CHAPTER 4

METHODS OF TAX EVASION
METHODS OF TAX EVASION

The analysis into the magnitude of evasion leads one to examine the methods through which evasion is practised by the taxpayer's. Methods of Evasion, in a way, are limitless depending upon the mental ingenuity of a taxpayer. The more Revenue comes to know about the devices, the more evaders are apt to leave those and who pursue new ones by employing their mental ingenuity. Thus there has been a hot chase between the tax evader and the tax collector for the devices. This hunt goes on both the sides ceaselessly.

4.1 Main Methods of Tax Evasion

A tax payer bent upon avoiding taxes by fraudulent means may resort to a number of devices, depending upon the impact of taxation and the prevalent economic and political conditions in the country. It may range from simple and crude to complex and ingenious methods. A significant feature of tax evasion is that new devices and techniques are evolved from time to time, in order to frustrate the Legislatures and Revenues.

All the methods of evasion, however in whatever form employed, result ultimately and fall in eight categories:

4.1.1 Omission of Income Altogether

This is achieved by:

- Omission of business receipts;
- Omission of income invested;
- Omission of gains from illegal transactions;
- Failure to keep any record etc.;

Chapter-4

- Omission of receipts from other sources;
- Omitting to report taxable income;
- Omitting to file a return of income in time, this may result either in escape from taxes altogether, or in making an inadequate assessment by the tax authorities.

4.1.2 Understatement of Income

This is accomplished by:-

- Diversion of funds;
- Falsification of records;
- Fictitious transactions in the names of dummies of benamies;
- Concealment of bank accounts;
- Non-recording of sales or recording them in lump sum at lesser amount
- Setting up of bogus firms having no real existence or showing bogus transactions;
- Conducting entire business transactions in cash thereby leaving no trace or evidence for checking the book version;
- Introducing money as loans for wife or daughter and paying interest thereon;
- Undisclosed income through the medium of employees, relatives and friends;
- Understatement in stock position;
- By suppressing documents of sales and other transactions;
- By reducing the sales, inflating the purchases, undervaluing the closing stock in the trading account in order to give a low rate of gross profit. This method is used by assesses having income from business;
By making fraudulent changes, manipulation of, and alteration in books of account;
By keeping transactions out of books of account;
Under-valuation of immovable properties for the purpose of Wealth Tax Assessment;
By intentionally not maintaining any standard form of books of accounts and thereby concealing income.²

4.1.3 Overstatement or Deduction of Expenses, Depreciation, etc.

This is done by:-

- Showing exaggerated business or other expenses;
- Charging personal expenses to business;
- Claiming fictitious losses;
- Padding of business entertainment and traveling expenses;
- Exaggerating contribution to charity;
- Other false deductions;
- By indulging in lavish and consumptive expenditure;
- Keeping incomplete accounts and claiming erroneous deductions, Categories (2) and (3) are accomplished by;
  a) Keeping double and even triple sets of account books – one for the Income Tax, another for Civil Court and the third for Private Use;
  b) Account books kept deliberately loose;
  c) Falsification of records and entries in effort to cover up their tracks.

² Supra note 110 at 61.
4.1.4 Claiming Exemptions Provided by Law which are not Actually Incurred

This is achieved by:
- Twisting facts as to come under the exemption;
- Creating false evidence as may lead to the grant of the exemption;
- Making excessive claims of exemption.

4.1.5 Deliberately Keeping Accounts Unclosed and Un-Adjusted

Tax payers keep their A/c unclosed and unadjusted:
- To manipulate the expenditure they actually head;
- To manipulate the income which they are actually earning.

4.1.6 Charging Capital Expenditure to Revenue

This is achieved by:
- Deliberately showing capital expenditure to Revenue Expenditure;
- Revenue Expenditure is comparatively relaxed by taxes.

