

TAX EVASION

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1. Introduction

I am greatly honored to participate in this conference as one of the speakers on the topic of "Tax Evasion" and in representation of Brazil. Let me take this opportunity to thank the invitation made by Dr. Luiz Gonzaga Furtado de Andrade, Alternate Secretary of Federal Revenue at the Ministry of Finance. I do hope that the results of this conference that counts with the participation of all countries in the Americas, may be practical, objective and constructive measures that may be of help in establishing better standards of administration for the respective tax systems.

2. Scope of the Topic

As the topic is one of a broad scope, I will have to limit myself, in the analysis of tax evasion, to the discussion of the following topics that were suggested by the Ministry of Finance of Brazil:

- (I) causes of tax evasion and its manifestations (overall approach to the problem);
- (II) effectiveness of the different existing sanctions, comments and suggestions (repressive aspects);
- (III) indication of steps leading to the formation of a tax consciousness (educational aspects).

3. Concept of Tax Evasion

Tax evasion, in a broad sense, is any action or omission tending to avoid, reduce or delay the payment of a tax.

Consequently, the action or omission of the taxpayer results in the suppression, decrease, or postponement of a tax revenue (duty to pay) and exceptionally results in a different type of infringement (of the duty to act or not to act) that may give room for tax evasion or conceal a previous tax evasion. In this way, directly or indirectly, the main target aimed at by the tax-evader is always a public revenue.

4. Etiology of Tax Evasion

Tax evasion has been always present in any tax system. It is, as many have pointed out (Giorgetti, L'Evasione Tributaria, 1964, p. 3; Rudick, The Problem of Personal Income Tax Avoidance, 7 Law and Contemporary Problems 243), a twin sister of the collection of taxes. Its total eradication, no matter how civilized, learned, or patriotic a people may be, is dependent on the disappearance of its determining factor: taxes. This is a Utopian ideal, visualized by anarchism, the millenium of Marxism, and by the theory of managed inflation, the cruel ersatz for taxes.

The persistence of this evil which can and must, however, be fought, has deep roots, some circumstantial, other inherent to human nature or to the social, political, or economic structures that influence it. Historically, taxes were considered as a bondage, nota captivitatis, and were therefore strongly opposed. In modern times, the ignorance of the legal tax complex, financial difficulties on the part of taxpayers and heavy tax pressures are responsible for large segments of tax evasion. Another factor is the rationalization of fraud under the pretext of misuse of tax funds, as though the improvement of standards in public administration could be achieved by increasingly meager budgets.

Apart from these factors, due emphasis must be given to the motive that was, and certainly still is, the most important single source of tax evasion - the desire to escape a compulsory reduction of one's own wealth. The utilitarian principle of profit maximization and cost minimization prevailing in free-market economies, plays an important role in tax evasion and in its financial, psychological, and legal aspects. Although that principle is today very much mitigated by social and political considerations, it is nevertheless still essentially valid and is an important conditioning factor of many individual behaviors. Against such an attitude, persuasive measures are useless. Actually effective is only repressive action, the more stringent, the more effective.

Against the ignorance, carelessness, and prejudice just referred to, educational projects and the creation of a true tax consciousness can achieve direct results.

5. Types of Tax Evasion

Tax evasion, which as we have seen, is a complex reality, can be classified into several types. A proper analysis of the following topic dealing with the effectiveness of the various existing sanctions, requires a preliminary indication of the aforementioned types. With this aim in mind, we have prepared the following table:

Evasion by omission (intentional or un- intentional)	{	economic evasion - abstention from tax- ation; tax shifting
		evasion by inaction - a) intentional (non-payment of taxes due) b) unintentional (ignorance of tax obligations)
Evasion by action (always intentional)	{	tax evasion (tax fraud, simulation) (illegal) tax avoidance (legal)

These various types of tax evasion are discussed below:

(a) abstention from taxation. This is the abstention of the individual from performing acts or from placing himself in a position that is legally defined as being taxable. Excessive taxation is the main explanation of such an attitude: abstention from importing goods which pay high customs duties, from consuming tobacco, alcoholic beverages or other products having a high cost due to taxation; change of domicile; migration of capital.

