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GOVERNANCE

TAX EVASION AND ITS EFFECTS ON DEVELOPING COUNTRIES; A CASE OF SOUTH AFRICA

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ABSTRACT

Purpose of the study: The study sought to examine the effect of tax evasion on the economy of developing countries in the case of South Africa.

Statement of the problem: Tax evasion is a challenging issue in most countries for the tax authorities and has existed for a long time. Tax evasion has been a typical problem, notably in countries with weak tax collection systems, and this formed the basis of the study. Tax evasion could be why many African countries are overburdened with foreign debts due to insufficient tax collection. Hence, the study was thought worthy for policy formulation among countries in all developing countries.

Research methodology: The study was literature based. The inferences were based on the findings from the preceding studies.

Findings: Based on the reviewed literature, it was found that tax evasion has a significant impact on the economies. Tax evasion happens when an individual or firm unlawfully avoids paying their tax which is an illegal act and attracts fines and penalties. Tax evasive practices widen wealth inequality along with weakening consumer purchasing power. Tax evasion adversely affects the economy, like the decrease in government revenues.

Conclusion: The study concluded that tax evasion affects the economy negatively. Tax evasion substantially minimizes government revenue and consequently influences the level of public expenditure. Tax evasion creates investment disruption in the form of the purchase of properties exempted from tax or under-valued for tax purposes.

Recommendations: The study recommended that developing countries such as South Africa need to build systems that will reduce tax evasion. The government should collaborate with the authority concerned with tax collection to ensure that those responsible for tax evasion face the full force of the law, fined and sentenced to assist in setting an example to other individuals who may be taking into consideration the vice. It is also recommended that the government use the tax more efficiently and reduce waste so that more individuals can be encouraged to remit their taxes.

Keywords: *Tax evasion, economy, developing countries, South Africa*

INTRODUCTION

Tax evasion is a challenging issue in most countries for the tax authorities and has existed for a long time (Gunn, Koch & Weyzig, 2020). Tax evasion happens when an individual or firm unlawfully avoids paying their tax which is an illegal act and attracts fines and penalties. Tax evasive practices widen wealth inequality along with weakening consumer purchasing power. Tax evasion adversely affects the economy, like the decrease in government revenues (Di Nola, Kocharkov, Scholl & Tkhir, 2021). Tax evasion is an unlawful method to lower tax liability through fraudulent strategies such as intentionally understating the gross income or inflating costs (Clough, 2021). It is an illegal effort to decrease one's tax burden. Tax evasion is done to show less profit to avoid tax burden.

Tien and Arunasalam (2022) argued that tax evasion adversely influences the economy and the nation's well-being. One of the effects is the reduction in government revenue that causes higher tax rates, negatively impacting corporates and households. Tax evasion substantially minimizes government revenue and influences public expenditure (Jemberie, 2020). In a nation where human capital accumulation relies on public spending, it is evident that tax evasion may influence this process. Collecting taxes and charges is the fundamental way for nations to create general revenues, making it possible to finance investments in human capital, infrastructure, and the delivery of services for residents and businesses (Brida, Carrera & Segarra, 2020). Tax cuts enhance demand by raising disposable income and motivating corporations to employ and invest more (Kopp, Leigh, Mursula & Tambunlertchai, 2019).

Tax evasion substantially minimizes government revenue and consequently influences the level of public expenditure. Tax evasion creates investment disruption in purchasing properties exempted from tax or under-valued for tax purposes (Janský, 2018). The general tax-evasive practices widen wealth inequality and weaken consumer purchasing power (Gautam, 2019). These tax-evasions schemes also skew economic statistics, hindering public and private sectors from managing the economy or making social policy, taking away respect for the law, inhibiting job development, encouraging corruption, and accumulating private capital by gratifying people and corporations for sheltering cash overseas instead of investing it locally in infrastructure and economic development. The main problem of policymakers is the impact of taxation on income distribution. When people and corporations lie about their tax burden through tax evasion, they change the real effects of taxation, particularly the impacts on income distribution (Torregrosa-Hetland, 2020).

A lot of standard analyses ignore these distributional repercussions and assume that tax evasion's primary and only recipients are the evaders themselves. The recent work has started to influence new studies on the impacts of tax evasion on inequality. Some result of work is that tax evasion might intensify inequality since chances to escape taxes tend to increase with income (Joshi, Outslay, Persson, Shevlin & Venkat, 2020). Recently it was discovered that people at the highest point of the income distribution use tax havens to hide considerable portions of their wealth, hence increasing wealth variations. However, corporate proof of the distributional effects of tax evasion remains unsettled.

Ozili (2020) noted that tax evasion is essential to public economics. Its most clear effect is decreased taxation, influencing the taxes that compliant taxpayers encounter and residents' public services. Beyond the revenue losses, evasion causes resource misallocation when individuals change their behavior to lie on their taxes, like their choice of hours to work, occupations to enter, and investments to undertake. Furthermore, governments must expend resources to find, determine, and punish non-compliance (Abdixhiku, Pugh & Hashi, 2018). Non-compliance changes how income is distributed in arbitrary, uncertain, and unjust methods, influencing macroeconomic statistics' accuracy.