4.1.7 Failure in ‘Tax Compliance’ by the Taxpayer

This is accomplished by:
- Deliberately failing to file tax return;
- Not filing return of old business but resorting to either change in name or to an entirely new business at the same place of shifting to some other locality in the city;
- Leaving the place altogether where the tax payer had done old business and leaving no trace to identify him subsequently;
• Deliberately filing a ‘Nil’ return or low income return from a changed place of abode;
• Filing of a fraudulent, incomplete or inaccurate return of income;
• Failure to report interest on bank deposits;
• Complete or partial failure to report the various sources of income
• Filing appeals against assessments supported by false account;

4.1.8 In Inter-Branch Transactions – National and Foreign

Whatever methods followed by a taxpayer to evade the tax, it is clear that sooner or later the money so evaded will be introduced by him into the business in the shape of either circulating or fixed capital i.e. for short and long duration.

Some of the money devices that are employed for introducing the evaded money may be enumerated as;

4.2 For Introducing Funds for Short Term

i. By post dating purchases and expenses and replenishing on the date of debit, in the book of account;

ii. By antedating sales and other receipt as advances received against later sales;

iii. By showing fictitious cash sales of the stock-in-hand and withdrawing the secret funds subsequently when the real cash sales take place;

iv. By striking cash balances periodically instead of daily, when the payments exceed money available.
v. By showing cash purchases as credit purchases in such an event the payment of purchases is made out of the secret funds. It is recorded later in the account books. When the disclosed cash balance is sufficient and the account of the bogus selling party is squared up;

vi. By purchasing raw material or stock-in-trade out of secret cash. The remaining cash must be adjusted after word;

vii. By splitting the entries artificially :- In the case of a taxpayer who maintains only a Rocker, it is open to him to credit the seller today and debit the goods purchases account not on the same day but subsequently and meanwhile use the said inflated cash balance;

viii. By omitting or postponing entry of cash deposited in the book by necessary manipulations in the cash book;

ix. By post-dating withdrawals and antedating receipts in Bank account;

x. By inflating the credit side total and deflating debit side while carrying it over to the next page in the cash book;

xi. By utilizing the services of brokers etc. for speculative or fictitious transactions;

4.3 For Introducing Funds for Long Term

I. By claiming large agricultural income or by sale of fictitious agricultural produce in collusion with some grain merchant;

II. By claiming gifts or loans from relatives;

III. By advancing secret money as loan in a fictitious name or benami to a well known party, who is not liable to income tax and simultaneously, introducing money in own account books in the shape of a genuine loan from that party;

IV. By undervaluing the stock-in-hand;
V. By opening secret fixed deposit or call deposit account with Banks in different names;

VI. By creating a charitable Trust or making anonymous donations to it and thereafter taking loans from it for investment in business;

VII. By collusively inflating the sale price or reducing the purchase price

VIII. By claiming windfalls in gambling or betting or horse races and the like;

IX. By giving ‘havala loans’ to the different parties.

Besides the above, there are special heads wherein evasion is too common. These are discernible in cash Credit Transactions, Charities, Benami Transactions and even in foreign income receipts as discussed below:

4.4 Cash Credits:-

Here cash is credited or say money is introduced in the name of taxpayer himself, his relations, benamidars, and third parties or even in fictitious names in the following forms;

a) Introducing and withdrawing the cash in fictitious names or in the names of third parties in the cash book without taking the same to ledger at all;

b) Crediting cash in the names of non-taxpayers and squaring up their accounts in the ledger before the end of the year;

c) By showing bogus advances received from constituents when cash is needed by an ‘Arhatia’ and debiting the same subsequently;

d) By showing a bogus cash or credit sale of gold or silver in collusion with same bullion merchant;
Chapter-4

e) By inserting spurious compensatory entries of debits and credits in the account of either a bank or a big party where the number of transactions is large without disturbing the final balance;
f) By crediting cash in the Head Office books with bogus cash receipt when cash is urgently needed by the taxpayer who has a branch or associate concern.