These do not represent actual tax evasion since they are actions which do not represent an infringement of the law. They are the result of a given tax policy which discourages certain behaviours.

(b) tax shifting. This is not again a true form of tax evasion in the sense that the tax shifting from the taxpayer to the consumer (indirect taxes) is achieved through the price mechanism or through private contractual agreements, without incurring in legal offenses.

(c) evasion by inaction. This can be unintentional and it is relatively frequently caused by the taxpayer's ignorance, in view of the extreme complexity of modern tax systems. Repressive measures have to be adopted in these cases (though naturally mitigated). Educational measures would seem to be wiser and more equitable.

If willful, such evasion derives from the voluntary inaction of the taxpayer who fails to pay his taxes when due, or to supply the adequate information required by the authorities for the tax assessment. Being intentional, this qualifies the infraction for much more severe sanctions.

(d) tax fraud. This is the typical tax evasion; it can be defined as the willful action of the taxpayer attempting, by illegal methods, to eliminate, reduce, or delay the payment of a tax. It may occur as a fraud (clearly illegal methods) or simulation (apparently legal methods).

(e) tax avoidance. This is a form of legal tax evasion. It is usually represented by the adoption of alternative methods of conducting a business or of holding property within the options, or loopholes, of the legal system. It is a resource to minimize tax costs.

After these preliminary considerations, I now turn to the analysis of the existing sanctions applied to each one of such forms of tax evasion. Their deficiencies and suggestions for improvements will be noted accordingly.

6. Tax Avoidance

In order to properly examine the problem of tax avoidance in Brazil today, a distinction must be drawn between (a) avoidance induced or permitted by the law, and (b) avoidance resulting from legal loopholes.

In the first case, legislation through a given fiscal policy, permits and even induces the taxpayer to practice certain acts or to devote himself to certain business activities which receive a special tax treatment. The Brazilian tax system in recent years has seen an extraordinary growth of tax incentives in the most diversified areas (over 50 different types of tax incentives).

Whether this is an advisable or unadvisable policy in the light of the fiscal needs of a country, it is a subject about which it would be dangerous to generalize. Each case must be analysed separately on its own merits. It cannot be denied, however, that such incentives have been granted in Brazil with the serious aim of promoting the economic development of especially depressed areas.

Different is the case of tax avoidance resulting from legal loopholes. The legislator, who cannot foresee all practical situations, leaves loopholes in the tax laws through which the ingenious taxpayer slips his particular case. There is a legal right to resort to these maneuvers within certain convenient arrangements for properties or business (v.g., bearer shares).

Though in the overall plans for the prevention of tax evasion, the elimination of tax avoidance does not seem of prime importance (as the elimination of tax fraud does), it is unquestionable that the loopholes that permit it must be continuously removed. Thus, it would be necessary to set up within the tax organization specialized groups, coordinated with the judiciary and legislative branches, for the identification of cases of tax avoidance and for the subsequent correction of the

weaknesses of the law. It should be plainly recognized that, in most countries, including Brazil, this mobilization of forces has been extremely deficient.

7. Tax Fraud

The sanctions existing in Brazil to penalize tax fraud seem to be, in general, quite effective. If tax evasion presumably continues to be significant (it being, however, impossible to quantify it even approximately), this seems to be due mainly to incomplete knowledge of the often intricate legislation and to the sectorial deficiencies of tax departments.

The sanctions applied to tax fraud are impressive and it is difficult to believe that they could be further aggravated.

(a) At the outset, civil sanctions should be mentioned, such as interest and monetary corrections. The latter, when introduced in 1964, eliminated one of the major reasons for tax defaults in Brazil as it will do in any inflationary economy: delay of payments to take advantage of the devaluation of the currency. By the way, the monetary correction of tax debts is a sanctions that must necessarily be adopted by all countries with inflationary public finances. The Brazilian experience in this area can be very useful.

