A Critical Appraisal of Tax Evasion as Predicate Offence for Money Laundering

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ARTICLE INFO			ABSTRACT
Article History:			*Tax evasion and money laundering are two global problems that are devastatingly impacting the global economy, economic security, stability, and economic growth. The primary objective of this paper is to examine the link between tax evasion and money laundering by looking at their historical origins, basic features, strategies, and economic repercussions. Money laundering and evasion of taxes are organised financial crimes that are related to one other, either explicitly or implicitly. Laundering of money was once thought to be solely involved with trafficking of drugs and financing of terrorist activities. At this moment, it has also been connected to tax evasion. The connection between both crimes is not well understood. Tax evasion is regarded a predicate offence for laundering money in certain jurisdictions, whereas it is not in others. This study finds that evasion of taxes is one of the most common motivations for laundering money activities. Furthermore, in order to address these activities more effectively, this article suggests recognising tax evasion as a recognised predicate crime for laundering money.*
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INTRODUCTION

Taxation is an important source of income for every nation in the current world financial order. If taxpayers strive to evade or avoid paying taxes and launder the money, the government will be unable to offer vital public services. These both crimes result in drop in revenue and disrupt the money inflow in a financial market of a country. It may also jeopardise a state's financial integration and social progress. Individuals in the global economic system willingly pay the taxes on their personal income and similarly, corporations pay taxes on their earnings.

Globalization is making it easy for the people who are interested in foreign investments through different financial institutions. According to an assessment report published by Organization for Economic Co-operation and Development (hereinafter referred as OECD), people are moving their fiscal assets to tax havens or offshores in order to evade taxes. Tax evasion is genuinely impacting all developed and developing countries. To fight evasion, there is a need of reforming the existing anti-money laundering control systems (Authority, 2015).

The relationship between tax evasion and money laundering often go hand in hand. Both crimes are directly or indirectly interlinked with each other. Money laundering and its related crimes have a long history dating back to 1980. At first, the scope of money laundering was only limited to trafficking of drugs. In early 2000, terror financing was started being linked with money laundering as many terrorists' organizations found it very useful to finance their terrorist operations. Presently, in the world of global economy, the financial crime of tax evasion is also associated with money laundering (Unger, 2017).

Establishing the link between both offences is complicated. Many nations treat tax evasion to be a predicate offence to laundering money. In nations where tax evasion is a predicate crime for laundering money, the perpetrator of a specific level of tax evasion is also prosecuted with laundering money (Unger, 2017).

This article aims at establishing the relationship between tax evasion and money laundering. It also examines the emergence of the two offences throughout history. Moreover, this study also discusses the crime of tax evasion as predicate offence for money laundering. Later on, it also explores the traditional and virtual methods of both crimes. Moreover, this article looks into the economic implications of money laundering and reasons of prevalence of tax evasion. Lastly, this research highlights on want of combating tax evasion in order to curb money laundering.

Historical Evolution of Tax Evasion and Money Laundering

Role of taxes in human history was not very significant regardless of its long history. The history of tax can be traced back to 3000-2800 BC. In the city states of Greece, tax was directly imposed on citizens. At that time, rational behind taxation was war. Taxes were imposed on personal properties and lands owned by Greek citizens. However, taxes were imposed only for short period of time. Later on, taxes were levied in permanent form on real estate and transactions related to such properties (McLure, 2020).

In modern age, taxes contribute in economic, social, and human development. Tax revenue has become a significant factor in progress and prosperity of any modern state. However, taxes can only be collected, if the citizens of state pay their fair share of taxes. One of the simplest reasons for evading tax is that everyone wants to earn an increase their net income (Hammar, 2009).

The concept of tax evasion can be defined in multiple ways. Legal Information Institute defines tax evasion as 'using of unlawful means to avoiding taxes. It further explains that tax evasion involves misrepresentation of income by an individual or a corporation from tax authorities (Legal Information Institute, n.d). As per the Supreme Court of the United States in the case of Sansone vs. United States, a conviction for tax evasion necessitate sufficient evidence of three components including the presence of a tax default, an intentional endeavour to dodge taxes, and a positive act trying to establish tax avoidance or attempt (Sansone v. United States, 380 U.S. 343, 85 S. Ct. 1004, 13 L. Ed. 2d 882 Supreme Court 1965).

