

FRAUD AND EVASION CONTROL

NBR must first consider whether the powers they have are sufficient to cope with VAT fraud and tacking evasion. When fraud is suspected or discovered in VAT it is nearly always necessary to remove books, invoices, correspondences and subsidiary records from the tax payers premises. If this is not practical then it is necessary to have the power to make copies of the tax payers records.

Rules 43 and 47 of Value Added Tax Rule, 1991 give NBR and the Government respectively the power "to summon and examine files and records" but this seems dangerously pedantic in the context of fraud. Incriminating evidence can so easily get lost in transit, it is often essential to remove documents and records as soon as fraud is suspected. NBR must be sure that Revenue Officers have the power to remove and/or copy books and records. Evidence obtained illegally will not be accepted in any court of law. It is better not to assume that the power is there in the law or rule but it is necessary to make sure before exercising save otherwise some very embarrassing situations may arise. When a fraud or suspected fraud case is to be transferred to the Investigation Directorate, all the documents and records should be photocopied and the photocopies sent to the Directorate with the Case Summary Form (F.C./01). The case officer who was responsible for the removal of the records should whenever possible retain the originals until required for court presentation. However one should remember that copying facilities are not always available at out-field offices and that original documents must be released to investigation staff and a detailed receipt obtained (Inventory Sheet Attached to Form F.C./01). A word of warning is appropriate here, when handing over tax payers records to investigation staff, that staff should be treated as an outside agency even if members are known personally. Nothing must be taken on trust, loss of a Tax Payers records is a very serious matter and it is the official who removed the records from the Trader's premises who will be responsible in Law. Form F.C./01 serves as a Transfer slip; case summary and receipt form. It should be prepared in triplicate, the top copy will be the investigation staff copy the duplicate will be retained by the Superintendent who will send the triplicate to the Head of Division. Obviously the Tax payer will ask for a receipt on the removal of his records and this must be given. However uplifting officials must show maximum care when issuing an official receipt and they must ensure documents, books etc., are securely and carefully stored while in official custody. There will be two types of fraud investigation, the local carried out by Circle Staff and the Directorate Investigation. It will be necessary to indentify these on the Computer from monitoring purposes through the medium of the location code. The Computer will have two direct inputs which will identify tax payers under investigation (i) the visit code and

(ii) revenue rating compliance code . The location code will complete the picture by indentifying who is carrying out the investigation. It will be easy to remove the tax payers under investigation from the normal control visit selection routine. Tax payers will not be returned to the normal control visit selection programme until a notification is received from the Head of Division on From F.C./03. This Form will also show the outcome of the investigation in terms of underpaid Tax recovered and financial penalty imposed. It will be necessary to produce reports showing Annual Fraud Detection achievement by the VAT officies. When a fraud case is investigated in the first instance by the Investigation Department staff the above procedures are to be followed. This can be achieved by liaison with the Circle Superintendent and Head of Division.

Identification No.

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Circle Name
 Circle Ref. No.
 Division Code
 Division Ref. No.

INVENTORY OF DOCUMENTS – RECORDS

Item No.	Description (e.g. Sales Day Book; Account Current, Purchase Invs. No.)
1	
2	
3	
4	
5	
6	
7	
8	
9	
10	
11	
12	
13	
14	
15	
16	
17	
18	
19	
20	

Received as above lines to

..... Investigating Officer

Date

& Investigation/ Audit/ Inspection

Directorate of Intelligence

INVESTIGATION CASE

Name :-

Circle Name

Address :-

Circle Ref. No.

Division Code

Division Ref. No.

Indentification No.

Activity Code

Location Code

Suspect Period From to

Est. Tax Loss (T/000) Taka

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Summary of Case :-

..... Date

..... Inspector

B. I. N.

..... Date

..... Superintendent

Tear off

Superintendent Circle Circle Ref. No.
.....

Case Accepted* Investigation Ref. No
.....

Case Rejected* Papers as per Inventory Sheet returned herewith.

Reason for Rejection :-

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.....
.....

..... Date Director

F.C./03 To Collectorate Computer Cell

..... Date Initials

Form F.C./03

INVESTIGATION CASE

Name : Circle Name
Circle Ref. No.
Address : Division Code
Division Ref. No.
Date Advised

Identification No.

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Activity Code

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Location Code

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The Computer Cell.

This case has been finalised. The Taxpayer should be returned to normal control visit selection with a scale of visiting set at :-

- (a) No chance in visiting scale: *
 - (b) Changed to per year. *
- (* Delete as appropriate)

Outcome of case :-

Tax Recoverable(Taka/000's)

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Financial Penalty Imposed(Taka/000's)

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..... Date Head of
Division.

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Division

Sir/Madam,

Input to Computer on

Date For
Commissioner

Data Processor No.

.....