(b) The pecuniary sanctions, fines and penalties, are extremely severe in Brazil. Fines of 100% of the value of unpaid taxes are common throughout our legislation. Penalties of 300% to 500% were not unknown (and still continue to exist today in some cases) in the tax practices of the country. In the legislations of the states, penalties may even become oppressive. In the State of Sao Paulo, to give an example, the legislation on added value tax contemplated fines of up to 2.000% of the unpaid liabilities. In this sector, therefore, it is hard to believe that Brazilian legislation could be made more severe.

(c) Political sanctions would complete the picture: closing of the commercial or industrial establishment, prohibition to enter into transactions with governmental agencies, seizure of goods, etc. Though questionable from a constitutional standpoint, it is clear that these sanctions act as a powerful deterrent to tax fraud.

(d) Finally, criminal sanctions: penalties in cash and/or imprisonment. Traditionally, Brazilian legislation did not contemplate criminal sanctions for cases of tax fraud, with the exception of two types of cases: contraband (Penal Code, article 334) and stamp counterfeit (Penal Code, article 293, 1 and 2). It was only in 1965 that a special law was enacted (Law 4.729), defining four different types of the so-called "crime of tax evasion" (crime de sonegação fiscal): false tax statements made in one's own benefit or for the benefit of third parties; insertion of false entries or omission of income or of operations in books or records required by the tax laws and aimed at omitting the

payment of taxes; alteration of invoices; issuance of documents or increase of expenses to obtain unwarranted tax deductions. Willfulness is a necessary element of a criminal violation under the law.

It is impossible, on the basis of the data available, to ascertain the quantity of criminal prosecutions initiated against tax evaders. The handling of tax matters suggests that there are several in course. Two main reasons, however, keep the criminal sanctions under discussion from becoming highly effective dissuaders of tax evasion: lack of publicity of eventual punitive judgments and the possibility, given by the law to the offender, of paying his debt before a decision is reached at the lower administrative court. This means that those who have infringed the laws can escape conviction (though liable for pecuniary and civil sanctions), if, after their wrongdoing is disclosed, they pay the tax that is due.

It seems to us that the main efforts against tax evasion should be developed in the area of general education. To this subject we now turn our attention.

8. Rationalism of Taxation and Tax Consciousness

A noticeable attitude both now and in the past, is that of many individuals who are absolutely irrational about compliance with their tax burden. In the course of centuries of arbitrary collection of taxes, that attitude could be justified. However, when public revenues are universally channeled to socially productive ends, as is the case today, this irrational mentality would seem to be a reactionary one. We have seen, under item 4 above, the causes of tax evasion which are the palpable manifestation of this refusal to accept the obligation to pay taxes that tax consciousness could help to eradicate.

Whenever faced with an inevitable reality, such as taxation, the individual will react either emotionally or rationally. Emotional behaviour determined by ignorance leading to fear, or by immaturity, leading to anxiety, is that of an obstinate refusal to admit reality. Rational behaviour implies a sympathetic mental attitude of attempting to understand the fact, of examining its causes and effects, and - when it is a social fact-, of eliminating its undesirable consequences. In more precise words, as Gehlen said, behaviour is rational if motive and purpose coincide, motive being consistent throughout the process and purpose being conclusive and logical for someone strange to the process.

Tax consciousness is nothing else than this rational attitude towards tax matters. It is achieved through an increase in the number of individuals capable of rationally understanding the causes and effects of taxation, of understanding why and how each one is inevitably involved in the process, of rightly discriminating what improvements are feasible and of determining, unbiased, the future guidelines for the same process. In one word, tax consciousness implies "understanding" and "judgment" of the process of taxation.

Below, I list the main steps which, I am convinced, could promote a dramatic change in taxpayer attitudes and give room for genuine tax consciousness.

9. Expansion of Direct Taxes

It is a well-known fact that in almost all developing countries tax systems are essentially regressive; that is, tax revenues are made up of indirect taxes which are shifted to the consumer through their addition to the price of commodities or services. Apart from the injustice indirect taxation represents and, in Brazil, it produces more than 65% of all federal revenues, it is unquestionable that taxation must be extended to a large number of individuals if a strong tax consciousness is to be attained. In fact, it is not enough to understand the tax reality intellectually as one would deal with mathematics or metaphysics. The planner must be personally integrated to the process so that he may feel the impact of the measures that were rationally advisable. We should not remain outside the process, but should be part of it. It is only thus, that the element of irrationality and emotion inherent to human nature may be taken into account.