The formal analysis of tax evasion assumes that the wrongdoer keeps the evaded tax in its entirety, therefore, is the single beneficiary of tax evasion (Dezső, Alm & Kirchler, 2022). This assumption is insufficient and misleading. The act of tax evasion sets in motion a range of basic equilibrium adjustments as people and corporations react to the changes in incentives developed by evasion. These adjustments cause changes in factor incomes and product costs, creating movements in factors and products. All these modifications influence the last prices that establish real income distribution impacts of tax evasion. The problem of tax evasion is a complex multidimensional problem. There are many different reasons why people and companies try to avoid reducing the taxes they have to pay for semi-legal or illegal practices (Drogalas, Anagnostopoulou, Pazarskis & Petkopoulos, 2018). Tax evasion could be why many African countries are overburdened with foreign debts due to insufficient tax collection. Thus, the study was thought worthy for policy formulation among countries in all developing countries. The study was literature based. The inferences were based on the findings from the preceding studies.

LITERATURE REVIEW

Didimo, Giamminonni, Liotta, Montecchiani and Pagliuca (2018) study argues tax evasion is a criminal offense of globalization.Tax evasion happens when an individual or firm unlawfully avoids paying their tax which is an illegal act and attracts fines and penalties. Tax evasive practices widen wealth inequality along with weakening consumer purchasing power. Tax evasion adversely affects the economy, like the decrease in government revenues. Tax evasion is not an issue coming from the corporation. Corporate tax evasion is a technique that includes various companies and territories all at once. Therefore, it has international effects since these companies do not pay their set taxes in the operating nations. The study recommended that countries need to build systems that will reduce tax evasion. The government should collaborate with the authority concerned with tax collection to ensure that those responsible for tax evasion face the full force of the law, fined and sentenced to assist in setting an example to other individuals who may be considering the vice. It is also recommended that the government use the tax more efficiently and reduce waste so that more individuals can be encouraged to remit their taxes.

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Androniceanu, Gherghina and Ciobănaşu (2019) evaluated the macroeconomic connections between tax evasion and public and private investment and their effects on economic development through a discrete stochastic development version. Taxation is necessary for numerous factors for growth. Tax evasion adversely affects the economy, like the decrease in government revenues that finance public infrastructure, education, etc. When private capital and public spending are substitutes in the productive industry, secret agents might utilize tax evasion to mobilize money to fund private domestic investment and alleviate the adverse externalities of tax evasion on effective public spending. A stochastic dynamic programming strategy was used to acquire the optimum usage and tax evasion rate plans. For that reason, the impact of tax evasion on economic development is unclear because of the trade-off between the gain from tax evasion to disposable income and the loss resulting from reduced production because of lower public input. A comparative characteristic was also done on optimal consumption values and tax evasion rate. Variations in the tax rate and fine have ambiguous impacts on optimal intake and rely on the enforcement criteria of the tax authority. In contrast, the effects on optimal tax evasion rate are primarily favorable and constant with the concept.

Montenegro (2021) examined the relationship between tax evasion and economic growth. The study findings showed that tax evasion hurts economic growth. Tax evasion is a challenging issue in most countries for the tax authorities and has existed for a long time. Tax evasion happens when an individual or firm unlawfully avoids paying their tax which is an illegal act and attracts fines and penalties. Tax evasive practices widen wealth inequality along with weakening consumer purchasing power. Tax evasion adversely affects the economy, like the decrease in government revenues. It is an illegal effort to decrease one's tax burden. Tax evasion is done to show less profit to avoid tax burden.

Gunn, Koch, and Weyzig (2020) study analyzed tax evasion by businesses in the case of the arising sector of business and human rights in the economy. It expresses the methods of company tax evasion and the human expenses of those methods. It considers the degree to which tax evasion problems have been resolved by business social responsibility before turning to business and human rights and examines the future value of the United Nations Guiding Principles on corporate and civil rights in this case. The study uses the experience of Switzerland since the nation has relation to abusive tax methods related to big multinational firms and its assistance for the United Nations Guiding Principles on the company and human rights.

Brida, Carrera and Segarra's (2020) study investigates how personal income tax evasion disparities impact long-run economic development. The framework and funding of a tax change are essential to accomplishing economic development. Tax rate cuts might motivate people to work, do saving, and spend. Still, if instant spending cuts do not fund the tax cuts, they will lead to an increased federal budget deficit that will, in the long run, lower national savings and raise interest rates. The net effect on development is uncertain; however, most evaluations recommend it is small or negative. Base-widening approaches may alleviate the impact of tax rate cuts on the budget deficit; concurrently, they likewise minimize the influence on labor supply, saving, and investment and hence reduce the direct effect on development. Nevertheless, they reallocate resources throughout sectors toward their highest-value economic usage, leading to increased effectiveness and possibly increasing the general size of the economy. The outcomes recommend that not all tax changes will have the same effect on development. Reforms that increase incentives, decrease current subsidies, prevent windfall gains, and prevent deficit financing will certainly have much more advantageous impacts on the long-lasting dimension of the economy but might also produce trade-offs between equity and performance.