The history of tax evasion goes back to the case of notorious Chicago mob boss, Al Capone, who involved in murder, theft and extortion. He ran Cicero Chicago suburb as his private kingdom and used to live a luxury life and was never charged for any crime. However, the only thing that he was questioned for was tax evasion. In 1931, he was sentenced for tax evasion with 11 years' imprisonment and was also fined and paid court costs (Tirosh, n.d).

In the modern world, money has become more vital than oxygen. Everyone in this world wants to get money and just more money. However, the amount of money someone earns depends upon his skillsets. There are some people who could cross any boundaries set by law and society to earn money. Those individuals get involved in offences such as laundering of crime proceeds. The offence of money laundering has a long history dating back over 2000 years. Chinese traders used cash rotation to conceal their earnings from the authorities (Joshi, n.d). The concept of money laundering can also be explained in multiple ways. A major money laundering watchdog agency, Financial Action Task Force define money laundering as 'a profit-generating activity for the individual who was initially responsible for the specific conduct. It is an act which enables a criminal to enjoy the benefits of a crime without exposing the source of money' (FATF, n.d).

It is impossible to determine that how much money is laundered in USA or any other country in the world. However, a report published by United Nation's Office on Drugs and Crime provides insight in this regard. It suggests that only in 2009, $ 1.6 trillion worth of crime proceeds were laundered all around the world. Another report of International Monetary Fund shows that in 1998, laundered money stands at two percent to five percent of the Gross Domestic Product of the world (FATF, n.d).

Nature of Relationship

Behind the causation of money laundering, there are several reasons. Tax evasion considered as a is one of the key reasons behind the laundering of money. A rich individual or a corporation wants to hide and protect their monetary assets from tax authorities, and they do not trust their government to use money for public good. They indulge themselves in laundering of tax evaded money (Qureshi, 2018). For instance, a rich individual or a corporation will misrepresent their monetary assets and profits to tax authorities of their native land and then they will transfer their money either to tax havens or invest in the real estate business in order to conceal their true identities. This constitute money laundering lead by tax evasion. This kind of laundering of money operation is usually done by some powerful and well-organized individuals or corporations who can easily defy tax and AML authorities with their vast influence.

The first estimation of tax evasion worldwide was done by Friedrich Schneider who also defined the term shadow economy, which also included money laundering and tax evasion activities. Walker (2009) in 2001, utilized his work to find out a relationship between tax evasion and money laundering. In order to prove his point, he combined his approximations of shadow economy with every country's GDP. According to his estimations, tax evasion is considered as money laundering in wealthy countries, while underprivileged nations consider it as a campaign against drug trafficking.

Tax Evasion as a Designated Predicate Offence for Money Laundering

United States criminal law defines predicate offence as 'a crime or criminal act that is committed as part of a bigger criminal conduct.' That larger crime may money laundering, racketeering or terror financing (Low, 2017). The origin of the unlawful or illicit funds is a predicated crime. "Money laundering" is a criminal activity that originally comes from the offences that it is based on. The execution of these specific predicate offenses necessitates the requirement for laundering money. The Financial Action Task Force has deemed many offences to be classified predicate offences for the offence of laundering money. Tax evasion, terror funding, illicit arms deals, narcotics trafficking, trafficking of humans including children and women, smuggling, and cybercrimes are among the crimes listed. The recognized predicate crimes for laundering money are depicted in **Figure 1.**

Money laundering has 20 recognized predicate crimes, as per the Financial Action Task Force. According to the watchdog agency, evasion of taxes may only be regarded a precursor crime for laundering money if a government has specifically identified it as such through appropriate legislation. After modifying their laws in accordance with Financial Action Task Force, most nations consider tax evasion as a predicate crime for the offence of laundering money (FATF, n.d).

In accordance with Financial Action Task Force recommendations, Pakistan's 'Schedule to Anti-Money Laundering Act, 2010' includes tax evasion as a predicate crime for laundering money. Money laundering has been deemed a predicate offence under the Income Tax Ordinance of 2001, the Sales Tax Act of 1990, and the Federal Excise Tax Act of 2005. Anyone discovered to be engaged in massive tax evasion might be prosecuted with laundering money under these legislations.

This article argues that tax evasion contributes to crime of money laundering in form of predicate offence. The tax evaded money gets cleaned through process of laundering of money.