The impact of indirect taxation is absorbed by the price mechanism. Paradoxically, the consumer, who is the actual taxpayer, is not aware of the tax he is paying. Conversely, the seller or producer feels the tax burden very acutely although, if normal demand prevails in the market, he does not pay any tax at all.

This absorption of the tax also blunts the fiscal perception of the individual who is not clearly aware of the tax disguised within the prices. To revive tax consciousness or to even awaken it, the taxpayer is to have an immediate and acute idea of the tax that is being demanded from him. At present, this is only possible through income tax. Income tax stimulates the consciousness of the individual, provokes his thinking, makes him become interested in government affairs and in the utilization of tax funds. What is more important, a sufficiently wide-based income tax tends to create an anti-evasion mentality and attaches a social stigma to tax evasion.

This expansion of the base on which income tax has an incidence must include the largest possible number of citizens, even those at lower income levels (who will naturally be taxed mildly). The example given by Brazil in this area is significant: in a few years the number of income tax returns has increased fourfold.

10. Education for Tax Consciousness

Apart from the measure that was just recommended, we would like to suggest some ideas on an educational program to promote tax consciousness.

It is clear that tax consciousness largely depends on a vigorous campaign aimed at attaining a better understanding of taxation in all of its aspects. From college onwards, tax consciousness should be awakened through an elementary explanation of the causes, operation and utilization of tax revenue. Later, more in-depth studies will be made by those who will handle tax matters in a professional way.

At the same time, tax administrators would have the responsibility of extensively promoting better knowledge of tax legislation and its changes and of providing direct assistance to taxpayers as well as of sponsoring lectures, seminars and tax courses and of printing pamphlets, booklets and other material that should be made easily available.

At another level, taxpayers' associations, which exist in many countries, should be incentivated and supported. The important role of these associations is known well enough as to not require further discussion.

11. Facilitating the Understanding of Tax Legislation

Better education on tax matters would provide larger numbers of better qualified professionals capable of interpreting and enforcing tax laws correctly. Tax laws become more and more complex, hermetic, and even contradictory and they are in a continuous process of change, tracing wealth wherever it is to be found and attempting to keep pace with the intricacies of modern business relations and modern technology. Two hundred years ago, Adam Smith who proposed the cardinal rules of taxation, said that taxes should be set forth in clear and precise terms in what concerns the amount to be paid, the manner in which payment is to be made and the persons liable for payment of the tax. This ideal being impossible to attain there should, at least, be talented people who may be able to advise corporations and individuals as to their tax obligations. Tax law will then no longer be an "esoteric specialty", as with some exaggeration it has been labelled. The empirical approach that still prevails in the handling of tax matters will also have disappeared by then.

Likewise, if one cannot demand more simplicity in the wording of tax legislation, one can notwithstanding require that laws be drafted in a technical and orderly manner. Legislators, legislative assistants and administrative officials should be adequately educated. Moreover, a periodical effort to bring the legal complex up to date, is a necessity. In a chaotic set of conflicting regulations where the applicable law is hard to find, if found at all, no tax consciousness can flourish

12. Conclusions

The main conclusions of this paper may be summarized as follows:

- (a) Tax evasion is inevitable but it must be strongly repressed.

It is determined by multiple causes: mainly, prejudice, ignorance, excess of individualism and excessive attachment to individual assets.

- (b) The typical forms of tax evasion are tax avoidance and tax fraud.
- (c) Tax avoidance must be combatted through improvements in legislation and by closing its gaps and loopholes.
- (d) An efficient system of sanctions is necessary to discourage tax fraud, particularly of criminal sanctions.
- (e) The establishment of a true national tax consciousness is a necessity for the improvement and modernization of the tax system.
- (f) The major steps leading to the establishment of tax consciousness are: expansion of direct taxes; a broad educational program; existence of tax specialists and periodical compilations of tax laws.