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Tax Evasion – An Important Source of Illegal Income in Georgia

A: Introduction:

The Problem of money laundering in Georgia is closely linked to the ongoing political, economic and social processes in the country. Money laundering is an international issue and it's not just a problem of Georgia, it is a global problem. The events of September 11th confronted the world, once again, with the necessity for counteracting money laundering and establishing appropriate legislation and control against it.

One of the main sources of illegal earnings in Georgia is tax evasion. The aim of this paper is to present the struggle against tax evasion, as an active counteraction against money laundering.

B: The history of the issue at hand:

It is worthy to note, that the scientific-practical study of the phenomenon of money laundering does not have a long history. This event originates in the 30's of the 20th century when criminal groups in the US invested their illegal earnings in laundry mats, in order to legalize their earnings. Developed countries started the thorough study and struggle against money laundering through judicial means and international cooperation in the early 80's. It was in 1986 that the US judicial system first acknowledged money laundering as a crime. In Paris, in 1989 seven developed countries founded the intercontinental organization - *FATF (Financial Action Task Force)*, which basically coordinates international efforts against money laundering.

It is noteworthy, that in the context of efforts taken against money laundering, there is less attention devoted to the issues of tax evasion. Even among 40 recommendations compiled by *FATF*, which represents the founding document for the actions taken against money laundering worldwide, there is practically no mention of the issue of tax evasion. This research paper is an effort to focus on the better usage of taxation tools in the process of fighting money laundering.

C: Methodology

In the process of this research, the following issues have been discussed: theoretical aspects of the issue of tax evasion; the causes of tax evasion; the international practice of accumulating “hot money” as a result of circumventing taxation laws; the criminal sources of ‘hot money’ in Georgia; the creation of these sources as a result of violating tax laws; mechanisms of laundering hot money and tax evasion in Georgia; conceptualizing mechanisms against laundering hot money (general methodology and taxation tools).

D. The Problem Analysis

1. Theoretical aspects of tax evasion

Tax evasion manifests itself in the tax payer’s deliberate action, which is directed at providing him/her with the opportunity to completely evade, or partially surpass the responsibility of paying taxes.¹

Tax evasion is characterized by an action, which is directed at reducing tax responsibilities. To put it differently, in the process of avoiding taxes, the subject acts deliberately, has a predetermined realization of the character of his/her actions, is willing to achieve a certain end, and consciously commits actions leading to that end.

The legal nature of tax evasion methods is significantly diverse. From the character and content of tax payers’ actions, we can deduce that tax evasion assumes three different forms:

- Tax evasion
- Tax avoidance
- Evading taxes without violating the law

Tax evasion is a way of reducing taxes, during which the taxpayer deliberately exploits the legal means to reduce the volume of his/her tax responsibility.

¹ Zviad Rogava. “Taxes, The System Of Taxation and Taxation Laws.” Tbilisi, Bakmi, 2002.

Tax evasion is actualized by the tax payer through violating the taxation law or through committing a crime, which implies the direct sabotage of the taxation law. The tax payer's action is illegal and unlawful even from the initial phase of tax evasion. These actions can be directed both at decreasing taxes and at completely hiding them.

Since tax evasion is made possible by the taxpayer's unlawful and deliberate actions, these actions can be subject to different forms of legal prosecution, more specifically to civic, administrative, criminal and taxation code.

Tax avoidance is a way of reducing tax responsibility, during which the taxpayer avoids a certain category of tax through active and oftentimes lawful means and hence does not pay a certain tax.

Depending on the character of taxpayer's action, tax avoidance can be divided into two categories: lawful and unlawful.

Below are the means belonging to the first (lawful) group:

a) The subject prevents himself/herself from engaging in activities that are subject to tax deduction. This represents rare, if not the only type of passive action. This kind of tax avoidance is ineffective and unpopular since it can partially or completely hinder the economic activity of the tax payer. For example, for the sake of avoiding the income tax, the subject does not acquire a certain asset.

b) The subject organizes a certain activity under the auspices of which the subject is not a taxpayer. Or the subject actualizes the activity which, under the law, is not subject to taxation. Or the subject engages in an activity the income from which is not subject to taxation.

The means of tax avoidance belonging to the second group are unlawful actions, during which the reduction of the tax responsibility or the complete avoidance of taxes is conducted through illegal means. Due to their nature, these means are closer to tax evasion and the violation of the law. Two main means belonging to this group are:

- ◆ The conduct of business activity without state registration.
- ◆ The conduct of economic activity without registering in the tax department.

According to the Georgian Law on Enterprise Ownership, the subjects involved in manufacturing should obtain a court registration (apart from the individual manufacturers who register in the tax department). Furthermore, besides the state registration, Georgian Tax Law obliges taxpayers to be registered at taxation authorities.

In case of violating above stated norms, according to the jurisdiction, enterprise owners belong to the pool of taxpayers but because of the absence of their registration in competent authorities, they actually aren't taxpayers. The absence of the state registration and the appropriate tax identification number empowers tax payers to conduct their economic activity without any control or the obligation to pay any taxes.

