A STUDY ON MACROECONOMIC IMPACT OF TAX EVASION AND AVOIDANCE BY THE MULTINATIONAL COMPANIES (MNCS) IN INDIA

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Abstract: The paper aims to highlight the economic and social impact on India as MNCs do not pay the right amount of taxes in the country. The paper discusses the techniques of tax evasion that MNCs uses in the host country. In the view of doing this the domestic economy suffers both qualitatively and quantitatively. The economic development, economic growth and social benefit dampen as the tax revenue for the country decreases. The paper also discusses the three ways to minimize and eliminate the tax looting by MNCs.

Keywords: Tax evasion, economic and social impact, government measures

1. INTRODUCTION

Under the companies Act, 1956 corporate tax is defined as a compulsory payment levied on the net income of the private and public firms operating in India. This is one of the major sources of revenue for any country and also a major expenditure made by the firms to the government. Multinational companies (MNCs) are businesses which operate in many countries other than their home countries. They aim to meet the global demand and earn huge profits due to expansion. There is a constant disagreement between the MNCs and the Government over the taxes of "what they should pay and what they actually pay". The MNCs resort to tax evasion and tax avoidance in order to retain their profits. Tax avoidance is a legal way to reduce the taxes by taking advantage of the existing systems and tax evasion is an illegal way to hide the profits by reporting inaccurate income (Slemrod and Yitzhaki, 2000). In a developing country like India this tax theft by MNCs legally and illegally has a major adverse effect both socially and economically. As per (Business Standard 2020) due to global tax abuse by MNCs, India is at a loss of $10.3 billion, a total of $3trillion GDP. The estimates also highlight the loss to the healthcare and education sector in the Indian society.

2. MODES OF TAX EVASION

The structure of taxation that is followed in India has many loopholes and the MNCs are taking advantage of those to gain more profit. The extent of FDI depends on the tax structure followed in a country. Some countries are loose on the policy because the financial account of balance of payments shows a credit entry when FDI comes to the home country and helps the government to meet the macroeconomic objective of low unemployment, economic growth and low prices. The MNCs uses various techniques to avoid and evade taxes in all possible ways. The main difference between the two is that evading taxes results in prison and penalty whereas the avoidance is a result of good financial planning.

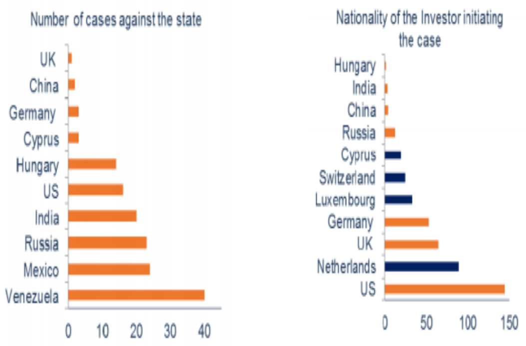
The table below indicates the various methods that are used by the MNCs globally to minimize and eliminate the taxes that should have been ethically paid to the host country but it doesn't happen so. Further these profits are sent to tax haven or zero tax countries and from there it is further circulated in illegal transactions giving rise to black money market.

Techniques	Meaning	Author
Relaxation by home country	Additional profits are relaxed	Markle,2015
Transfer Pricing	Reduction in invoice values	Lanz & Miroudot, 2011
Royalty Payment	Reduction in tax liability	Dischinger & Riedel, 2008
Intra Corporate Loans	Deducting Interest payments on loans	DeMooij, 2011
Round Tripping	Tax haven countries collecting royalties	Contractor, 2015
Inversions	Merging with low tax countries	Browning, 2016
Overhead Cost	Cost divided by the parent firm to their subsidiaries	Sikka & Willmott, 2010