COMBATTING EVASION

A sound knowledge of the mechanism of evasion is essential if any policy for fighting evasion is to be devised. Evasion necessarily depends on the opportunity of evasion and, for the VAT, such an opportunity may be both a matter of discovery and planning. Planned evasion demands on the one hand good conversance with the VAT laws, rules and current practice together with the loopholes therein, and the willingness and the courage to capitalise on such loopholes. Planned evasion is more possible for irregular VAT units than the regular established units. Unplanned evasion is the result of the units concern for reducing tax liability. But any opportunity of evasion, if it exists at all, has to be discovered by a competent person. Discovery of an opportunity may come from different sources. But in many cases where no scope of evasion is apparent, the VAT officer himself may come up with a novel plan. Usually this will be an evasion of a highly technical nature and may require stretching the legitimate discretionary authority vested in an officer. In the tax arena, officers who are capable of finding out loopholes in a seemingly 'hopeless case' command special respect from the clients.

Modes of Evasion

Choice of a mode of evasion is a limited domain. In reality a VAT unit does not have much discretion in choosing a mode of evasion in respect of his goods. Any person who is conversant with the VAT laws and practice is aware that the opportunity of evasion related to an item is usually situational and hence, rather invariable. Opportunity available with one item cannot be at will used for another item right away. Suitable opportunity is rather item specific and indeed depends on a large number of diverse factors such as the

physical characters of the item, the intensity of legal enforcement prevailing at the time of clearance and manageability of the relevant officers and also visibility of the evasion mechanism.

It may be noted that popularity of a particular method of evasion differs with groups of commodities, and also between different stations. Such differences arise because of peculiarities of the local system of accountability, risk-taking attitude of the people involved, extent of physical surveillance, formal encoding of rules of conduct and procedural matters and the quality of record maintenance. Technological innovation also provides different opportunities of evasion.

It will transpire from the detail account of the modes of evasion that any proper investigation of a detected or suspected case and even general auditing will demand on the part of inquiry-officer or the auditor profound specialised knowledge that transcends mere common sense. Unless this condition is fulfilled, it can not be expected that any inquiry, investigation or audit by the most honest and sincere officer will meet with any fruitful discovery.

Undervaluation

Undervaluation is the most infamous way of evasion. Here the unit declares a lower price than the actual price. This may again be done in two ways. Usually the taxpayer gets into understanding with the receiver of goods and a lower price is declared in the documents. The taxpayer may decide to totally ignore his counterpart if he is daring enough to forge documents and replace the genuine ones.

Underassessment

The most prevalent form of co-operation by the VAT office is the underassessment of the goods. Underappraisal usually implies hiding of actual price of the commodity and accepting the declared price as the assessable value. In practice, the most prevalent principle of assessment for the purpose of assessment is the "uniformity in taxation" in respect of the comparably similar commodities produced within a narrow range of time.

Misdeclaration of Quantity

Misdeclaration of quantity is resorted to whenever there is little scope of under valuation and where counting or measurement of quantity is a prohibitively problematic task. The advantage is that (i) there is little scope of detection from documentary audit or scrutiny and so, (ii) once the

consignment is cleared out there is virtually no way to establish that an evasion had been effected. Misdeclaration of quantity is a favourite form of evasion. Miscalculation, may also take place. Straightforward error of calculation either in calculating the assessable value or the tax liability may be restored to by the taxpayer. Another way to evade tax liability may through forging of payment receipts(know as *treasury challan*) for clearance.

Involving Officers in the Evasion Process

To involve or Not

After having decided to evade, the immediate problem for the taxpayer is to decide whether the co-operation of the relevant officers will be unavoidable in effecting an evasion plan or not. Involvement of an officer will have cost implication for him, and so it is not necessary that he will approach the concerned officer for co-operation in all cases of evasion.

Who are to be involved

Involvement of senior officers depends on the distribution of legal authority and also on assessment of the risk involved. In matters where a senior officer is the authority for approving such a case, his involvement is unavoidable.

Why negotiation ?

The process of involving the officer in the evasion phenomenon includes negotiation between the taxpayer and the officers. Such negotiation demands open communication between the involved officers and the taxpayer. Communication may be direct or indirect.

Monetary Transaction

The amount of money that has to be paid to the officer depends on many factors like the amount of risk involved and demand pattern of the officer. Many officers are there who try to exploit the taxpayers if they are new in the evasion process. Many are there who are rigorous in calculation of the amount of benefit they are offering the taxpayer in exchange for bribe. They calculate their entitlement based on the differential amount. Problem arises when the amount of benefit accruing to the taxpayer is not clear or negligible.

Attitude and Motives

Why people evade taxes? Much of the answer lies in the definition of tax itself. A tax is a compulsory contribution to government made without reference to a particular benefit received by the tax-payer. The absence of a

perceived direct benefit causes taxation to be regarded as burdensome in a way that prices, paid in exchange for goods and services, are not. While the essential role of the state in providing certain benefits and services are recognised, people often fail to establish a connection with the tax they pay to the government and the services rendered by the government. Absence of this linkage between the state's service and the charges payable to it, which has been termed as fiscal connection encourages people to rationally seek reduction of personal liability of taxes while wishing that the government's beneficent role is maintained. Similarly many people think that paying taxes to government is a wastage of money. Tax non-compliance is just one of the many forms of peoples behaviour flouting government as an institution.