Traditional and Virtual Methods

Tax evasion and money laundering are committed through various methods and some of these methods share some common characteristics. These are some common methods of tax evasion.

- The simplest method of tax evasion is to not pay due taxes when authorities calls for it. A person will not pay his taxes before or after the expiry date of filing tax returns.

- Cash smuggling is one of the methods that is usually used in tax evasion as well as laundering of money. The earnings of evaded tax are actually transported from on jurisdiction to another in order to launder money. Cash smuggling is done in order to save money from tax regime and preserve the future economic benefits for the person who is involved in such criminal operation.
- Tax evasion is also committed through by presenting false tax returns. The tax payer present wrong data to tax administration in order to lessen his/her tax dues or to completely evade it. Misrepresentation of tax returns also constitute tax evasion.
- Corporate tax evasion occurs whenever a corporation or firm tries to avoid taxation by filing fraudulent financial transactions that take place during the whole yearly tax asses period, or by keeping falsified accounting records to represent lower revenue. Business tax avoidance allows a company to pay less in taxes on its initial earnings.
- Tax exemption and privileges are usually offered to individuals and corporations by government in order to promote businesses and attract foreign investments. However, some unqualified opportunists get rewarded from such schemes and they enjoy benefits from those schemes by presenting fake documents in order to claim tax exemptions. Tax evasion from such schemes is usually done by some top-level corporations that always look for such opportunities.
- Some taxpayers indulge themselves in bribing tax officials which is a common practice in most countries. In order to evade tax payment, individuals offer bribes to tax officers to make it go away.
- Some dirty rich individuals or corporations move their money to offshore centers or tax havens. They maintain offshore accounts in tax havens such as Switzerland. Swiss banks are famous for their greater bank secrecy. They do not disclose their clients' accounts to their native tax authorities. As a result, a significant portion of taxable earning is diverted outside of the nation without being taxed (Bazar, n.d.).
  On the other side of coin, process of money laundering involves three steps. This involves things like "placement, layering, and integrating". The term "placement" refers to the depositing and investing of capital or financial resources into capital markets. The second stage of "layering" is shifting cash reserves to separate the income from its origins, and the stage three of "integration" restores the cash as a genuine resource and returns it to its rightful owner (Mulig, 2008).

With the technological and scientific improvements, virtual methods of money laundering are also evolving. Exploiting flaws in online payment mechanisms is among the most popular digital methods. Internet banking platforms are not without flaws. Such openings are used by launderers. They use sophisticated techniques to get access to the business identities for their own illicit activities. They strive to deceive people in order to get personal details about their "bank accounts", which they subsequently use to conduct unlawful and unauthorized activities (Tookitaki, n.d).

Socio-Economic Implications of Money Laundering

Laundering of money has become a major issue for all growing economies. This crime has some serious impacts on the national and global economy. Money laundering sternly effects government's revenue, inflows of money and also common man. It also slowdowns economic growth and it also control the rates of exchange markets.

First and foremost, it impacts economic growth of a state. Economic growth is very essential for all growing countries and money laundering primarily targets it. Money generated from legal process is transmitted to illegal operations. In such situation, illegal

business operations prevail over legal corporate business and damages the reputation and legitimacy of the economy of the country (Gjoni, 2015).

Moreover, money laundering cause destruction in financial sector. Financial sector of a country plays an important role in legitimate and strong economy. However, money launderers take advantage of it by putting in or out huge amounts of cash into financial markets of a country in order to make it unstable and destroy its reputation. Money laundering could also cause failure of banks and fiscal recessions in a country (Unit, F. I., n.d.).

Finally, this paper contends that laundering of money contributes to a worldwide trust deficit. The Financial Action Task Force is an international monitoring organisation that combats financial frauds such as laundering of money and similar offenses. It demands from its member countries to strictly deal with "money laundering and its predicate offences" and if a country fails in compliance with its recommendation, it is added to grey or black list. These ranking is based on how far a society has changed in combating money laundering. If a nation is placed on a black or grey list, the financial repercussions are severe. It harshly impacts its trade with other countries as well as diplomatic relations and opportunities for future trade agreements.

