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CURBING THE MENACE OF TAX EVASION AND AVOIDANCE AND PROMOTING A HEALTHY TAX REGIME

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ABSTRACT

The article seeks to address the issue of tax evasion and avoidance, which is used as a powerful method resorted by big businessman and firms to shift the burden of paying taxes on other individuals resulting in an unfair and unequal distribution of tax across the country. The article highlights the distinction between **tax evasion** and **tax avoidance** and emphasises on the importance of taxation as a means of generating revenue for the welfare of the public and growth of the economy. This article aims to address the underlying factors behind tax evasion. and tries to analyse the morality of aggressive tax avoidance with the help of three ethical theories. Through this article, an effective solution is drawn out to combat the contemporary problem of tax avoidance and ensure that every individual pays a fair share of tax.

INTRODUCTION

Taxation is regarded as the only method through which revenue is generated for the government to invest in infrastructural and development projects used for welfare of the public. There is a positive correlation between the revenue generated through tax collection and the provision of public goods and services. Tax is needed to boost the economic growth of the country; hence payment of tax is regarded as a moral obligation cast on every citizen. However due to higher tax rates imposed on large firms, they often engage in acts of deception and concealment by evading payment of tax. **Tax evasion** is a practise which is regarded as illegal, unethical. Sometimes **Tax Codes** are drafted in such a way that they often contain a legal loophole. Big firms can take advantage of such loopholes and are able to shift their tax burden by exploiting differences in tax jurisdictions. Such a practise is not regarded

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as illegal but is regarded as unethical as ethics demands every citizen to pay a fair share of taxes. Firms which are granted tax exemptions and incentives are the ones who underpay and compel others to overpay so that there is continuity in growth of public goods and services. The reason why firms engage in tax evasion is because they owe a fiduciary duty towards their shareholders to minimize the tax rates.

ARTICLE REVIEW

Shifting Tax Burdens through exemptions and evasions: An empirical investigation of Uganda[2]

By: Bernard Gauthier &Ritva Reinikka

Through this book, the author undertakes a case study of Uganda and tries to analyse with the help of empirical data, the practice of tax exemptions and evasions undertaken by large firms in Uganda to escape tax burden. Tax revisions were implemented in the year 1995-97 with a motive to ensure tax compliance with the existing tax regime and to make tax administration more efficient. However, despite the reforms, exemptions and evasions have prevailed over 3 years and there has been no improvement in dispersion of tax burdens, majorly due to the economic mismanagement caused due to these reforms and increasing mistrust in government. The survey conducted shows how tax evasions and exemptions vary based on firm's size. During the period of 1995-97, the data collected shows that there has been increase in exemptions when measured in terms of imports and sales tax. Moreover, due to indirect taxation, there has been a rise in distribution of tax burden. The data shows that smaller businesses engage in tax evasion as they are not able to benefit from tax exemptions like big firms and hence it is the medium sized firms who bear a disproportionate share of taxes for both the firms. The survey conducted also revealed a difference of 83% in the authority's tax assessment and the firm's own assessment which shows the firm's involvement with tax exemptions.

Factors influencing tax payers to engage in tax evasion: Journal of Innovation and entrepreneurship[3]

[2] Bernard Gauthier and RitvaReinikka, *Shifting Tax Burdens through Exemptions and Evasions :An Empirical Investigation of Uganda*, POL'Y RES. WORKING PAPER, 2735, pg. 24 (2001).

[3]Kassa, *E.T. Factors influencing taxpayers to engage in tax evasion: evidence from Woldia City administration micro, small, and large enterprise taxpayers*. J. INNOV. ENTREP.10, 8 (2021).

The purpose of this study is to examine the numerous factors that lead taxpayers to participate in tax evasion. Economic issues such as corporate sanctions, stagnation, and rising tax costs all encourage taxpayers to participate in evasion. Social, moral, and demographic issues are also essential. **Moral obligation, tax fairness, and tax knowledge** are all viewed as important predictors of tax evasion. Taxpayers with low tax morals are frequently lax in fulfilling their tax obligations and participate in evasion. Tax morals are frequently influenced by factors such as financial level, marital status, and religion. **Tax rate** and **Tax Knowledge** are two further elements that influence tax avoidance. Unfair tax rates encourage taxpayers to engage in tax evasion. Taxpayers who are knowledgeable about the tax system are less likely to engage in tax evasion.

