitarian law
- To foster knowledge of the impact of private military activities on the enjoyment of human rights
- To analyses the international responsibility and accountability of corporations
- To review the criminal and civil liability of PMCs/PSCs and their employees for serious violations of human rights and international humanitarian law
- To examine the existing regulation at national, European and international levels

- To explore ways in which the EU could regulate or facilitate the regulation of PMCs/PSCs to assure compliance with human rights and international humanitarian law.

## **RESEARCH METHODOLOGY**

The research methodology that has used by the author for the making of the research paper is secondary method. Various books, journals, articles, bare acts, and other internet resources have been used for the purpose of this research.

## **HYPOTHESIS**

In order to ensure conformity with international humanitarian law and human rights, the aim of this paper is to determine how often privatized military firms and security undertakings (PMCs/PSCs) are used in situations of armed conflict and to analyses the regulatory system in national, European and international contexts.

## **SCOPE**

The scope of the research paper is to make a critical analysis of the provisions and regulatory framework in protection of PMCs/PSCs and find out how often they are used in armed conflict also drawing attention to their humanitarian rights and analyzing if the same are safeguarded.

## **LIMITATION**

The research paper is limited to analyzing the role of international laws and the additional Protocol in protecting and safeguarding the PMCs and PSCs.

## REVIEW OF LITERATURE

### *Articles*

#### **1. INCOME TAX EVASION: A THEORETICAL ANALYSIS BY MICHAEL ALLINGHAM AND SANDMO, 1972.**

The authors of this article discuss the present taxation issues date back to that time itself being those of administrative tax and the theory of optimal taxation system. They describe the basic structure of tax and go ahead to consider the shortcoming of the same vis a vi the recent developments. Since the article is from 1972 the article talks about the issues from the time being the issue of administrative tax and the theory of optimal tax. Furthermore, they suggested some changes in the legislation so that it could refrain the taxpayer from tax evasion. While suggesting the author is also acknowledging the fact that it would be not easy to implement these suggestions stating reasons for the same.

#### **2. GOVIND BHATTACHARJEE, TAX ON HIDDEN INCOME, ECONOMIC & POLITICAL WEEKLY, VOL. 55, ISSUE NO. 42, OCT 17, 2020**

The author of this article is a retired director general of CAG. In this article, he talks about the CAG report of 2019 and critically analysed it. Firstly, he traces the history of agricultural taxation in India. He goes back to the previous reports of all the committees to elucidate the fact that tax exemption on agricultural income is not appropriate. He discussed reports such as the Law Commission report 1972, the TARC report, etc. He highlighted the irregularities present in the present taxation system in giving exemption to the taxpayers on their agricultural income. He further discusses the findings of the CAG report in which the records were not properly maintained. There was no transparency while giving exemptions. The rich farmers and big companies are the ones according to the statistics who were given the maximum exemptions. Furthermore, he also focused on the point that how it is affecting the revenue of the government and GDP of the country as well. It was also explained well how the government can take a step to solve this issue.

**Books:**

**1. TAX EVASION AND THE SHADOW ECONOMY. UNITED KINGDOM, EDWARD ELGAR, 2012**

This book deals with committees' report and important documents of Dr. Rajendra Prasad of that time when he was the president. This book talks about how there was a debate on whether to give the power to levy a tax on agricultural income to the state or the center. This book highlights the debates, discussion done at that time for the same. It also focuses on the criticism of the final decision by different members to give the power to the state to tax agricultural income. This gives the reader an idea of how this rule came up and what was the history behind giving the power to the state. A committee was set up at that time which was assigned with work of drafting. These books also cover the other reports and documents that consist of the history of taxation agricultural income in India. Further, it gives us the reasoning behind giving the power to the state solely.