Reasons for Prevalence of Tax Evasion

The extent of tax evasion can be attributed to a number of factors. The issue of evading taxes is complicated, and it produces enormous inequity in society by allowing wealthy people to ignore contributing to growth. Many states are lacking systematized estimation of tax evasion. The cause of tax evasion may vary from country to country. These are some reasons for prevalence of tax evasion:

- The tax administration structure of a country is weak
- Illiteracy and unawareness about importance of taxation
- Complexity and ambiguities   in tax legislation
- High inflation discoursing people to pay taxes
- High rates of taxes creating tax pressure
- A significant Shadow economy
- Business promotional regimes offering tax incentives and exemptions
- Lack to trust of citizen on government's ability
- Inefficiency of tax officials and tax administration
- Regressive taxation
- Tax havens or offshore centers with low tax rates
- Manual tax system not able to cope with digital economy (Collosa, (2019).

Combating Money Laundering by Controlling Tax Evasion

Tax evasion as an associated crime, contributes in crime of money laundering. This article argues that money laundering could be curbed by controlling tax evasion first.

Figure 2 elaborates the relationship between tax evasion and money laundering. It is argued that when a wealthy individual or a corporation commits tax evasion, it becomes very difficult for them to hide such physical monetary assets from the eyes of tax administration. If criminals intend to benefit from the profits of evading taxes later, they engage in money laundering to make the money look genuine.

These people and businesses are usually better organised than that of the average person who engages in low-level tax avoidance. They relocate the funds out of its actual source to a shell corporation or overseas locations through skilled laundering agents in order to save the earnings of evading taxes. They make it very difficult for taxation or anti-money laundering agencies to track that cash through a combination of "placement, layering, and integration".

After going through laundering process, money becomes legitimate apparently. This cleaned money is transferred to the person or company who obtained it via evading taxes. Additionally, it is deposited in tax-free economic projects or plans in the foreign investors to invest to escape additional taxes (FDI).
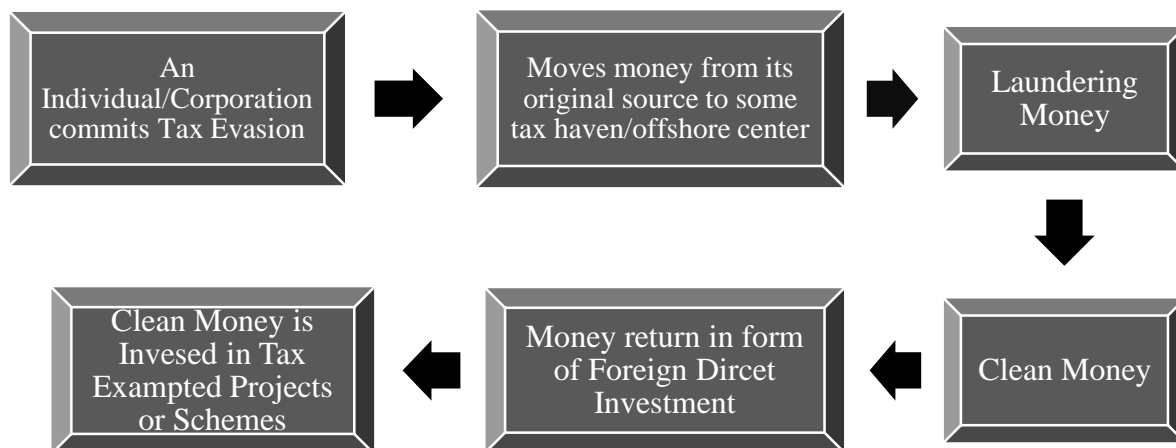
As a result, it is believed that this is a "vicious cycle" which continues to thrive and has a significant economic impact. In order to protect the proceeds of crime of tax evasion, people get involved in money laundering. Hence, this article emphasis the need of combating tax evasion by reforming the tax administration and legislation in order to eliminate the crime of money laundering.

CONCLUSION AND RECOMMENDATIONS

This article concludes that tax evasion should be treated as source crime of money laundering. This research article strongly advocates the need of reforming the existing tax administration and anti-money laundering regime of countries that are suffering due to both crimes. The money laundering lead by tax evasion could only be curb by combating tax evasion first. This article recommends that governments must reform and digitalize their tax regimes in order to identify and punish the tax evaders who are involved in money laundering. This article also recommends that there is a need of global action plan and mechanism to counter money laundering and its designated predicate offences.

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