

# Tax Evasion in Personal Income Tax

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**Abstract.** Tax evasion is an illegal act of not paying or underpaying tax. With a significant rise in the number of tax evasion cases in recent years, discussions based around this topic has increased overall. Its substantial level of severity not only affects the tax evaders themselves, but also influences the economy as a whole. Although there are many types of taxes that are likely to be evaded, for example corporate income tax, this essay aims to discover several aspects of tax evasion in personal income tax, such as the ways in which people tax evade, including the question of why people tax evade and real life examples of public figures. It focuses on the current consequences of tax evasion in today's society, including research conducted across different countries and how they deal with tax evasion cases. Moreover, detection methods of tax fraud used by tax authorities and the government are mentioned.

**Keywords:** Tax evasion; personal income tax; detection of tax evasion.

## 1. Introduction

Since the implementation of tax paying on personal income in 1799, it became an essential source for governments to fund people's education, transport, welfare system and social services [1]. However, problems arise when it comes to people deliberately attempting to avoid paying taxes for their own benefit, which is generalised by the term tax evasion. It plagues the tax system around the world, interfering with the distribution of the government's financial assets and government's ability to carry out social and economic policy [2]. Moreover, with the world constantly evolving financially and economically, the ways in which individuals engage in tax evasion within the context of personal income tax can be multifaceted, decreasing its level of detection and identification.

## 2. The Ways in Which People Tax Evade

### 2.1. Why Do People Tax Evade

The reason behind tax evasion on personal income tax is often driven by the evaders' desire to reduce tax liabilities due to high tax rates or personal financial needs: they aim to minimize tax burden for more disposable income and maintain their earnings. Other possible motivations towards tax evasion include one's distrust in government's utilization of their spendings of tax revenues, resulting in his or her reluctance to follow the laws stating how one's value of tax is determined, in addition, complicated tax legislations make it easier for evaders to find loopholes and thereby take advantage of the weakness within the tax system.

### 2.2. Why Are Some People More Likely to Tax Evade Than Others

Tax evasion can be committed by individuals of various backgrounds, for example high income earners. These individuals are more inclined to evade taxes due to the substantial financial gains they are receiving, as the greater the income, the higher the tax liabilities which subconsciously allows one to risk this crime.

### 2.3. Analysing Real Life Cases

Firstly, focusing especially on public figures and celebrities (as tax evasion cases in the entertainment industry demonstrate a rise in numbers [3]), actress Fan Bingbing from China was accused by several of committing tax evasion in 2018. She received 30 million Chinese Yuan (which

equals 3.3 million in British Pounds) from the shooting of a film, and from this amount, 10 million were proclaimed for tax purposes, while the remaining 20 million yuan evaded personal income tax of 6.18 million Yuan, with an addition of 1.12 million Yuan of underpaid business tax and surcharges, amounting to a total of 7.3 million Yuan [4]. Eventually, she was fined a total of 883 million Yuan. In this case of serious tax evasion, Fan Bingbing has been reported of agreeing on what is called a "Yin Yang contract" (Dual contract), where the contract parties of the same matter produce two contracts but with different contents; one is revealed to the public, while the other remains internal, of which the public contract holds fake information of the revenues involved.

In 2021, famous influencer and live streamer on Chinese social media, Wei Ya, was discovered and confirmed to have tax evaded by The Hangzhou Tax Inspection Bureau using data analysis [5]. Firstly, Wei Ya falsely reported the true value of her personal income from the livestream platform, set up a number of individual proprietorships and cooperated with her partnership fictitious businesses in order to convert her personally gained income into income from business operations, and falsely declared tax without abiding to law. This means that tax evaders take advantage of business-related deductions and exemptions that reduces their taxable income, making it appear as though this income rightfully belongs to the business. The case immediately attracted media attention and demonstrated the legal consequences for individuals like her as she had been fined 1.34 billion Yuan for evading taxes of up to 643 million Yuan [5].

In 2018, Paul Manafort, a chairman of Donald Trump's former campaign from the United States, was convicted of several crimes including tax evasion. He had concealed the existence of millions of dollars in income from political consulting work in Ukraine in offshore bank accounts [6]. Manafort failed to report this income to the Internal Revenue Service, effectively evading his tax obligations. Ultimately, he was fined a restitution of \$6 million - \$25 million, as well as a 47-months stay in prison. The method that Manafort had used to commit the crime is by creating offshore (countries located outside the individual's country they live in) bank accounts [7]. In doing so, the individual transfers his or her assets to foreign jurisdictions with bank secrecy laws (a vital requirement of keeping customers' financial information completely confidential and not disclosing it to third parties [7]) and wanted tax regulations, thereby hiding his or her financial activities away from their home country's tax authorities, and minimizes tax liabilities as tax evaders underreport revenue from their offshore accounts. These offshore accounts offer confidentiality, effectively making it more difficult for tax authorities to identify and track the outgoing or incoming assets.

