



## TAX EVASION AND BLACK MONEY IN INDIA: CAUSES AND REMEDIES

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### ABSTRACT

Tax evasion occurs when individuals deliberately fail to comply with their tax obligation. The resulting tax revenue loss may cause serious damage to the proper functioning of the public sector, threatening its capacity to finance its basic expenses. This study covers the overview of the tax evasion in India, delineating the number of factors responsive for tax evasion and examining the possible remedies to reduce the problem of tax evasion.

**Keywords:** Tax Evasion, Black Money, corruption.

### INTRODUCTION

In India, most of the persons do not pay their taxes. They try to avoid this by some illegal means or by taking the benefit of some loopholes in the Indian tax system. Tax evasion is the term for the efforts by individuals, corporate, trusts and other entities to evade taxes by illegal means. It is the deliberate, misrepresentation or concealment of the true state of their affairs to the tax authorities to reduce their tax liability or to avoid the tax liability by declaring less incomes, profits or gains than actually what they earned or overstating their expenses. Thus the amount which would have been used for economic and social development is used for anti social activities. All this creates black money and social evils in the society. Thus tax evasion is not a problem in development of country but also harmful for the country. The level of Evasion Tax also depends on the chartered accountants and tax lawyers who help companies, firms, and individuals evade paying taxes.

### Defining 'Black Money'

There is no uniform definition of black money in the literature or economic theory. In fact, several terms with similar connotations have been in vogue, including 'unaccounted income', 'black income', 'dirty money', 'black wealth', 'underground wealth', 'black economy', 'parallel economy', 'shadow economy', and underground' or 'unofficial' economy. 'Black money' can be defined as assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession.

According to National Institute of Public Finance and Policy (NIPFP) defines-

“Black Money is the aggregate of incomes which are taxable but not reported to authorities.” Thus, in addition to wealth earned through illegal means, the term black money would also include legal income that is concealed from public authorities:

- To evade payment of taxes (income tax, excise duty, sales tax, stamp duty, etc);
- To evade payment of other statutory contributions;
- To evade compliance with other laws and administrative procedures

### **PURPOSE OF STUDY**

1. To analyze the factors leading to generation of Black money and causes for tax evasion
2. To know the impact of Tax evasion and Black money.
3. To find out remedial measures.

### **RESEARCH METHODOLOGY**

The data presented in this paper is secondary source. Journals, text books internet, magazines, news papers, conference books. books on income tax and reports.

### **Factors Leading to Generation of Black Money**

Black money arising from illegal activities such as crime and corruption has an underlying antisocial element. The 'criminal' component of black money may include proceeds from a range of activities including racketeering, trafficking in counterfeit and contraband goods, smuggling, production and trade of narcotics, forgery, illegal mining, illegal felling of forests, illicit liquor trade, robbery, kidnapping, human trafficking, sexual exploitation and prostitution, cheating and financial fraud, embezzlement, drug money, bank frauds, and illegal trade in arms. Some of these offences are included in the schedule of the Prevention of Money Laundering Act 2002. The 'corrupt' component of such money could stem from bribery and theft by those holding public office – such as by grant of business, leakages from government social spending programmes, speed money to circumvent or fast-track procedures, black marketing of price-controlled services, and altering land use regularizing unauthorized construction. All these activities are illegal per se and a result of human greed combined with declining societal values and inability of the state to prevent them. Factors leading to their generation are both social and administrative.

Thus the fight against generation and accumulation of black money is likely to be far more complex, requiring stronger intervention of the state, in developing countries like India than in developed countries. It needs a stronger legal framework, commensurate administrative measures, and a very strong resolve to fight the menace. It also calls for political consensus as well as patience and perseverance.

### **Generating Black Money by Manipulation of Accounts**

There can be two different modus operandi involved in the generation of black money. The first is the crude approach of not declaring or reporting the whole of the income or the activities leading to it. This is the likely approach in all cases of criminal, illegal, and impermissible activities. The sophistications in such an approach mostly get introduced subsequently for the purpose of laundering the money so generated with the objective of making it accountable and converting it into legitimate reported wealth that can be openly possessed and used.

