

Tax Evasion - A Major Threat to Economic Development and Growth – Causes and Remedies

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Abstract: *Taxes are the major source of revenue to the government. Tax evasion is a serious threat which hampers the economic development to a greater extent as majority of the welfare measures undertaken by the government are funded by the taxes collected. Tax evasion is a scenario where people evade tax through illegal and fraudulent means. It might be in the form of understating profits, gains and turnover and overstating losses and expenses, nonpayment of taxes the tax evaders find every opportunity to evade tax. This results in a huge amount of revenue loss to the government so that the country faces economic stagnation. The economic scenario is such that these tax evaders can even buy the government with volumes of black money. Tax evasion also leads to economic inequality where the rich becomes richer and the poor becomes poorer. This is one of the major reasons for India's poor economic growth since independence despite being very rich in natural and human resources. This review paper focuses on highlighting the causes and ill effects of tax evasion in the overall development of the Indian economy and also suggests a few measures to resolve this issue and there by paving way for the growth of the country.*

Keywords: Tax evasion, economic development, economic growth, illegal, black money

1. Introduction

Tax evasion refers to deliberate omission of income on a tax return, the nonpayment of taxes owed or not filing a tax return altogether, to avoid having to pay taxes to the government. It is an illegal act and attracts penalty and proceedings against the persons.

It is an unlawful attempt to minimize tax liability through fraudulent techniques to circumvent or frustrate tax laws, such as deliberate under-statement of taxable income or willful non-payment of due taxes.

Quiet often people get confused between Tax Evasion and Tax Avoidance and hence use them interchangeably. However there is a huge difference between the two. The former one is illegal while the later is legal. The following points clearly draw the line of demarcation between the two.

- 1) Tax evasion is a deliberate attempt to escape payment of taxes through fraudulent techniques such as under-statement of taxable income, over-statement of expenses and losses, willful non disclosure of material facts, non-payment of taxes etc. While Tax avoidance is also a deliberate attempt to escape payment of taxes but not through fraudulent techniques. Here, the assessee tries to minimize or avoid his tax liability through a proper tax planning like investing in tax free securities and bonds, LIC policies, Mutual Fund Units and in other legal portfolios.
- 2) Tax Avoidance involves taking benefit of the loopholes in the law. Conversely, Tax Evasion involves the deliberate concealment of material facts.
- 3) The arrangement for tax avoidance is made prior to the occurrence of tax liability. Unlike Tax Evasion, where the arrangements for it, are made subsequent to the occurrence of the tax liability.
- 4) Tax avoidance is completely legal however Tax Evasion is a criminal activity.
- 5) The result of tax avoidance is postponement of tax, whereas the consequence of tax evasion, if the assessee is

found guilty of doing so, is either imprisonment or penalty or both.

Thus it is important to understand the differences between the two so as to fulfill our social responsibilities.

2. Reasons for Tax Evasion

Here are the major reasons for tax evasion in a developing economy like India:

- a) Low level of voluntary tax compliance
Majority of the population do not voluntarily comply with the tax procedures. This is attributed to the following reasons.
 - Low tax morale
 - Low quality of services in return for taxes
 - Tax system and perception of fairness
 - Low transparency and accountability of public institutions.
 - High level of corruption
 - Lack of rule of law and weak fiscal jurisdiction
 - High compliance costs
- b) Weak enforcement of tax laws
Even though the tax laws are very strong and rigid, the effectiveness of their enforcement still remains a question mark. The implementation of tax laws is ineffective due to the following reasons:
 - Insufficient amount of tax collection
 - Weak capacity in detecting and prosecuting inappropriate tax practices
 - Corrupted tax officials

The reasons listed above do not occur in isolation and some are mutually enforcing. Often, tax evasion and avoidance are by-products of deficient political, economic and social governance in a country. Especially in these circumstances – which are not untypical for many developing countries – any ‘exit strategy’ away from evasion and avoidance needs to be based on a profound analysis of the current situation and the types of tax evasion and avoidance used predominantly.

3. ILL Effects of Tax Evasion

Tax evasion and thereby establishment of parallel economy has been creating the following serious impacts on the social and economic system of the country.

- 1) Tax evasion has been causing reduction in country's economic growth
- 2) The direct effect of tax evasion is the loss of revenue, and increase in inflation
- 3) Impact on morale
- 4) Increase in corruption
- 5) Increase in prices of land and houses
- 6) Black money has resulted in transfer of funds from India to foreign countries through clandestine channels which decrease country's reputation globally.
- 7) Tax evasion leads to poor standards of living of the rural masses and the people BPL as the government cannot undertake welfare measures at the national level.
- 8) It also brings disequilibrium in the economic condition of the country resulting in the rich becoming richer and the poor becoming poorer.