4.5 Charities:-

The charities paid and income revived by charitable institutions have been exempt on grounds of public policy under all tax laws of the world at all times in one form or the other. The common devices of tax evasion practised through or under the guise of 'charities' are:

i. By utilizing the funds collected in the market at customary rates from the sellers by way of 'Dharmada' 'Gaushala' 'Hanumanji' etc. and:-
   (a) Not paying the same to the charity or charitable institutions, or
   (b) Claiming exemption without paying their own contribution, or
   (c) Paying it after a number of years, or
   (d) Claiming exemption for doing business on their behalf without any authority;

ii. By claiming exemption from charitable fund contributed voluntarily on the one hand and taking loans out of these funds for own business;
iii. By claiming exemption on bogus charitable expenditure in foreign countries;
iv. By becoming an office bearer of the trust and doing business on its behalf, pocketing profits and debiting losses to it, as the case may be;
v. By claiming exemption for donations to such educational institutions whose main object is other than educational purpose;
vi. By not maintaining regular and complete accounts by the charitable institutions.

4.6 Benami Transactions:

These transactions are in the nature of a hypothetical deal in the name of unreal, imaginary or nonexistence person. The purpose of such deals can obviously be to put funds in secret trust with a view to avoid a creditor, or reduce tax burden.

"In a Benami Transaction, the benaminder absolutely disappears from the title. The contract is really between ‘A’ and ‘C’ though one or other of them might have assumed the name of ‘B’. In such cases rule of evidence is not admissible to show that a person who appears on the face of a written contract to be personally a contracting party is not really the contracting party and therefore is not liable, as such upon the contract has no application and is quite wide in the case. Court is not precluded from enquiring into the real nature of the transaction between them.

3 The TEC and Prof. Kaldor both have emphasized that evasion through benami transactions is widely prevalent.
Benami Transactions fall down two heads:-

a) those are relating to movable property

b) those are relating to immovable property

4.6.1 Relating to Movable Property

The assets which are kept in Benami are usually cash, fixed deposits and shares in public limited companies. Transactions in these are either under the name of family members, trusted employees, God and idols or fictitious names with necessary permutations.

4.6.2 Relating to Immovable Property

Immovable properties are usually held benami in the name of family members only and not of outsiders. They cannot be held in fictitious names as the title deeds in regard to them are registered documents. Shelter under such transactions is taken by a taxpayer either prior to assessment or at the assessment stage or lastly at the stage of collection of the tax whichever and whenever it suits him.

4.6.3 Foreign Income

Tax evasion and multiple taxes have been blended in international tax relations from the very inception. Some countries either do not levy income tax on foreign income or levy it at nominal rates. In cases where such income is taxed, the problem of tax evasion is dealt within their respective international tax agreements. In our country this is dealt with either by:

(a) The tax status of alien for income tax purpose and the levy of tax on their income either directly or through their agent.

(b) By taxing the foreign holdings and operation of our own residents and national having assets and income abroad.
As regards the first, formally the problem presented much difficulty due to the proximity of Indian states. Fortunately with their integration in the Indian Union, the largest unitary loophole of tax evasion by foreigners or even by Indian nationals of shifting to Indian States and of their smuggling profits is effectively plugged. The problem regard to the income of the aliens, however, does not present much difficulty because there is documentary evidence to check their import and exports and currency regulations and there to denote their remittances.

It is the second category of income, given above, that presents the real problem, it is more so in the case of those who go abroad solely with the object of withdrawing their wealth and income away from the attention and reach of the tax authorities of their own country. Such persons also take advantage of the administrative inefficiency in this respect in our country, in regard to the supply of information, from those countries with whom India has entered into tax agreements, bearing on trade profits, their tax incidence and the collection of tax thereon.

4 Vide pamphlet "The Effects of Taxation on Foreign Trade and Investment" by united Nation, p. 53.