**2. MCGEE, ROBERT W.. THE ETHICS OF TAX EVASION: PERSPECTIVES IN THEORY AND PRACTICE. NETHERLANDS, SPRINGER NEW YORK, 2011**

This is the 63<sup>rd</sup> edition of the book which deals with Direct Taxation. to talk about the part of Minimum Alternate Tax, it covers each and every aspect of the same and has delineated it step by step. It is a very reader friendly book which not just shows and explains about the law but also make general public understand the applicability of the law. MAT being a confusing concept with all the additions and amendments, Taxmann has been able to solve all query by answering it well. Majorly it tells us about MAT complying well with the Accounting Standards. Further the basic focus is to make the reader under the importance of the MAT regime and break the Section 115 JB into bits so as to make the provisions clear and understandable. It also focuses on the constitutionality of the same making it clearer.

**DEFINITION OF TERMS**

1. **Tax:** A compulsory contribution which is levied by the ruling government of a state on the income of the citizens of the said state in exchange or in lieu of some goods, services or transactions.

2. **Evasion:** The act of avoidance of a said thing that is supposed to be done in a way that makes it seem as though done with malice and trickery.
3. **Revenue:** The income before the deduction of any expenses and costs incurred out of performing an activity of sale of goods or services of even usage of capital or assets is termed as revenue
4. **Penalty:** Penalty in the basic layman's language would be a punishment imposed for the breach of any rule, law or contract in force.
5. **Tax Rate:** Tax rate is usually referred to the percentage that is set for charging and individual or corporation

## CONCEPTUAL FRAMEWORK BEHIND THE RATIONAL OF THE STUDY

The government collects tax revenues for many sectors. Undoubtedly, there exists a lot of disparity between the tax collected from each sector. The intervention of the government becomes a very controversial yet necessary aspect when it comes to the need to stabilize the economy as well as restrict anti-social activities that will eventually hinder the fast-paced growth of the economy, which if ignored will lead a situation very similar to that The United States of America faced due to minimal governmental intervention in important matters leading to a power crisis. As much as the government is justified in intervening in the forms of either forming or running companies, or taxing people it is also imperative to understand that to intervene the government must have the accurate facts at their disposal as without the same it would create a havoc and end up with the government being responsible for creating policies and schemes that are faulty in nature and don't benefit the citizens when implemented. The accurate facts are a luxury that has a lot of roadblocks making it a task for the government to obtain the same, the major roadblock in the access of accurate information is the existence of underground economies which in a simpler sense would be money laundering and tax evasion which by their mere presence increase significantly the cost of obtaining the economic goals of the country by raising up the social and economic costs.

Money laundering and tax evasion is not the problem of only developed countries, but if recent trends are to be believed it is more present in developing and underdeveloped markets and economies simple because the lack or limited availability of resources lead to their being a weaker system of checks and balances which in turn gives a adequate chance for such activities to prosper. It is important to understand that money laundering and tax evasions are crimes under the Indian law and therefore there also exists punishment for these organised crimes, because such criminal activities pose a very serious threat towards disrupting and disheveling the economic stature of a country, there is a vicious circle of money which is formulated by generations of black income, earned through tax evasion which in turn leads to a black economy which if left unchecked for a time being grows as a parallel economy posing a huge threat to the existence of the national economy. Tax evasion has always been a grey area for the government over the period of several decades and it has always bene an area of concern which is often ignored by various govt due to the absence of the Adequate resources to look into the matter. It is quite a shock as to how countries still struggle with tax crimes despite of being developed and progressive. The concept of tax has been as old as time and has been steadily progressing to match the everchanging global trends

It must be noted that the only way to understand explain and get a viable solution for the problem of money laundering one must be aware of there being crime in the society and that the said crimes pose a serious threat to it.

Therefore, it becomes an immediate need to find ways to not only curb the crimes of terrorism and organised crimes but also a need to understand and make ourselves familiar with how these crimes are actually planned and performed, this paper deals with the biggest form of organised crime known to man, which is the crime of money laundering and tax evasion which continues to pose threat to most of the countries in the world thereby making it an even important topic to research into.

## **TAX EVASION**

Through this chapter we will be laying emphasis on the term tax evasion, by explaining what does it mean what are the methods through which it is undertaken, its effects on the economy

and the way it levies and gives way to black economy that in its later stage poses a threat to the national economy of the state.