Aggressive tax avoidance: A conundrum for stakeholders, government, and morality[4]

By: Dinah M. Payne and Cecily A. Raiborn

This paper addresses the ethics of aggressive tax avoidance using various ethical theories of **utilitarianism, social contract**, and **John Rawls theory of social justice**. **Aggressive tax avoidance** refers to taking advantage of the legal loopholes in the tax system. Various tax codes are written in such a way that they offer an advantage to big firms to use it to their own benefit and avoid payment of taxes. Firms engaging in aggressive tax avoidance do not violate the letter of law but violate the spirit of law. Hence it is regarded as an unethical practise as business all over the world have a moral obligation to meet the changing needs of the society and pay a proportionate share of their taxes. This paper highlights the difference btw **tax evasion, tax avoidance and aggressive tax avoidance.** Aggressive tax avoidance is then understood in terms of a corporate entity's **tone at the top** and the **Corporate Social Responsibility (CSR**). The conclusion reached after the final reading of the article is that the practise of manipulating the language of the law to avoid paying taxes is seen as highly inappropriate and unethical and change must be suggested to prevent shifting of tax burden through a disclosure of **financial statement** and **corporate ethics report.**

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[4]Dinnah M. Payne and Cecily A. Raiborn, *Aggressive tax avoidance: A conundrum for stakeholders, government, and morality,* 147 J. BUS. ETHICS, 469 – 487 (2018).

ANALYSIS

In order to reduce tax liability, people generally resort to 2 methods: **Tax evasion** and **Tax avoidance**. These 2 terms may often be used interchangeably, but are quite different from one another.

Tax evasion:

Tax evasion is regarded as an illegal practice of concealing full income or increasing deductions in order to reduce tax liability. It refers to the failure to pay taxes that are legally due. The act of evading taxes is regarded as unethical and a violation of both the letter as well as spirit of law. It attracts criminal liability and promotes circulation of black money in the economy.

Initiatives taken by Indian Govt. to reduce tax evasion

Indian government has taken several steps to curb this problem by introducing prosecution and penalties under several acts. **Income Tax Reward Scheme** has been implemented in order to compensate informants on tax evasion. A consensus has been reached between **India** and **US** to restrict Americans from avoiding taxes with the aid of Indian firms. **TheSpecial Bearer Bond Scheme** has been enacted with a view to help black money holders invest in special bonds.

Apart from implementation of these acts, the govt has also increased the tax bracket, reduced the deduction rate, and implemented lawful tax evasion techniques. **Tax administration reform commission** has been established with the aim of introducing substantial changes in the tax regime and to simplify the process. The **finance bill** has also incorporated a provision for auditing hidden tax transactions.

Various judicial precedents have also been established dealing with tax evasions. In the case of [5]**Calcutta Chromotype Ltd. V. Collector of C. Ex, Calcutta**, it was held that there are questionable methods of deceiving the authorities by evading tax payment which cannot be appreciated. Such actions would attract criminal liability.

Tax avoidance:

Tax avoidance, on the other hand, is regarded something which takes place inside the legal framework. It allows the taxpayer to retain certain amount of income when there is no legal

[5] Calcutta Chromotype Ltd. v. Collector of C. Ex., Calcutta, 1998 (99) ELT 202 (SC).

obligation imposed on him. It is different from evasion, as it involves a full disclosure of the sources of income. There is no infringement of the word or spirit of the law.

Aggressive tax avoidance is a concern which has arisen in the contemporary times and has allowed various firms to take advantage of legal loopholes in the tax codes and avoid payment of tax. Such practice cannot be termed as illegal but is regarded as unethical. The letter of law is not violated but the act is a clear violation of the spirit of law. The importance of **spirit of law** was highlighted in the case of [6]**Gregory v. Helvering (1935),** in which spirit of law was held to be a broader concept than the letter of law. In India, big business organisations such as **Reliance Corporation, Tata industries, Vodafone, Google** etc are skilled at the art of tax avoidance. The most preferred tactics employed by these corporate firms involve transferring money from India to **tax havens** through subsidiaries. Countries which have adopted the **territorial approach** to taxation are more likely to indulge in tax avoidance since under this system, there is no obligation to pay tax on profit earned overseas. **Residential approach** on the other hand, taxes residents for revenue generated from all sources of income, including foreign income.