Different Factors

While the fiscal psychological model purports to explain evasion in terms of peoples attitude and motives, the economic model considers some deterrent factors as the crucial determinate of attempts at evasion. The economic model assumes that people are rational being whose only objectives are maximisation of utility from evasion. Evasion provides utility by way of extra income or saving of expenditure subject to certain deterrent elements. Utility from any attempt at evasion is uncertain because there is the chance of detection and detection may lead to punishment which may plausibly be construed as a cost of evasion. It has been argued that deterrent theory of punishment is special version of the general economic principles that raising the price of something will reduce the amount purchased.

Administrative corruption

Further realism was infused into the tax evasion model by incorporating the role of venal officers in effecting evasion. Thus, bribe paid to the corrupt tax official was considered as a cost to the evader which reduced the net gain from evasion. It was also suggested that anti-corruption policy could be strengthened to increase the expected cost of accepting bribe, which would cause the tax officials ask for higher unit bribe that would discourage evasion. While instrumentality of administrative corruption was not altogether ignored, obviously, evasion was still viewed as a problem of a taxpayer non-compliance and a public employee perspective was lacking. It may be recalled that the problem of the evasion of VAT has been considered more as a problem of corruption by the officials than as a tax-payer non-compliance.

A Model of VAT Evasion

Evasion may be on two counts: undervaluation of goods and services, and underreporting of quantity. From this premise we can write the following equation which is good for expressing evasion relating it to the two basic causative factors:

$$E=(V-v)t+V(Q-q)t$$

where, v = Assessable value of the goods as declared by the taxpayer

V = Normal value

Q = Quantity actually removed

q = Quantity reported as removed

t = tax rate.

Costs of evasion may include at least two major elements. First, the taxpayer may have to purchase co-operation of the officers in the act of evasion. In such a case he may have to give as bribe share of the evaded amount to the relevant officer. Secondly, he may have to minimise risk by spreading money among some potentially threatening agencies or persons who may be directly involved with law enforcement or in a position to leak out the information which might call for intervention by other agencies.

Policy Implications

The principal policy implications that are evident on interpretation of the model are :

- (i) Constant surveillance (physical and paper work) is necessary ;
- (ii) Discretion in the fixation of assessable value should be abolished.
- (iii) Evasion would be lower with higher rate of penalty.

However, legal provisions to combat evasion are to be applied by VAT officials and their attitude is very important in order to curb evasion successfully.

Corruption¹ is a cause (or an effect ?) of evasion. The following simple framework provides a useful tool to both identify causes of corruption as well as combat corruption:

$$C = M + D - A - S$$

Where,

C – corruption, M – monopoly, D – discretion, A – accountability and
S – public sector salaries.

Corruption thrives where there is discretion and monopoly, accountability is weak and public servants are poorly paid. The main causes of corruption are also — (a) nature of the regulatory environment, (b) the lack of transparency in government, (c) the influence of powerful business interests, (d) low salaries for public servants, (e)

weaknesses in the legal framework, (f) the self-sustaining cycle of corruption, etc. One view of corruption is that it represents a disguised form of taxation, an earmarked tax, as only the actual users of services need to pay.

Frustration, including annoyance with the compliance costs, may tempt a trader to evade the VAT. Straightforward greed may also tempt him. All commentators describe the theoretical self-checking mechanism of VAT and all go on to elaborate how this does not work. Estimates of VAT evasion range from 2–4 percent of revenue forgone (the United Kingdom) to 40 percent (Italy).² However, there may be frustrations within the VAT administration as well.

In Bangladesh the main problems experienced by VAT administration is the resistance from the taxpayers to keep the prescribed VAT records. Every representative group of taxpayers under VAT complains that record keeping is time consuming and increases cost and hence almost every representative group prefers payment of a "lump sum" at the end of tax period instead of paying at the standard rate. Even fixation of narrow base for valuation is preferred to compromise with the credit mechanism. Enforcement is mainly dependent on 'consent' of the taxpayers and hence a number of deviations or distortions are allowed to perpetuate. Again, these 'distortions' or 'deviations' can be attributed to local peculiarities of the overall tax culture that exists in Bangladesh. On the other hand, the taxpayers allege that they can not pay the exact amount of 'tax due' due to the complicated and non-transparent tax administrative procedures that we have in France, lumpsum tax liability of small firm with annual sales of goods and hotel services under 500,000 F, of other services 150,000 F and for the perfumes, 175,000 F, is estimated on the basis of a *forfait* (i.e., by mutual understanding between the firm and the administration, rather than by actual calculation of tax due on sales and tax paid on purchases).

- 1. Government That Works, Reforming The Public Sector. The World Bank, Bangladesh, March 1996, P.60.**
- 2. Alan A. Tait Value Added Tax, International practices and problems, IMF, washington, D.C. 1988, p. 304**