Tax evasion is not only an example of modern-day corporate crime but it is not a far-fetched fictional concept that such money which is illegal in nature is a primary aspect of criminal activities and even terrorism which are one of the most dangerous threats to the sovereignty of an economy. If we were to trace the root of tax evasion we would have to go back and look at the history of when we believe that the tax evasion crimes began to happen, in 1972 and article called “Income tax evasion : a theoretical analysis”<sup>iii</sup> by Michael Allingham and Sandmo was published which we can safely say was one of the very first texts on this topic, although the revolution and actual use of the term of tax evasion can be dated back to only thirty years ago it was not a foreign practise in the older times as well.

There exists a very conceptual difference between the two concepts of tax evasion and tax avoidance which can simply be traced with the most important aspect that surround them both: Legality. While one tax evasion is simply an illegal action, breaking of the rules, tax avoidance is bending the rules in such a way that they serve to benefit the person bending them without causing a liability before the law.

Tax avoidance is done to reduce the taxes in such a way so that it does not make the process illegal, the same can be achieved by changing the income of labour into that of capital which is taxed at a much lower rate given the fact that there is a detailed statement present for one’s actions. Tax evasion as we have discussed time and again is simply a violation of the legal framework wherein there is no bending of the rules because to the tax invader there are no rules that exist and the same is done with a malicious intent of refraining to pay any tax for the income accumulated out of performing economic activities over a period of time which if it was done keeping in mind the aspects of the law, would be taxed.

In 2002, the Kelkar Committee said while giving exemption there is no distinction drawn between the rich and the poor. There is also an increase in corruptive practices such as laundering of income. The incomes are twisted in such a way as to portray as one that gets a lower rate of tax. It further contributes towards tax evasion by the wealthy people and the big companies which was never the primary intent of the exemption given.

Moving ahead it is necessary to establish that tax exemption plays a very important role in understanding how the government provides people incentive towards carrying out a specific set of financial activities which help the government boost the economic growth so it acts as a win win situation for both the parties, to understand what type of incomes may fall under this category we will start by looking at a few examples first one being agricultural income, as it is known that agricultural sector acts as a backbone for the economy of our country it is safe to say that offering tax exemption on this type of income offers a boost to the farmers undertaking such activities.

A second example could be the tax exemption offered to industrialists that set up their industries in Special Economic Zones, which are usually underdeveloped parts spread out across various states in the countries and with the incoming development and industrialisation a boost in terms of employment is offered to the people of that area which is rewarded by the government in forms of subsidies to the industrialist.

## **MONEY LAUNDERING: MEANING AND METHOD**

Money Laundering can be referred as the way through which criminals through an organised process create an illusion that the money, they are spending is actually theirs to spend.<sup>iii</sup>

When we trace back to history to find what the origin of money laundering was through gambling which gangsters took part in and the money that was involved was in cash which if deposited in the bank would raise a lot of eyebrows, therefore the money was stored in safe places by these gangsters and later used in businesses created by them like laundries also giving birth to the term of Money Laundry.

When we look at the various methods of money laundering, we come across

1. **Smurfing:** This method involves various individuals depositing cash in the bank in small amounts is as to not raise suspicion
2. **Bank Complicity:** Through this way of money laundering there exists the involvement of an employee of the bank, this way of money laundering is not popular keeping in mind the modern day practices followed in banks to ensure transparency.

3. **Purchasing Assets with Cash:** The purchase of expensive luxury items like jewellery, cars or assets like land, boats etc are common amongst money launderers when looking to disperse money, the catch here is that these assets are often purchased under the name of a family member or associate.

There are several other methods like casinos, loans, value tempering etc that are also viable methods of money laundering.