It is noteworthy, that the current tax law subjects any legal entity to tax responsibility despite its registration conditions. More specifically, according to the article 28 of the Georgian taxation law, the tax responsibility falls on the taxpayer from the moment the taxation conditions set in the legislation start applying.

Tax planning - tax evasion without violating the tax law- represents the taxpayers deliberate lawful way of reducing the total tax responsibility. This entails the complete exploitation of tax privileges defined by the law and other “loops” and mechanisms found in the law itself. Tax planning also includes actions which are directed at lawful means of tax evasion.

To put this differently, in the case of tax evasion, taxpayer organizes his activity in a way that his tax obligations are lawfully reduced to the minimum and this activity does not come in contradiction with the existing legislation. In the instance of tax planning, tax payer uses the means permitted and not prohibited by the law for the sake of reducing his tax obligations. That is, this activity does not entail the criminal or illegal composition and hence does not lead to consequences created by tax avoidance (i.e. in the form of subjecting these actions to criminal or administrative prosecution).

Tax planning, as usual, is envisioned on long term basis (on a few tax quarters). Unlike tax planning, tax evasion is mostly targeted at tax reduction in a given moment, simultaneously or solely at one or many aspects of taxpayer's activity.

2. *Reasons behind Tax Evasion*

The problem of tax evasion is acute not only in Georgia. The problem of criminality in the system of taxation is prevalent in all countries, without exception.

It is possible to single out reasons, which encourage enterprise owners to evade taxes:

- ◆ Moral (conscious – psychological)
- ◆ Political
- ◆ Economic
- ◆ Technical (legal)

Moral (conscious – psychological) reasons are usually prompted by the nature of tax laws.

While the authority of any other law is founded on its long-term and consistent practice, which is mostly secured by its all encompassing, persistent and non-partisan character, tax laws do not have any of the above characteristics.

Tax laws are not all encompassing by their nature because they grant certain privileges to certain category of tax payers who, as a result, are put in a position of having an advantage. This condition often tempts the taxpayer to move to the “privileged position,” which usually leads to their engagement in tax evasion.

The persistent nature of laws means lasting credibility of their legislative decree over a long period of time. This, unfortunately, does not characterize tax laws. For example, there have been more than 20 amendments made to the Georgian tax law since its issue date. Constant amending of the tax law downplays its authority, and as a result, creates the sense of non-obligatory fulfillment of tax obligations in the mind of the taxpayer.

There is less respect towards tax legislature than towards other laws even among the law-abiding citizens since they believe that the state sets laws solely for the purposes of fulfilling its own interests. The state is perceived by the taxpayer not as a legislator, but as a big creditor, who sets the rules of its own game. As a consequence, taxpayers think it possible to avoid their own tax debts to the state.

It should be noted, that moral reasons behind tax evasion are not determined exclusively by the nature and the character of tax laws, but by the system of taxation as a whole. In the environment of high taxes, when the taxpayer pays a big portion of its assets in taxes, the taxpayer begins to feel suppressed by the state. Tax evasion can be a reaction to such suppression.

It should be emphasized, that the main reason behind tax crimes is the psychological mindset of taxpayers which is characterized by their negative approach towards the system of taxation and their low level of legal awareness.

Political reasons prompt the taxpayer towards tax evasion when taxes are set by the state not only for the purposes of covering its own expenditures, but also as an instrument for conducting social and economic politics. That is, tax evasion can be a certain form of political protest.

Taxes present themselves as an instrument for economic politics when the state increases taxes on certain sectors of production for the sake of reducing their market share, or vice versa, the state reduces taxes on potentially viable or less developed sectors for the sake of catalyzing their development. In this scenario, industries for which taxes have risen, try to evade taxes.

Economic reasons often encourage taxpayers to evade taxes. These reasons can be divided into two types: reasons which depend on the financial status of the taxpayer and reasons which are the result of the general economic juncture.

Sometimes, the financial status of the taxpayer is a determining factor for tax evasion. The taxpayer evaluates the degree by which gains received from tax evasion outweigh the possible negative implications of not paying taxes. If from the economics point of view, the tax evasion is profitable, then the taxpayer will not pay taxes in most of these cases.

If the financial status of the taxpayer is stable, then he will not pursue the option of tax evasion, in order not to hamper his business reputation. By the same token, if the financial viability of the taxpayer is critical, he is on the verge of bankruptcy and tax evasion is his only rescue, then he will most definitely pursue the option of tax evasion.

Economic reasons which are determined by the general economic environment manifest themselves in the times of economic crises or on the contrary, in the period of the economic boom.

During the period of economic crises, the government of any state is obliged to come up with appropriate measures for stabilizing the economy. Cases of tax evasion increase during this period because the “shadow economy,” which starts to form in parallel with the legal market, operates according to its own rules, ignoring the rules set by the state. The deals sealed on such markets are not subject to taxation since they are beyond any state control. In this environment the enterprise owner is tempted to want to work in such a market and hence to evade taxes.

On the other hand, the cases of tax evasion may increase during the period of economic boom and the environment of increased economic cooperation, union and trade expansion. As a rule, tax control is limited by state boundaries, and thanks to free capital flows, enterprise owners obtain the beneficial environment for hiding their earnings.