Table 1.1

From the above mentioned list the most common method of tax evasion and avoidance used by the MNCs are transfer pricing and round tripping. Transfer pricing is a method to shift the profits by underpricing their exports from a high tax country to a low tax country and reduce the tax rates effectively. Egger et al. (2010) . This further leads to intra firm trade and profit shifting which help the MNCs to gain a

higher amount of profit which is not coming under the tax structure. The differences in the global tax rate also encourage the transfer pricing. Another way to this income shifting is by manipulating the arm's length principle which can potentially eradicate the full tax revenue under the transfer pricing (Eden, 1998).
For developing countries like India the FDI plays a major role in bringing macroeconomic stability. The form of FDI can be direct as well as indirect. Under this the domestic funds are offshored or placed in tax haven countries by the investors of the home country to take the tax benefit, hide the income earned through illegal sources. This money comes back in the country via shell companies and this whole process is known as round tripping (Kalotay, 2012). The overall impact of round tripping is creation of deadweight loss on the economy as the government of home country losses on the tax revenue share. Round tripping does not raise the domestic revenue because it is the domestic money only outflowing and due to tax differentials, interest rate differentials and loopholes in the tax structure the domestic money inflows back (UNCTAD, 2016)



Source: Investment Policy Hub UNCTAD

Fig 1

The graph shows that the middle income countries are observing the highest investor state dispute settlement and the developed economies are hosting this round tripping.

The other methods mentioned in the table are also used by the MNCs in different countries where profit shifting is convenient. In all the ways the impact on the economy and society is adverse. The macroeconomic stability is compromised and the social adversity arises as corruption rises and accountability decreases.

Economic and Social impact of tax evasion on India
India is a very fast developing economy. The FDI investments have increased the employment rate and productivity of labor/ capital within the country. The country's potential has increased and the capacity to produce has also grown leading to economic growth of the country in the recent past years. The revenue generated by the taxes paid by the MNCs are a big source to stimulate development for the country. The above mentioned underreporting challenges the government fiscal spending which dampens the economic improvement planned by the government. Economic impact that a country faces because of MNCs evading and avoiding taxes are

1) *Economic Growth:*
   The productive capacity of the economy decreases. The budget allocated to the development sector. The MNCs tax generates revenue for the government, the revenue creates a multiplier effect and the domestic income increases along with the output that further leads to the increase in the net exports. The gdp (C+I+G+Nx) increases. This all is lost as MNCs cheat the taxes.
2) *Inflation:*
   The level of prices rises and inflation sets in a country. The main objective of the government of maintaining price stability is lost and the effects of inflation makes the poor poorer. High prices impact the standard of living as the cost of living increases and society uses inferior quality goods.
3) *Contractionary fiscal policy:*
   To meet the fiscal balance the government will require raising the tax slab in the society and resorting to contractionary fiscal policy. This will further reduce the MPC (marginal propensity to consume) and the investment demand by firm's decreases
4) *Morale of the nation:*
   Tax evasion encourages the society to indulge into illegal activities and shift the income to tax haven countries. The ethics and culture of the country is at stake from a larger perspective. Corruption and black money damages economic development.
5) *Political Instability:*
   Huge political instability sets in the economy. Government may resort to hiding the identities of top businesses to safeguard their political corporate relation and position. This will have a negative impact on the country's progress.
6) *Income Inequality:*
   The inequality of income within the society will increase due to this theft of taxes by the MNCs. There will be a high fiscal deficit leading to income inequality which further leads to a poverty trap.

3. MEASURE TO CONTROL TAX EVASION

The three ways suggested in the research conducted by are prison punishment, changing tax structures and improvising the tax culture within the country (Kirchler, 2007). A proper way to administer tax by arranging timely strict audits will create a fear of punishments amongst the mncs. They will maintain the right records and will minimize the underreporting. The country should also resort to naming and shaming the company's publicly who deliberately avoid taxes. This will put the brand image on stake and MNCs may refrain from doing evasion on the cost of brand name. The tax filing must be user friendly and with minimum processes. The tax filing will become easy. Making the MNCs sign a moral contract may work with respect to boosting the ethical consciousness. Last but not the least the corporates should strictly pay full taxes under the corporate social responsibility plan that they create in their business plan.

4. CONCLUSION

The conclusion can be achieved with three main points. Firstly, the techniques of tax evasion are very wide; it requires narrowing down and the loopholes require to be fixed. The supranational bodies should unite against the MNCs evading taxes even in one country and blacklist them from trade in the global economy

Secondly, the government should take in consideration the economic and social benefit of the MNCs coming to a developing country and create an accountable environment motivating MNCs to resort to ethical functioning. This will create more benefit than the cost of international firms operating in India.

Thirdly, the fines and punishment as a measure to control tax evasion and avoidance should be higher than the tax rate. This way MNCs will be more mindful of paying right taxes at right time to the right country by all right means

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