



ETHICS AND FINANCIAL ENGINEERING



By

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“There is no such thing as a good tax” said Winston Churchill but does it justify making tax evasion into a national sport? Tax planning, tax evasion, tax avoidance, tax flight, tax dodgers and tax havens have become common expressions to describe various complex situations in our national sport. The players are the government, tax administrators, finance professionals, lawyers, bankers, brokers, touts and commission agents. It is a lucrative sport, played non-stop 24 x 7, though it weakens the cardinal virtues of social justice and efficiency. Sometimes we are compelled to pause and think, is there any ethics in this complex game?

The lead player undoubtedly is the government and its myriad functionaries, churning out fresh new taxes, increasing tax dosage of existing levies, and fabricating amnesty schemes for artful tax dodgers. The government is the aggressive player, making its own rules and regulations, targeting and hunting a few, while asking the vast majority (non tax payers) to enjoy the spectacle. For this service the spectators are rewarded with doles, exemptions, subsidies, and concessions. Ethics is the first casualty in this discriminatory game.

The game of hide and seek starts, as the hunted try to blend and merge amongst the crowd of tax free spectators. Helping them are numerous professionals from the fields of law, finance, trading and banking, Avoid, evade, dodge or hide, the choice is wide. For a hefty fee the game can be played locally or can be shifted to exotic locales like Monaco, Switzerland, Isle of Man, Mauritius, Liechtenstein and many more spread across different continents. The name of the game is “stash the loot here or there.” Where is the place for ethics, morality and scruples?

Yet, a magnificent charade is created to instill public confidence. Tax administrators are often exhorted and lectured upon by politicians to be fair, transparent, impartial and accountable. Ethical aspects of tax administration revolve around these qualities, and these often cause great dilemma in the tax officials. How does one deal with selective application of the law, inconsistency in applying the law, safety of exercising discretionary powers and lack of autonomy? To overcome these problems, the government has enacted the Citizens Charter, to bring about ethical conduct among tax administrators. The Citizens Charter prescribes uniform guidelines and timelines to be observed and adhered to while discharging official duties. However, sadly, neither the taxpayers nor the tax administrators pay attention to this Charter. While auditing and inspecting, if the timelines prescribed in the Citizens Charter is kept as a yardstick of performance, much relief would accrue to the taxpayers, and efficiency would improve among the tax administrators.

Enforcement system includes a continuous education about tax obligations that creates awareness of responsibility among tax payers. On this front there is a perceptible change that can be noticed. Both, Direct and Indirect taxes regularly undertake sustained publicity in the print and visual media informing the public about tax obligations. If the government could make it a matter of compulsory study in schools, it would make future citizens of this country, tax conscious and responsible.

As a further safeguard, the need to have a well defined tax appeals hierarchy is of paramount importance. Though there is a system in place, it is malfunctioning, inasmuch as; there is a scarcity of knowledgeable manpower, trained manpower and impartial conduct of officers. There is a pronounced propensity to have a revenue bias in order to protect their careers and reputation. The officers have neither judicial protection like that for judges, nor is there a shield for protection from vindictiveness from the department. If this issue is sorted out, the tax payers and tax administrators

can make a more positive contribution for fostering overall ethical behavior on the tax front.

Tax compliance is a complex and multidimensional issue involving several external players like lawyers, accountants and bankers. The general tendency of human beings everywhere is to try to pay as little tax as possible. To this end tax planning is an exercise popularly resorted to. Depending on the professional advice given, tax planning can end up as tax avoidance, tax evasion and tax fraud. Tax avoidance involves intelligent circumvention of laws or trying to postpone tax liability. Prominent players in the game of tax avoidance are film personalities, sports persons, and politicians. The most prominent case to make headlines recently on this score is that of Mr. Donald Trump, President designate of U.S.A. He is alleged to have avoided paying millions of dollars in taxable income on forgiven debts. Very often ambiguities and lacunae are exploited for illicitly gaining tax advantages that were not envisaged by legislators. An unlawful act done to avoid tax liability results in tax evasion, it is a criminal act inviting imprisonment or penalty or both. Deni Healey, a former British Chancellor, says “The difference between tax avoidance and tax evasion is the thickness of a prison wall.”

Tax evasion involves fabrication of records, misrepresentation, falsification of data and suppression of material facts. The purpose of tax planning is to lessen tax burden by taking legitimate advantage of tax exemptions, deductions, concessions, rebates and allowances that are legally permitted. For fostering an ethical climate the government needs to focus and advertise the legitimate concessions that are available to the tax payer. The present system encourages seeking professional help from tax practitioners, and they may suggest adopting colorable devices. To identify if a transaction is employing a colorable device, tax administrators are legally empowered to go behind the transaction to examine the ‘substance’ and not only the ‘form’. The Supreme Court in *M/s Mc Dowell and Co Ltd vs Commercial Tax Officer 1985(154 ITR 148 SC)* has held that tax planning to be legitimate it must be within the legal framework and colorable devices cannot be a part of tax planning. The government therefore needs to educate the tax payer as to what is ethical tax planning, otherwise innocent people may get entangled in tax frauds. Two forms of tax evasion, transfer mispricing within multinational corporations and falsified invoicing between apparently unrelated companies takes a heavy toll on the revenues of the developing world. Tax flight occurs when there is relocation of business in order to save taxes, for example by making use of offshore tax havens. “Tax havens aren’t just about tax. They are about escape – escape from criminal laws, escape from creditors, escape from tax, escape from prudent