In 2012, British comedian Jimmy Carr was criticised by involving in what was called the K2 tax scheme, sheltering 168 million pounds a year from the Treasury [8]. This case was significantly controversial as its announcement was made, as the scheme was technically legal at the time but "morally wrong" [8]. It worked by individuals receiving both salary and loans to an offshore company as mentioned earlier that were not subject to income tax in the UK, as it did not undergo the UK tax system, and did not incur tax. After the case had drawn the government's attention, they soon identified it as a possible loophole within the tax system and implemented adjustments to these schemes. For example, in 2013, the GAAR (General Anti-Abuse Rule) was implemented, removing the tax advantage that an individual tries to gain [9]. This way tax evasion schemes that abuse the tax system can be challenged.

### **3. Consequences of Tax Evasion**

#### **3.1. How Do Tax Rates Differ Across Different Countries**

Table 1 is the specific personal income tax rates across the stated countries, with China and the United Kingdom as having the highest PIT rate.

**Table 1.** Personal Income Tax (PIT) rates

Country	Headline PIT rate (%)
China	45
India	39
Sweden	20
United Kingdom	45
United States	37

Source: PwC

China's rapidly developing economic growth over the past decades has encouraged the government to increase the tax rate to maintain and support this growth, and UK's progressive taxation method, where individuals with a higher personal income pay a higher percentage of their income in taxes, provide a range of personal income tax rates. Sweden has the lowest personal income tax due to its balanced mix of taxes, the government tries to evenly distribute tax burden into income taxes and consumption taxes like VAT (value added tax).

### 3.2. How Can Tax Evasion Be Detected

Tax evasion can be detected through various methods and mechanisms used by the government or tax authorities. To begin with, data and financial analysis detects fraud or tax evasion dependent on sources such as third-party data providers, financial institutions and returns provided by employers [10]. In doing so, tax authorities can identify discrepancies as well as inconsistencies in the incoming values and expenses. Audits are an example of data analysis methods that are conducted to individuals so data and reviews of their financial report can be obtained to assess their financial activity [10]. Moreover, as the modern society develops rapidly and efficiently, artificial intelligence is a useful tool in analysing large amounts of data and patterns that could potentially present or demonstrate tax evasion. Its quickness and accuracy enhance its role in detecting abnormal transactions of an individual and red flags.

On the other hand, between countries there are tax authorities that cooperate to exchange information internationally to detect offshore tax evasion and, again, irregular transactions consisting of large amounts of assets. Similarly, tax authorities have the power to access banking information, such as records of offshore transfers of assets, identifying individuals who have purposefully concealed various transactions or people who have not reported their incomings and outgoings correctly. Tax gap can also be examined by tax authorities by comparing the tax liabilities needed to pay based on economic activity, and larger gaps can indicate tax evasion. Furthermore, an individual's previously owed tax is likely to be fairly consistent, this way abnormal amounts of tax paid can signal potential tax evasion as well.

### 3.3. The Ways in Which Different Countries Deal With Personal Income Tax Evasion, Including China, India, Sweden, United Kingdom and United States

Consequences and punishments for personal income tax evasion can vary between countries. Firstly, in China, tax evaders face a series of consequences such as penalties, fines and obligations to pay the evaded tax plus interest. In special cases criminal charges like imprisonment can be used, depending on the severity of the case [11]. Penalties include fines of up to three times the evaded value or more. For example, if the tax evasion value ranges from 10,000 Yuan to 100,000 Yuan and between 10% to 30% of the taxable income, the taxpayer will be subject to a fine between 300% to 500% of the tax evaded.

Tax evaders in India can face penalties, fines and prosecution under the Income Tax Act [12]. Penalties can include fines of up to 300% of evaded tax value [12]. Criminal penalties can lead to imprisonment. In Sweden, tax evaders face penalties, fines and imprisonment for severe cases. The penalties include fines of up to 40% of the tax that would have been imposed or credited [13]. In the UK, there are penalties, fines and potential criminal prosecution under the Fraud Act 2006. The

penalties include fines of up to 200% of the evaded tax amount, and in serious cases, it can lead to imprisonment. In the US, tax evaders face civil penalties instead of criminal penalties [14]. The penalties can include fines of up to 75% of the underpaid amount.

The penalties stated above can vary based on the severity of the cases, the amount of tax evaded and whether it involves criminal intent. Also, the laws involving paying taxes change from time to time in order to keep up with the economy of the world or the specific country, and the government aims to update the laws with their newest regulations.

#### 4. Conclusion

In conclusion, tax evasion in personal income tax is a multifaceted problem and social behaviour with economic and legal implications. This essay sheds light on multiple key aspects of tax evasion, such as the motivations behind this crime and why people evade taxes, which is due to high tax rates, unfairness of the tax system or loopholes that can be spotted by tax evaders.

Real life examples give an analysis of how exactly people tax evade and the widespread nature of tax evasion. To reduce and minimize the problem, countries have used methods such as data analysis to detect tax fraud and implement penalties on those individuals.

Although tax evasion is impossible to completely put a stop to it, we can tell that countries and tax authorities put in the efforts to strengthen their tax system and are committed to maintain a fair environment for their citizens when it comes to paying taxes. They try to encourage all citizens to understand how vital public services are and how the needs of the society require all individuals' contribution.

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