TAX DODGING

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"Tax evasion refers to … deliberate criminal non-fulfilment of tax liabilities. In contrast, tax avoidance refers to deliberate acts of reducing one's taxes by legal means. However, the distinction is not always clear because tax laws are not always precise. Moreover, when taxpayers try to find loopholes with the intention to pay less tax, even if technically legal, their actions may be against the spirit of the law and in this sense considered noncompliant."[1]

Most literature on tax evasion discuss both evasion and avoidance as a collective way of escaping taxes and use terms like 'tax non-compliance' or 'tax dodging'. With the increasing focus on tax dodging globally and its impact on revenue generation, there is a need for raising awareness around tax issues, promoting a culture of tax compliance, increasing transparency among corporations and promoting international cooperation between governments on tax matters.

In a globalized world, more than two-thirds of trade is between related group entities. The inter-group transactions offer an opportunity for multinational enterprises to locate their profits in favourable tax jurisdictions with low taxes or no taxes. Taxation has thus acquired new complexities with political, legal as well as international ramifications.

- Speech by the President of India, Shri Pranab Mukherjee at the Valedictory Ceremony of the 65th Batch of Indian Revenue Services

MAJOR METHODS OF TAX DODGING

1. *Money Laundering*

- According to the definition adopted by the Interpol General Assembly in 1995, money laundering is "any act or attempted act to conceal/disguise the identity of illegally obtained proceeds so that they appear to have originated from legitimate sources".[2]
- One of the most important consequences of money laundering is rampant tax evasion. Since the laundered money cannot be sourced, it cannot be taxed either and this means a substantial loss of public revenue.

2. *Hawala*

- *Hawala* is a process of funneling money from one location to another (usually abroad or from abroad to the domestic country) through a network of hawala brokers (service providers facilitating the process for a commission). It is an informal channel for transferring money and other assets.
- In South Asia, it appears to have developed into a full-fledged money market instrument, which was only partially replaced by the instruments of the formal banking system in the first half of the 20th century. Today, hawala is the dominant channel for migrant workers' remittances to their countries of origin.
- Many white hawala transactions are remittances and not illegal in other jurisdictions (except in some cases). However, black hawala is associated with serious criminal offences like narcotics trafficking, fraud, illegal money transfer etc.

3. *Tax Havens*

- Tax havens are locations with zero or low tax rates to attract foreign capital and business. However, there is no precise definition of tax havens.
- Tax havens, as they exist today, can be classified into three groups: (a) UK based tax havens (b) European tax havens (c) New tax havens from the transitional economies in South America and Africa.
- One of the main issues regarding tax havens is their lack of transparency. By the early 1990s, the number of tax havens had grown to almost a hundred. Bank for International Settlements (BIS) data (quarterly statistics) shows that almost half of international loans and one-third of Foreign Direct Investments (FDI) are routed through tax havens since early 1980s, avoiding substantial amount of taxes worldwide.[3]

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[1] Wenzel, Michael (2002), "The Impact of Outcome Orientation and Justice Concerns on Tax Compliance: The Role of Taxpayers' Identity", *Journal of Applied Psychology*, 87, 629-645

[2] http://www.interpol.int/Public/FinancialCrime/MoneyLaundering/default.asp

[3] "The history of tax havens" by Ronen Palan, URL: http://www.historyandpolicy.org/papers/policy-paper-92.html. See the Introduction.

- A large amount of financial resources circulate among different countries in the name of 'FDI' whereas in effect, such 'financial resources' do not generate the expected benefits of FDI (such as technology spill over effects, employment, innovation etc.) and the sole purpose of circulation (or round tripping) is to escape legitimate tax payments.

- Double Tax Avoidance Treaties have increasingly been controversial for their misuse or 'treaty shopping' whereby conduit/shell companies are set up aiming at availing treaty benefits only without any commercial purpose. As per the tax treaty between India and Mauritius, a company having residential status in Mauritius is exempt from paying any capital gains tax in India resulting in revenue losses considering almost 40% of FDI is routed through Mauritius.

4. *Transfer Pricing*

- Transfer price is the price at which goods and services between related companies are transacted.

- Theoretically, the concept and practice of transfer price is not illegal. But over the years, transfer prices have been severely manipulated in order to shift profits from high tax countries to low tax countries.[4] Consequently, there are substantial losses of legitimate tax revenues of governments of different countries.

5. *Trade Mispricing*

Trade mispricing[5] refers to intentional over invoicing/ under invoicing of exports and imports in order to escape taxes. Trade mispricing occurs when the import or export price for a particular good is invoiced at a level that either exceeds the market price (over-invoicing) or is below the market price (under-invoicing).

- **As per the White Paper on Black Money released by the Union Ministry of Finance, trade mispricing worth Rs. 67,768 crore was detected from 2010 to 2012.**
- **Reportedly, more than 3,000 cases related to transfer pricing worth more than $9 billion are under litigation in India. (Financial Times. March 20, 2013)**
- **Christian Aid (2008) estimates that developing countries may be losing over US$160 billion a year through transfer mispricing and false invoicing.**

POLICY RECOMMENDATIONS

- Comprehensive review of India's Double Tax Treaties by Ministry of Finance to understand its impact on revenue generation.
- Making tax crimes a scheduled offense under the Prevention of Money Laundering Act (PMLA) as suggested by India's Financial Intelligence Unit (FIU)[6] as tax-related offense is currently only a civil crime.
- Public registries of beneficial owners of all companies/ trusts/corporations to increase transparency and provide a deterrent to setting up conduit (or benami) companies or trusts.
- Although implementation of General Anti-Avoidance Rules (GAAR) has been postponed to 2016, it should be carefully applied drawing appropriate inferences from countries that currently have GAAR in place.
- Coordination between countries with regard to tax laws is essential especially on forums such as G20, BRICS, OECD and UN Tax Committee so the global standards that are set work in favour of both rich and poor countries.

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[4] A bad intention of escaping taxes through such practices is termed "transfer mispricing" and not "transfer pricing."
[5] Transfer mispricing is sometimes difficult to distinguish from trade mispricing, since the former also may include transferring goods/services aboard and related to export/import misinvoicing.See, the URL: http://www.taxjustice.net/cms/front_content.php?idcat=139 .
[6] "Measures to Tackle Black Money in India and Abroad" (2012), Report of the Committee Headed by CBDT, Ministry of Finance

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