financial regulation – above all escape from democratic scrutiny and accountability”(Nick Shaxson, *Treasure Islands: Tax havens and the men who stole the world*) Whether it is tax avoidance, tax evasion, or tax flight, their effects are similar, namely, a reduction of revenue yields and are based on the same aim i.e. to reduce tax burden. Tax avoidance and evasion serve as important motives for capital flight. Capital flight is the unrecorded transfer of assets from one country to another. Mr. Donald Trump has started focusing on Capital Flight, “Any business that leaves our country for another country, fires its employees, builds a new factory or plant in the other country, and then thinks it will sell its products back into the US without retribution or consequence, is wrong! There will be a tax on our soon to be strong border of 35% for these companies wanting to sell their products back across the border.” Many global banks facilitate tax dodging by moving funds of multinationals across countries. Most tax evasion cases ultimately end up as tax frauds

Tax frauds are aggravated forms of misrepresentation, falsification and withholding of information. There is a clear element of cheating involved in a case of tax fraud. Ultimately, tax dodged funds are utilized for criminal activities, market rigging, insider trading, payment of secret political donations, kickbacks and terror funding. Unfortunately, this provides a lucrative operational base for lawyers, finance professionals and bankers to exploit legislative gaps and fragmented regulation. This is where awareness of ethical values can play a pivotal role in curtailing tax evasions, tax frauds, and tax flights.

Another aspect, very peculiar to India, that needs to be considered is, the eager willingness of trade & industry to get entangled in tax litigation, which is now perceived as a very effective route to postpone tax liability indefinitely. The phenomenal delay in disposal of cases at all levels is sought to be regarded as the best tax avoidance measure. Many assesses voluntarily seek issuance of a show cause notice in order to set up a legal tax blockade for at least a decade. Ethical considerations do not arise to prick the conscience. Start a legal proceeding and comfortably forget about it.

R.W. Mc Gee in his unique work “Opinions on the Ethics of Tax Evasion” questions “Why do people evade paying taxes? This is the central question addressed in this volume by Robert McGee and a multidisciplinary group of contributors from around the world. Applying insights from economics, public finance, political science, law, philosophy, theology and sociology, the authors consider the complex motivations for not paying taxes and the conditions under which this behavior might be rationalized. Applying theoretical approaches as well as empirical research, *The Ethics of Tax*

Evasion considers three general arguments for tax evasion: (1) in cases where the government is corrupt or engaged in human rights abuses; (2) where citizens claim inability to pay, unfairness in the tax system, paying for things that do not benefit the taxpayer, excessively high tax rates, or where taxes are used to support an unpopular war; and (3) through philosophical, moral, or religious opposition. The authors further explore these issues by asking whether attitudes toward tax evasion differ by country or other demographic variables such as gender, age, ethnicity, income level, marital status, education or religion. The result is a multi-faceted analysis of tax evasion in cultural and institutional context, and, more generally, a study in ethical dilemmas and rational decision making.

A few philosophical studies concluded that tax evasion is never justified. The literature of the Baha'i religion strictly prohibits tax evasion, the main argument being that individuals have a duty to obey the laws of the country in which they live. A study of the Mormon religious literature reached the same conclusion and for the same reason. Two philosophical studies of the ethics of tax evasion have been written from a Jewish perspective, both concluding that tax evasion is never, or almost never, ethical according to the Jewish literature. A third Jewish study, both philosophical and empirical in nature, found that although the Jewish literature was firmly against tax evasion on ethical grounds, the Jews who were surveyed were more flexible on the issue. An empirical study of Mormon views found that many Mormons were also more flexible on the issue than their religious literature would suggest.

Several philosophical studies concluded that tax evasion could be ethical in certain situations. Robert Pennock concluded that tax evasion was ethical in cases where the country collecting the taxes was engaged in an unjust war. Alfonso Morales regarded a man's duty to feed his family as more important than feeding the state's coffers. Gregory M.A. Gronbacher and D. Eric Schansberg concluded that the Catholic religious literature permits tax evasion in certain situations, a view that concurs with the Crowe study. Gronbacher's study of the Christian literature reached the same conclusion. Two Islamic scholars examined their religious literature and reported that Muslims have a duty to God to contribute to the poor. They did not address the issue of the relationship of the individual to the state and the corresponding duty to pay taxes. A survey of the Islamic business ethics literature by a non Muslim scholar found that tax evasion can be justified in cases where the effect of the tax is to increase prices or where the tax is on income."

In "The Ethics of Tax Evasion" by Robert W. Mc Gee, Author Sanjay Bose in the chapter 'Hindu Ethical Considerations in Relation to Tax Evasion' writes " The subject of Hindu ethics, and literature pertaining to it, stretches through 3000 years of history and represents a vast array of research and analysis by both Indian and Western scholars. Yet, discerning a clear set of ethical principles based on definitional and methodological clarity remains elusive.....It is at times, difficult to distinguish the lines separating philosophy, ethics, and religion.....Much of Hindu ethics is therefore interpretative, a logical extension of established, but dynamic principles, possessing enough characteristics of a flexibility to adapt to the change of age."

To conclude, ethical taxation will guide future tax policies, the way taxes are imposed and taxes are paid. This will lead to disintegration of tax evasion and tax frauds. The sagacious words of R. Buckminster Fuller "You never change the existing reality by fighting it. Instead, create a new model that makes the old one obsolete."

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