The same approach of not declaring or reporting activities and the income generated there from may also be followed in cases of failure to comply with regulatory obligations or tax evasion on income from legitimate activities. Different kinds of manipulations of financial statements resulting in tax evasion and the generation of black money are

### **Manipulations of Accounts for Tax Evasion**

**Out of Book Transactions:** This is one of the simplest and most widely adopted methods of tax evasion and generation of black money. Transactions that may result in taxation of receipts or income are not entered in the books of account by the taxpayer. The taxpayer either does not maintain books of account or maintains two sets or records partial receipts only. This mode is generally prevalent among the small grocery shops, unskilled or semi-skilled service providers, etc.

**Parallel Books of Accounts:** This is a practice usually adopted by those who are obliged under the law or due to business needs to maintain books of account. In order to evade reporting activities or the income generated from them, they may resort to maintaining two sets of books of account – one for their own consumption with the objective of managing their business and the other one for the regulatory and tax authorities such as the Income Tax Department, Sales Tax Department, and Excise and Customs Department.

**Manipulation of Books of Account:** When books of accounts are required to be maintained by taxpayers under different laws, like the Companies Act 1956, the Banking Regulation Act, and the Income Tax Act, it may become difficult for these taxpayers to indulge in out of books transactions or to maintain parallel books of accounts. Such parties may resort to manipulation of the books of accounts to evade taxes.

**Manipulation of Sales/Receipts:** A taxpayer is required to pay taxes on profit or income which is the difference between sale proceeds or receipts and expenditure. Thus manipulation of sales or receipts is the easiest method of tax evasion. Other innovative means may include diversion of sales to associated enterprises, which may become more important if such enterprises are located in different tax jurisdictions and thereby may also give rise to issues related to international taxation and transfer pricing.

**Under-reporting of Production:** Manipulation of production figure is another means of artificially reducing tax liability. It may be resorted to for the purpose of evading central excise, sales tax, or income tax.

**Manipulation of Expenses:** Since the income on which taxes are payable is arrived at after deducting the expenses of the business from the receipts, manipulation of expenses is a commonly adopted method of tax evasion. The expenses may be manipulated under different heads and result in under-reporting of income.

**Other Manipulations of Accounts:** Besides inflation of purchase / raw material cost, expenses like labour charges, entertainment expenses, and commission can be inflated or falsely booked to reduce profits. In these cases, bogus bills may be prepared to show inflated expenses in the books.

**Manipulation by Way of International Transactions through Associate Enterprises:**

Inter corporate transactions between these associate enterprises belonging to the same group or owned and controlled by the same set of parties may be arranged and manipulated in a way that leads to evasion of taxes. This can often be achieved by arrangements that shift taxable income to the low tax jurisdictions or tax havens, and may lead to accumulation of black money earned from within India to another country.

**Manipulation of Capital:** The statement of affairs or balance sheet of the taxpayer contains details of assets, liabilities, and capital. The capital of the taxpayer is the accumulated wealth which is invested in the form of assets or as working capital of the business. Manipulation of capital can be one of the ways of laundering and introduction of black money in books of accounts.

**Manipulation of Closing Stock:** Suppression of closing stock both in terms of quality and value is one of the most common methods of understating profit. More sophisticated versions of such practice may include omission of goods in transit paid for and debited to purchases, or omission of goods sent to the customer for approval. A more common approach is undervaluation of inventory (stock of unsold goods), which means that while the expenses are being accounted for in the books, the value being added is not accounted for, thereby artificially reducing the profits.

**Manipulation of Capital Expenses:** Over-invoicing plant and equipment or any capital asset is an approach adopted to claim higher depreciation and thereby reduce the profit of the business. As already stated, increase in capital can also be a means of enabling the businessman to borrow more funds from banks or raise capital from the market.

**Generation of Black money in Some Vulnerable Sections of the Economy**

While the source of generation of black money may lie in any sphere of economic activity, there are certain sectors of the economy or activities, which are more vulnerable to this menace. These include:

1. Land and Real Estate Transactions
2. Bullion and Jewellery Transactions
3. Financial Market Transactions
4. Public Procurement
5. Non-profit Sector
6. Informal Sector and Cash Economy
7. Trade-based Money Laundering (TBML)
8. Tax Havens
9. Offshore Financial Centers

**CAUSES FOR TAX EVASION**

1. High tax rates.
2. Complex tax system.
3. Inefficient tax authorities.
4. Ineffective Enforcement of law.
5. Multiple taxes.
6. corruption.

