

# Tax Evasion & Black money in India

By- Krishnaraj Singh & Raj Vikram Singh

## Abstract

*Tax is a major source of government revenue and it contributes for the overall development and prosperity of a country. Raising government revenue in terms of income tax, custom duty, excise duty, entertainment tax, VAT, land revenue tax etc. from various sectors in order to initiate development and welfare programmes that are meant to improve the company's situation. This paper reviews about the causes & impact of tax evasion and black money on the government and also reviews about the measures taken by the government to reduce tax evasion.*

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## Introduction

Tax evasion is the illegal practice of not paying taxes, by not reporting income, reporting expenses not legally allowed, or by not paying taxes owed. 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. The level of Evasion Tax also depends on the chartered accountants and tax lawyers who help companies, firms, and individuals evade paying taxes. Thus tax evasion is not a problem in development of country but also harmful for the country because it reduces government's revenue and income flow of the country. The people think that their tax money is not properly utilized by the government or the tax rates are high.

Tax evasion is a illegal method which creates black money and parallel economy whereas Tax avoidance is the legitimate minimizing of taxes, using methods included in the taxcode. Businesses avoid taxes by taking all legitimate deductions and by sheltering income from taxes by setting up employee retirement plans and other means, all legal and under the Internal Revenue Code or state tax. The only purpose of tax avoidance is to postpone or shift or eliminate the tax liability.

**Causes of tax evasion:** Tax evasion has been causing reduction in the country's economic growth. It brings disequilibrium in the economic condition of the country resulting in the rich becoming richer and the poor becoming poorer. It's most important adverse affect is perhaps on equity. A wage-earning factory worker pays tax. A restaurant worker whose income is the same but who receives part of his income in tips does not reveal it for tax purposes. Thus, one bluecollar worker gains at the expense of the other. This is horizontal inequity. A salaried employee in the organised corporate sector earns the same reported as the their incomes appear to be the same for tax purposes. As inequity and inefficiency lead to lower revenue intake for government, its functional capacity, efficiency and effectiveness suffer because of tax evasion. Capacity suffers due to lower availability of resources. The result could very well be an increase in tax rates, or the imposition of distortive taxes, thereby initiating a vicious cycle of inequity and inefficiency. The major impact of tax evasion on the government is the generation of black money which is a socioeconomic evil. The existence of rapidly growing black money in our economy has grave and disastrous consequences.

**Black money:** The money earned by the illegal activity controlled by the country is known as black money. Black money proceeds are usually received in cash from underground economic activity that are not taxed, the 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.

## How black money is generated?

The most common source of black money is illegal means through the black market or underground economy, such as drug trafficking; weapons trading; terrorism; prostitution; selling counterfeit or stolen goods, such as credit cards, or selling pirated versions of copyrighted items, such as software and musical recordings. The portion of country's income that is tied to black economy affects the growth of country's economy. The black economy constitutes a financial leakage, as tax income from unreported earnings is not received by the government, thereby constituting a loss of revenue. In addition, as these funds rarely enter the banking system, economies are stifled because money remains hidden that otherwise could be used by banks to stimulate the economy by funding small business owners and entrepreneurs. Furthermore, black money causes the financial health of a nation to be underestimated.

It is also generated by the manipulation of accounts, there are different modes of manipulation. . The first is the crude approach of not declaring or reporting the whole of the income or the activities leading to it. Different kinds of manipulations of financial statements resulting in tax evasion and the generation of black money are:

- **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.
- **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.
- **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.

**Impact of black money:** The flow of black money can seriously affect the entire economic system, some major impacts are discussed below:

1. **Dual economy-** The increase in the amount of black money in India over a period of time lead to the perpetual growth of economic dualism which consists of *Parallel economy*(black money economy) operating side by side with the *Official* or *Reported* economy on the country. The black economy represents not less than one fifth of the aggregate economic transactions. There is also interaction between the reported and unreported activities such that it is difficult to identify black money from the white money economy. Such a *Parallel Economy* will ruin the entire economic development of the country.
2. **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.
3. **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.

4. **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.
5. **Loss of Revenue to the Government-** Black money is largely attributed to tax evasion. Its direct impact is the loss of the Government revenue. Since the Government fails to get sufficient tax revenue due to large-scale tax evasion, it is forced to resort to high taxation and deficit financing which again carry their ill-economic effects. . As it is almost impossible to estimate the amount of black money in any economy, unreported earnings cannot be included in a country's gross national product (GNP) or gross domestic product (GDP).
6. **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.
7. **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.

### Measures taken by the government to fight against Tax evasion.

The Government has taken several measures to effectively control and curb the prevalence of parallel economy and unaccounted transactions. Major steps in this regard constitute:-

- Enactment of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 w.e.f. 01/07/2015 to more effectively tackle the cases involving black money stashed abroad.
- Enactment of the Benami Transactions (Prohibition) Amendment Act, 2016 w.e.f. 01/11/2016 to effectively deal with domestic black money cases.
- Constitution of the Special Investigation Team (SIT) on Black Money in May, 2014 under Chairmanship and Vice-Chairmanship of two former Judges of Hon'ble Supreme Court. The SIT has so far submitted 6 reports to Hon'ble Supreme Court.
- Constitution of Multi-Agency Group (MAG) for coordinated and effective investigation in 'Panama paper leaks' cases and Paradise Leaks cases.
- Task Force (TF) on Shell Companies constituted under the joint chairmanship of Revenue Secretary and Secretary (Ministry of Corporate Affairs) in February, 2017. The task force has met 6 times so far.
- Linking of Aadhar with PAN has been made mandatory for filing Income Tax Returns and for applying for new PAN from 1st July 2017.
- Restriction on cash transaction of Rs. 2 lakh or more (Section 269ST of I. T. Act), no deduction under section 80G if cash donation exceeds Rs. 2000 w.e.f. 01.04.2018, restriction on donations of Rs.2000/- or more to political parties otherwise than by a bank account or through electoral bonds.
- Quoting of PAN made mandatory for all cash deposits above Rs. 50,000 and aggregating to more than Rs. 2.5 lakh for the period from 9 November to 31 December, 2016.

### 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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