## **NEXUS OF TAX EVASION AND BLACK ECONOMY**

The underground economy has been discussed multiple times in this paper and the importance of drawing a nexus between the how tax evasion gives birth to the concept of black economy is one that requires special attention, the black economy consists of all kinds of transactions on which taxes are avoided in such a way as to scam the government out of the money towards which it is liable. The black market includes but is not limited to activities such as prostitution, illegal sale of goods and services, gambling activities. Underground economy transactions are usually cash transactions so that the government is unable to trace those transactions and that they go unseen. The size of black money accumulated directly affects the size of the black economy which directly affects the resources government needs to cope with the issue of money laundering.

**“Legalistic** - The distinction between evasion and avoidance can be taken as purely a question of legal boundaries: Evasion is outside the law; avoidance is not.

**Moralistic** - It is sometimes argued that certain types of avoidance are just as morally wrong as evasion and therefore should be treated the same as evasion for the purposes of analysis.

**Agnostic** - 'Evasion' and 'avoidance' are merely two arbitrary segments of a continuum that stretches from innocent tax planning to outrageous fraud.”<sup>iv</sup>

The attempt to curb taxes and also to keep a check and balance on the tax system in the government has been undertaken by the government by introducing VAT or Value added taxes which are a part of the economic community, now in a recent update to these taxes the concept of VAT has been changed to that of GST and is also referred to as the Goods and Services tax.

Another example of taxes levied by the government on its citizens is the excise duty or the excise tax which is imposed on the goods which are termed as luxury like alcohol, tobacco, fossil fuels, cars etc. These taxes are not levied keeping in mind the deterrence that government wants to impose on people, rather it is a form of the rich pay more and poor pay less that a socialist government promotes.

## **GLOBAL CO-RELATIONSHIP BETWEEN TAX EVASION AND MONEY LAUNDERING**

The problem of crimes and illegal activities related to tax are ever growing and challenging in the current economy not only for India but the world at large, it is even more alarming to understand that with the developed state of technology that enables every information at the disposal of those who wish to misuse it is, and the money earned by the way of tax evasion is on the rise keeping in mind that the modern world uses the means of “one click away” for everything making money laundering in the age of e commerce a walk in the park.

Over the years the attempt at curbing international money laundering attempts have been immensely to control the situation before it becomes out of control, but due to the term tax not sounding anywhere near a word that could be linked to crime or even be labelled as dangerous as terrorism it therefore becomes a tough nut to crack when educating the masses about the severity of the crime and therefore bringing in required framework to fight the same.

An important aspect of the same is the concept of DNA or the double taxation agreement which was made as a way to provide relief to ensure that companies that has foreign source of income do not get taxed twice, but this system has time and again been exploited in a way as to escapes the payment of taxes thereby making it an unviable concept unless backed properly.

## **CONCLUSION AND SUGGESTIONS**

Tax evasion has always been a grey area for the government over the period of several decades and it has always bene an area of concern which is often ignored by various govt due to the

absence of the Adequate resources to look into the matter. It is quite a shock as to how countries still struggle with tax crimes despite of being developed and progressive. The concept of tax has been as old as time and has been steadily progressing to match the everchanging global trends.

The only way to deal with the problem of organised crime like tax evasion threatening to rip apart the national economy is by actually understanding the concept and the roots in which the problem lays, which is only possible if the awareness and education about white collar organised illegal activities are increased and that the concerned personal are armed with the ability to sense and stop the building up of immense black money wealth before it's too late.

Therefore, the most important thing is to understand that the modernisation of the world with inclusion of various new technologies gives invitation to to even more difficulties when trying to trace down just where and how the money comes from and just where and to who does it go, costing government money and resources in not only looking for such criminals but also making the government suffer huge losses when it comes to the income that is accumulated on the government's land but not taxed.

Some recommendations that I have come up with which will help immensely according to my understanding in battling with this problem, and in a realistic way are:

1. Monitoring Transactions
2. Reporting of Suspicious transactions
3. Spreading awareness about organized crimes
4. Immediate action towards sensitive income tax leaks
5. Customers practice due diligence
6. A committee set up to examine and study in depth the problem of tax evasion so that at a later stage that committee can be the major contributor to forming a legal framework that is fit for today's problems.

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