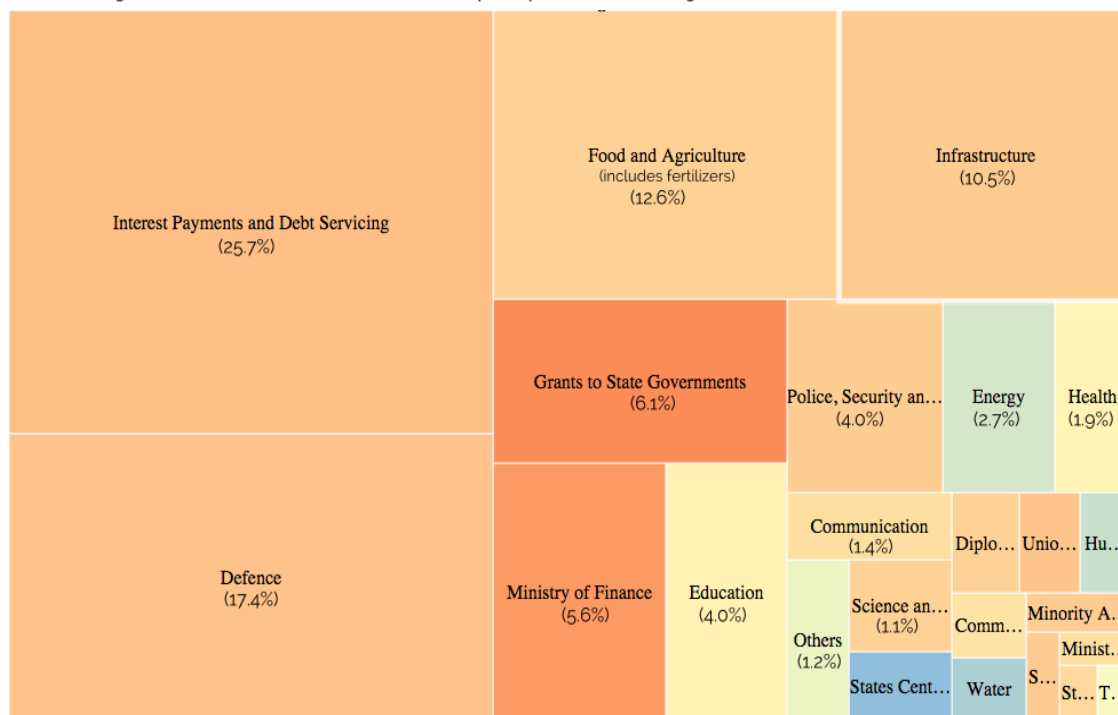
- 9) Due to tax evasion of majority of the rich population, the government is forced to increase the rates of tax every assessment year for increasing its revenue which results in increased tax burden of those who pay taxes promptly.
- 10) Majority of the developmental activities do not take place due to tax evasion.

4. Measures to Curb Tax Evasion

India is a country wherein excellent and brilliant laws are framed with respect to all disciplines. Yet the country suffers from severe law and order issues due to the poor execution of such laws. Tax laws are no exemption from this drawback. The government, in spite of making its best efforts to recover taxes, is still not able to succeed in its mission completely. The following table shows the importance of tax as a major source of revenue as it is used for the maintenance and development of the major sectors of the country.

How your taxes are used - breaking down expenditure for Union Budget 2015

Note: This might contain minor errors as the author is not an expert in public finance and might have misunderstood some nomenclature.



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Source: Union Budget Expenditure Budget, Volume 1 (indiabudget.nic.in/ub2015-16/eb/st02.xls)

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In spite of the importance majority of the population of the country is still negligent about payment of taxes of proper filing of IT returns.

The following measures are suggested to the government as well as the taxpayers to overcome this issue:

- 1) **Reduction of tax rates by the government:** This might bring a positive response as it creates a sense of feeling

in the public that the government is really striving hard to reduce their tax burden.

- 2) **Simplified Tax Laws and procedures:** The Indian Tax System has been bombarded with many complex and cumbersome procedures as compared with the tax system of the world economies. This issue must be resolved as early as possible as it invokes a positive response. However, the e-filing system and self assessment scheme is definitely a boon for tax payers.

- 3) **Well organised and a more Autonomous Tax Administration Structure:** Not only the tax system, but also its administration is complex as the tax authorities are widespread across the States wherein the system of levy, collection and the rates of taxes vary in accordance to the Tax Laws of the concerned State. However, this issue, to a greater extent is resolved with respect to indirect taxes with the introduction of GST.
- 4) **Increased awareness among the taxpayers:** Proper measures must be ensured at various levels to educate the taxpayers about the importance of tax as a major source of revenue to the government through various seminars and conferences through media.
- 5) **Corruption free officials and taxpayers:** People also resort to bribery to evade tax i.e they bribe the tax officials to reduce or evade tax completely. This practice must be stopped and both the parties must not resort to this illegal practice.
- 6) **Stronger penalties for non compliance:** The penalties for non compliance of the tax procedures must be made stronger in addition to which it must also be ensured that these penalties are properly implemented.
- 7) **Sense of responsibility among the taxpayers:** The taxpayers must also realize that compliance with the tax procedures are crucial for the overall development of the economy and must develop a sense of responsibility that the non compliance of these procedures are detrimental to their individual growth as well. Social conscience needs to be aroused amongst people against tax evasion, for attaching social stigma for tax evaders and to work as sentinels for identifying black marketers and tax dodgers
- 8) **Use of Media:** Tax laws should permit wide publicity through media regarding persons found guilty of tax evasion irrespective of their power, position and status in the society.

5. Conclusion

Having been aware of the ill effects of tax evasion, it becomes each one of our responsibility to support the government by complying with the tax procedures and pay taxes promptly. As it is rightly said that every drop of water makes an ocean, it can also be said that our small contribution makes a huge difference in the growth of the economy. Instead of expecting for change to happen, let us be the change agents who can bring in a drastic development by just fulfilling our responsibilities promptly. If each one of us speaks the same language, then there will be least or no scope for us to be exploited by any institution or authority. So let us fulfill our duties first and claim our rights next.

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