

Accounting essays - tax evasion popularity



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Tax evasion is a national pastime that is growing ever more popular.

Nick Montague defines taxation as the means by which a civilised society performs that sometimes-uncivil task of taking money from one group in order to give it to another. This definition highlights an important purpose served by taxes. As it is already known, that taxes are a fiscal policy instrument used by the government to achieve broad macroeconomic goals. Generally speaking, taxes are a means used by the government to provide its residents with amenities and facilities like hospitals, safety and education. Thus, any shortage in revenue means that the people wouldn't be able to avail the benefits. From this perspective, as law-abiding citizens, it is imperative for people and corporations to pay taxes. Despite, this common knowledge, tax evasion is prevalent in the society, even worse, individuals and corporations go through great length to devise tactics of evading taxes. The main reason why individuals and corporations engage in tax evasion activities is that it increases the level of disposable income and profits respectively.

Tax evasion is defined as the failure to meet tax liabilities by illegal action, such as not declaring income. Needless to say tax evasion is a criminal offence. Prior to starting a discussion on tax evasion it would be essential to briefly highlight that in the UK, tax administration is divided between two departments of state, the Inland Revenue and Customs and Excise. The Inland Revenue administers Income Tax, Corporation Tax (on company profits), Capital Gains Tax, petroleum taxation (relating to oil exploration and extraction in the UK and surrounding waters) and Stamp Duties (e. g. on land

transactions). The levying of VAT, tax on gambling and customs and excise duties is the responsibility of the Customs and Excise Department. In addition to these two revenue departments, local authorities levy the new “Community Charge” (poll tax) and the Department of Social Security is responsible for national insurance contributions. Often tax evasion is confused with tax avoidance. According to Denis Healey, former UK Chancellor of the Exchequer: *The difference between tax avoidance and tax evasion is the hickness of a prison wall.*

This paper will aim to present an in depth analysis of why individuals/companies engage in tax evasion. It will also analyse whether the self-assessment system encourages or discourages tax evasion. And, finally the paper will conclude by evaluating the efforts made by the government to combat tax evasion.

It must be highlighted that taxation is used for many other purposes than raising revenue. Some writers have argued that the purpose of taxation can also be seen as an instrument of economic and social policy to influence behaviour. In other words, it can therefore be the intention of the tax that it is avoided. For example, it has been argued that higher taxes on alcoholic drinks (Cook and Moore, 1994, Irving and Sims, 1993) and tobacco (Viscusi, 1994) would reduce the consumption of those products and lead to improvements in the health of the population. In the UK, Inland Revenue has, traditionally, had a deferential approach towards income. With the introduction of self-assessment system from 1996/7 there has been a movement away from that stance in recent years.

Evasion of taxes

Tax evasion analysis typically assumes that evasion involves individual taxpayers responding to some given policies. However, evading taxes could require the collaboration of at least two taxpayers. Detection depends on the costly avoidance activities of both transacting partners. An increase in sanctions leads to a direct increase in the expected cost of a transaction in the illegal sector, but it may also increase the incentive for the partners to cooperate in avoiding detection. The total cost of transacting in the illegal sector can fall, and tax evasion may increase. Most countries tend to follow a progressive taxation system, more the income more tax would be levied. From this perspective it might appear that it is unfair for the government to levy more taxes on individuals/companies for generating more income for the economy and themselves. However, it must be noted that in addition to boosting the economy, it is government's responsibility to think about economic development and welfare of everyone. They have to balance economic growth and economic development. This concept has been debated and the viewpoint of unfairness of the tax system has led parties to evade them, in other words, discovering ways and means of not paying the dues to the government.

Research studies conducted to find out the extent of the UK black market economy indicate that it has increased. The number of unincorporated business accounts and company accounts received annually by the Inland Revenue have increased from 2m to 2.25 million and from under 600,000 to nearly 700,000 respectively between 1984/85 and 1988/89 alone (Inland Revenue, 131st Annual Report, 1989).

Surveys conducted by Brown, Levin, Rosa and Ulph (1984) concluded that about 5% of workers in Britain held two or more jobs and that the income tax lost from “second job” tax evasion probably amounted to around 1.1% of income tax receipts or 0.3% of national income. Their survey excluded evasion by persons who have only one job (which includes large numbers of the self-employed), Capital Gains Tax and VAT evasion, and evasion of tax by companies.

In response to deterring people from engaging in tax evasion, Inland Revenue introduced the self-assessment system, very simply, is a way of working out and paying tax. As required by the Inland Revenue (IR), self-employed people, company directors, minister of religion are required to fill up the self-assessment form at the end of every tax year. Supporting documents are provided to make it easier for the people to fill up the form and submit it. With the improvement in technology, IR offers business services for employers, individuals, contractors, companies and agents, option to fill up the forms online, which ensures automatic tax calculation, quicker repayment, and online acknowledgement which is safe and secure. Thus, IR is removing any possibility of hassle and introducing the convenience factor to make people comply with the tax requirements.