According to Drogalas, Anagnostopoulou, Pazarskis and Petkopoulos (2018), tax payment is a public obligation and an enforced contribution by the government to contribute to her primary source of income to give general products and services to its people. It is a mandatory unrequited contribution to the government. Tax evasion frequency essentially and adversely harms taxation's macro-economic goals, developing a gap between actual and potential government tax profits and bringing about numerous problems that require quick response and solutions. However, a lot of the government undertakings to exercise its sovereign right to gather tax, many individuals do not like paying tax even though there is terrific gratitude that tax needs to be paid and these propels some individuals into tax evasion, making the government continuously stop working to increase the set tax revenues. The research investigated how tax evasion influences tax incomes in India. The research used a survey study layout that entailed gathering data from a sample of people via response to questions. The research focused on 40 tax evaders. The analysis counted on secondary information to examine these instances, relevant publications by government agencies, institutions like Tax Justice Network, studies of other authors and writers in the form of articles, publications, bulletins and newspapers journals, and from the internet. The researcher utilized quantitative approaches to quantify the issue by developing mathematical data. A regression evaluation was used to determine the impact of tax evasion on tax revenue. From the regression version, the researchers learned that there were elements' affecting tax earnings in India, whereby the overall tax evasions, cash supply, GDP per capita, and exchange rate. They affected it favorably and adversely. The research discovered that the intercept was 0.758 every year. The four independent variables researched (overall tax evasions, money supply, GDP per capita and exchange rate) discuss a significant 69.7 percent of tax revenue in India with equity as represented by adjusted R2 (0.584). The researchers noted that the coefficient for overall tax evasions was -0.475, indicating that overall tax evasions adversely affected India's tax revenue. The research concluded that tax evasion adversely but dramatically influences tax revenues in India. The study advised that because of the potential unfavorable impacts of tax evasion on tax revenues in India, new policy standards found in the budget speeches and various other tax policy records need to be applied, as an issue of urgency, almost promptly.

A study by Davis, Cebula and Boylan (2021) analyzes the empirical impact of corporate income tax evasion on GDP growth rate, using historic data from 1960-2012 for Sweden. The economic concept proposes that corporate tax evasion substantially negatively influences the GPD growth rate. Previous empirical works on cross-country panel data support this substantially negative relationship between growth rate and company tax evasion. Nonetheless, empirical results using nation-specific time-series data reveal inconsistencies and contradictions to this conventional wisdom. Using time series data, it was discovered that company tax evasion substantially affects Swedish economic growth.

Kemsley, Kemsley, and Morgan (2021) noted that tax evasion happens when an individual or firm unlawfully avoids paying their tax which is an illegal act and attracts fines and penalties. Tax evasive practices widen wealth inequality along with weakening consumer purchasing power. Tax evasion adversely affects the economy, like the decrease in government revenues. A study by Janský (2018) showed that tax evasion negatively affects an economy's growth. Tax evasion is a challenging issue in most countries for the tax authorities and has existed for a long time. Tax evasion has been a typical problem, notably in countries with weak tax collection systems, and this formed the basis of the study. Tax evasion could be why many African countries are overburdened with foreign debts due to insufficient tax collection.

RESEARCH FINDINGS

The study discovered that tax evasion adversely influences the economy and the nation's well-being. Tax evasion is a challenging issue in most countries for the tax authorities and has existed for a long time. Tax evasion happens when an individual or firm unlawfully avoids paying their tax which is an illegal act and attracts fines and penalties. Tax evasive practices widen wealth inequality along with weakening consumer purchasing power. Tax evasion adversely affects the economy, like the decrease in government revenues. Tax evasion is an unlawful method to lower tax liability through fraudulent strategies such as intentionally understating the gross income or inflating costs. It is an illegal effort to decrease one's tax burden. Tax evasion is done to show less profit to avoid tax burden. Taxation is necessary for numerous factors for development. Tax evasion substantially minimizes government revenue and consequently influences the level of public expenditure. When people and corporations lie about their tax burden through tax evasion, they change the real effects of taxation, particularly the impacts on income distribution. People with high-income distribution use tax havens to hide considerable portions of their wealth, increasing wealth variations.

CONCLUSION AND RECOMMENDATIONS

The study concluded that tax evasion affects the economy negatively. Tax evasion substantially minimizes government revenue and consequently influences the level of public expenditure. Tax evasion creates investment disruption in the form of the purchase of properties exempted from tax or under-valued for tax purposes. Tax evasion creates negative impacts on the economy and the welfare of society. Tax evasion affects the productivity of the tax system, reducing the amount of revenue that could be raised given the statutory system. One of the impacts is the fall in government revenue which can lead to higher tax rates, negatively affecting firms and households. The study recommended that developing countries such as South Africa need to build systems that will reduce tax evasion. The government should collaborate with the authority concerned with tax collection to ensure that those responsible for tax evasion face the full force of the law, fined and sentenced to assist in setting an example to other individuals who may be considering the vice. It is also recommended that the government use the tax more efficiently and reduce waste so that more individuals can be encouraged to remit their taxes.

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