## Impact of Black Money on Indian Economy

The flow of black money can seriously affect the entire economic system of India. Some important impacts are discussed here:

**1. Less Tax for the Government:** Many times, the Indian Government has failed to collect the estimated amount of tax from the people of our country and for this, credit has to go to the black money driven underground economy. Recently, a report was submitted to the Finance Ministry of India that divides the spread of black money in different sectors like real estate, mining, telecom etc.

**2. Uncontrollable Inflation:** When black money is out in the market, the amount of money in the system is higher than the Government expects. This causes the prices of commodities to increase to a level beyond normal. This is a direct result of people having more money offering more money on specific items. Even if the Government tries to control the credit flow in the market by taking necessary measures, the amount of black money present upsets the move, resulting in some sort of pressure on the economy.

**3. Leads to Mass Poverty:** The distribution of wealth and income in our country has been severely affected by the growth of underground economy. The common people get affected indirectly in so many ways. The tax evaders are keeping the money away from the deserved. .

**4. Lack of Technology:** Due to the existence of black money, India is facing the problem of shortage of capital. This has the direct impact on the up gradation of technology in all sectors. The major reason behind such backwardness is the parallel economy.

**5. Impact on Growth by moving investments on Gold, Stones and Jewellery:** People who are looking to turn black money into white money are largely investing in precious metals like Gold and other jewelry. There are people who believe that almost 70% of the total gold investment in our country is black money. One reason for people to invest in gold is that it is hard to trace. People in black market may buy gold bars, coins, jewelries etc. because one can buy gold easily and can be converted back to money anytime. This flow of underground money has caused Indian economy to stall on its growth.

**6. Corruption:** While corruption creates black money in the economy, it can also be a result of the growing underground market. People with black money are able to bribe the administrators and politicians to get what they want. By doing this, they are able to get what they want and others are pushed down the stack.

**7. Inflated Real Estate:** When people with deep pockets are ready to pay more for a piece of land, the price of surrounding land also tends to increase; thus artificially inflating the prices of an entire area. Generally, people involved in black money market are always ready to pay more for a piece of land as this helps in converting their colored money to legal money.

**8. Transfer of Indian Funds Abroad to Safe Heavens:** The black money generated in India is kept in foreign tax havens. For this, money has to be transferred from India to other countries through secret channels. Under-invoicing of exports and over-invoicing of imports are two of the main methods used by black money holders for transferring money overseas.

**9. Encourages Anti-Social Activity:** It is no doubt that black money is a curse to any country. Black money is always promoting anti-social activities in the society. Bribery, mentioned earlier, is only one example. The anti-social effects of black money include activities like terrorism, a huge threat already to our country.

### **Measure by Government**

Generation of black money, stashing it abroad in tax havens and recovering such illicit wealth secreted in these accounts was one of the dominant issues in the run up to the 2014 General elections. In fact on assuming office one of the first decisions of Narendra Modi led NDA Government was to constitute a Special Investigating Team [SIT] as mandated by the Hon'ble Supreme Court to look into these matters.

While the SIT was operating on a narrow compass the fact remained – much was left to be done by the Government. It is in this background that Budget 2015 has pronounced certain measures to deal with the “generation of black money and its concealment effectively and forcefully.”

This statement of intent has been backed by providing highest priority to investigations into cases of undisclosed foreign assets. This is over and above that investigation conducted by SIT. According to the Finance Minister “major breakthrough” has been made with the Swiss Authorities and certain critical and actionable information obtained from such authorities

### **CONCLUSION**

High tax rates, corruption in public sector units, multiple tax rates and inefficient tax authorities are the main causes of tax evasion. It suggested that reduction in tax rates, simplifications of tax laws, remove loopholes in the tax system and some extent proper processing of information available the under the annual information return can be best tool for improving Indian tax compliance. Therefore there is a need for creating transparent, friendlier and less discriminatory administrative system. Further there is also a need to educate the people about Indian Tax law and create such an environment in which they pay their due taxes, do not evade the tax and feel proud in discharging their duty to pay.

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