Many initiatives have been taken to combat tax evasion. In the UK, for instance, attempts are being made to increase co-operation between the Inland Revenue and Customs and Excise. This has involved joint policy consultation and improvements in exchanging information. One particular initiative has been to set up a joint unit to provide a single source of

information and advice for businesses facing financial difficulties and who wish to enter into voluntary arrangements.

A step in this direction has been that of the European Union Savings Directive. It aims to counter cross border tax evasion by collecting and exchanging information about foreign resident individuals receiving savings income outside their resident state. The Government believes that exchange of information between tax authorities is the best way to ensure that individuals pay the right amount of tax on cross-border income from savings. The Government therefore supports the Directive, the ultimate aim of which is effective taxation by exchange of information.

The above is a major step towards decreasing evasion of tax. The above highlights the importance of transparency in accounts and benefits of sharing information across the countries. Introducing VAT was also an attempt towards tax harmonisation and making it more difficult for companies to evade tax. The recent scandals of Enron and Parmalat have highlighted the importance of having transparency.

VAT was introduced to combat cheating, smuggling and minimise tax evasion. The same principle was behind harmonising VAT in the EU – one of the advantages was the limited possibility for fraud in the supply chain. However, it was found that VAT system was used to systematically defraud tax administrations. Despite the efforts made to minimise tax evasion, fraudsters have detected the inherent weaknesses that exist in the controls exercised and have been exploiting those weaknesses for their own financial

gain. It was found that with the introduction of the VAT and intrastate system, compliance costs had been reduced by approximately two-thirds.

It is a known fact that taxes in any form, whether direct or indirect, is a source of revenue for the government. Government tends to use tax money either from individuals or businesses to fund various country development projects and work towards providing a better living condition to its citizens. While this is an idealistic picture about the motive of the government, in reality, people tend to evade taxes for many reasons. It has been a subject of constant debate to find out the best measure or basis for taxation and the latest taxation system for indirect tax is the consumption base. It has been argued that it would more suitable to charge taxes based on the consumption made. VAT is the tax system which follows the above mentioned tax base. The purpose was not only to curb tax evasion but also be an efficient model for taxation. The European model of the VAT system has been applauded and adopted by many countries as it is a common belief that VAT system based on the European model provides least possible way of evading tax because it has a system of invoicing which helps in establishing an audit trail. Authors like Crossen have listed the various advantages associated with the following the VAT system.

Amongst other things, to ensure that tax evasion is minimised, the government needs to look into improving tax compliance. The following pointers were suggested to improve tax compliance:

- Training employees so that they have an understanding of the entire system of tax administration.

- There should be better publicity about how the tax system works, the benefits derived from complying with the tax system and how the IRS deals with abuses of the system.
- Making the procedure automatic to eliminate any possibility of reducing unscrupulous practice.
- Simplification and fairness is required because continuous changes and complexity in tax law have a negative effect on compliance. Also the law should be applied consistently.
- Organisational structure should be arranged so that taxpayers' issues or problems can be resolved through a single point of contact. There is also a need for specialisation so that expertise of particular industries may be developed to improve dealings with taxpayers and there should be better customer service.
- Better and increased cooperation with state, local and foreign governments is required to tackle the problem.
- More assistance should be provided for small businesses to help them comply and increase their awareness levels.
- Coordination of compliance efforts would be required and incentives must be provided when people comply and penalties must be imposed when people evade taxes. A more organised approach to influence legislation
- A sense of responsibility must be inculcated in the people towards taxes. It is easier to get something done when people take responsibility towards it.

Inland Revenue faces problems to tackle the problem due to shortage in trained tax inspectors, reflecting the department's more general difficulty in recruiting and retaining staff. Research studies conducted in this area have indicated that people tend to move towards the private sector where pay and conditions are perceived to be better. The department believes that the situation can only improve when there is more political commitment in Government to tackling evasion, supported by the allocation of the necessary resources to pay inspectors competitive salaries.

Conclusion

In summary it can be said that though steps have been taken to minimise tax evasion yet it exists and continues to exist. Despite the efforts made towards curbing it, there will always be elements in the society who would come up with mechanisms to defeat the system. The challenge therefore lies in keeping up the efforts to minimise tax evasion. As individuals taxes must be paid accurately and as corporations ethical business practices would ensure that illegal activities like tax evasion could be kept at bay. Thus in conclusion it can be said that even though tax evasion appears to be a national pastime that is growing ever popular, measures are being devised to combat it.

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