US taxpayers have resorted to several legal loopholes to avoid international tax obligations. 2 major mechanisms used by US company include:

1. **Check the box loophole (1997)** – it is a kind of tax arbitrage which allows US companies to take advantage of the differences in tax rates in various jurisdictions.
2. **Look through Loophole (2006)** – this loophole enabled US companies to be more competitive and flexible by eliminating restrictions in business operations. It allows one **Controlled Foreign Corporation (CFC)** to receive income from another **CFC** without disclosing it.

It has been observed that such beneficial tax rules that encourage tax avoidance has led to an increase in resentment among the taxpaying sectors of the society. Tax exemptions granted to certain companies is seen as an unfair competitive advantage. The managers of these companies are often faced with an ethical dilemma, i.e., whether to comply with fiduciary obligation towards shareholders by minimising taxes as much as possible or fulfil their duty towards society by paying their fair share of tax.

[6]Gregory v. Helvering, 293 U.S. 465 (1935).

According to the **Organization for Economic Cooperation and Development (OECD)**, the **G-20** countries have moved their focus to the issue of **base erosionand profit shifting (BEPS)** in order to reform the international taxation system. According to the OECD's findings, **BEPS** has impacted government, enterprises, and individuals for a variety of reasons, particularly when carried out by shell firms. Governments have suffered as a result of reduced access to public resources. **Transfer pricing agreements** are used to move revenues from higher-taxing countries to lower-taxing countries.

We employ three theories in determining the morality of active tax avoidance:

1. Utilitarian approach
2. Rawls theory
3. Social Contract theory

As per the **Utilitarian approach**, which talks about maximum benefit for the greatest number, this practise is regarded as unethical as it does not take into consideration costs and benefits born by all stakeholders and only provides benefit to a certain section of the society. In fact, the harm caused by reduction in tax collections and reduced public benefits would outweigh any benefit arising to big companies as a result of such incentives.

According to the **Rawlsian analysis**, the 3 principles of justice do not apply to the practise of tax evasion and avoidance. The fundamental **principle of equal liberty**, which argues that everyone has an equal entitlement to basic liberties, does not apply here because corporations have more resources than small enterprises or individual taxpayers. Corporate entities frequently consume a greater proportion of resources while contributing far less tax than individuals. The **difference principle**, which holds that inequalities must be structured so that they benefit the least advantaged members of society, is likewise inapplicable, because corporations are the most advantaged members of society. Third, the **principle of fair equality of opportunity** is inapplicable because it stipulates that the finest opportunities should be available to the most disadvantaged segments of society. Large firms on the contrary, are regarded as the most advantaged. Lastly, this practice is also considered unethical as per the **contractual rights theory**, as this theory presumes that businesses have a moral and legal obligation towards the society and hence must pay a fair share of taxes.

CONCLUSION

Hence, we see, that though initiatives have been introduced by the Indian government to combat the problem of **tax evasion**, **tax avoidance** is still seen as a huge problem of generating revenue for the govt. in India and several other countries. Since such activity is mostly undertaken by firms to maximise their profits, change must be introduced in the taxation system to comply with corporate entity's **tone at the top** and [7]**Corporate Social Responsibility (CSR)**. **Tone at the top** refers to a company's commitment to be honest and ethical in its dealings. Changes in taxation can only take place through a combined effort of all stakeholders, i.e., govt., managers, shareholders and individual taxpayers. Govt. should introduce changes in tax codes in order to eliminate all legal loopholes. Managers should respect their societal obligations by paying their fair share of taxes and reducing the load on other persons. This will also enhance their firm's reputation in the eyes of the community. Stakeholders should raise their voice about submission of an **ethics report** along with the **CSR report**. With an effort to eliminate tax avoidance, the [8]**COSO Internal Control Framework** has been established which demonstrates an organisation's level of ethical commitment by establishing internal controls. These suggestions can only be effective when reforms are first introduced at domestic level and then implemented internationally.

[7]Brian Edmonson, *What is Corporate Social Responsibility (CSR),* THE BALANCE (Jul. 13, 2022), https://www.thebalancemoney.com/corporate-social-responsibility-csr-4772443.

[8] Jacy, The COSO Internal Control Framework, ACCOUNTING INTERNAL CONTROLS (April, 30, 2021), https://accountinginternalcontrols.com/coso-framework/.