Technical (legal) reasons are determined by the complexity of the tax system, which hinders the effective administration of tax control by the state and provides the taxpayer with a chance to evade taxes. Furthermore, it should be noted, that oftentimes the tax legislation itself provides the taxpayer with every opportunity for seeking ways of tax reduction. More specifically, this is determined by:

- a) The presence of conditions in the tax legislation that exempt certain taxpayers from paying taxes. This encourages taxpayers to seek ways for using these privileges;
- b) The existence of different tax brackets, which also prompt taxpayers to choose the most favorable tax brackets for them.
- c) The existence of different ways of misrepresenting and appropriating real unit prices, values of real financial turnouts and income generated within a certain enterprise. This circumstance directly affects the calculation of taxation basis.
- d) The existence of loops in the tax legislature, which can be explained by imperfect legal technicalities and the ignorance of prevalent circumstances which occur at the time of paying or calculating taxes.

It is necessary to note, that the tax payer might seek tax evasion not only because of one of the reasons mentioned above, but also because of the coincidence of more than one of these reasons. That

is, these reasons are not mutually exclusive, but rather come in correlation with each other and together encourage even the law obeying citizens to evade taxes.

3. The International Practice of Accumulating “Hot Money” Due to Violations In the Tax Legislation.

The “Shadow Economy” is the type of economy, which exhibits destructive characteristics, brings damage to the society and its members, generates illegal earnings and promotes tax evasion on these earnings. The shadow economy can be defined as an economy, which is not subject to taxation.²

It’s noteworthy, that in western countries the “shadow capital” is directly related to tax evasion. For example, the Criminal Law of the German Federal Republic does not provide the direct definition of the “shadow capital.” As German experts suppose, this definition is a derivative of article 73 of the Criminal Law, which regulates matters of expropriation for law perpetrators, more specifically for robbery, fraud and the appropriation of financial means etc. Furthermore, German experts on tax legislation claim, that Article 73 of the Criminal Law of the GFR gives basis for classifying the “shadow capital” as any material benefits received from executing machinations related to raw materials, semi-finished goods and end products.

German experts devote special attention to studying origins of hot money created from tax evasion, and ways of its legalization. The German expert on tax legislature, K. Kotke, thinks that for the purposes of taxation, “hot money” encompasses not only material benefits received from violating the tax legislation, but also from income which should have been received from taxation. For example, an enterprise owner is obliged to enter 3 million marks in their asset declaration form, but in reality, he only registers 2 million. As a result, the enterprise owner has gained the amount equal to one million marks plus 530, 000 marks - the tax which should have been paid on his declared assets. As a result, the enterprise owner generated “hot money” which is equal to 1, 530,000 million marks.

² I. N, Solovyov. ” *Legalization of earnings generated through illegal means and their tax deductibility*”, “**Nalogovi Vestnik** # 3 (2000), 23-25

When characterizing “hot money”, the issue of secret ways of its formation should be taken into account, as it becomes difficult to determine sources of hot money in the aftermath of the process of their legalization. For example, if these earnings are invested in stocks, bonds, real estate or commercial enterprises, hot money is legalized and gets hidden under legal financial turnings.

Some experts categorize violations in tax legislation together with those crimes, which are used by organized groups as direct, indirect or atypical elements. Furthermore, experts claim that the common characteristic of these crimes is not their ability to bring organized groups direct material benefits, but rather administering the damage, creating appropriate conditions for carrying out crimes, or creating dubious circumstances around these crimes for confusing the investigation.

The above claim is partially true, but it does not encompass the understanding of full social costs of tax legislation violations: experts consider that tax legislation violations are present in practically all operations conducted by organized crime groups.

The judicial practice in the US often comes to using articles governing tax legislation violations not only for taxation violations. Activities directed at accumulating illegal earnings (Drug trafficking, weapons trade, prostitution and others) are considered as indirect ways of evading taxes since it is easier to prove taxation violations than to gather enough evidence for proving other, more serious crimes.

4. The Sources of Hot Money in Georgia

4.1 Criminal Sources

An important factor facilitating illegal earnings in Georgia is its uncontrolled territories: Abkhazia, Samachablo and Pankisi Gorge.

One of the main sources of illegal earnings in Georgia is the Narco-business. In the US State Department report on “*Money Laundering and Financial Crimes in 2001*” it was stated that Georgia is

a transit route of heroin from Afghanistan to Europe. Georgia is also a transit route for morphine from Afghanistan to Turkey.³

Pankisi Gorge is mentioned in the context of such international crimes, as kidnapping for ransom, which has become prevalent in Georgia due to links between local and Chechen (seeking a refuge in the Gorge) criminal groups. There have been numerous cases of kidnappings: The kidnappings of four staff members of *Red Cross Organization* during the fall of 2000; two Spanish businessmen in the beginning of 2001, the member of the Georgian Parliament from downtown Tbilisi in May of the same year, the British banker, Peter Shaw in 2002 and other publicized cases.⁴

One of the significant sources of hot money formation is weapons trade. There is substantial ground for weapons trade in Georgia because of unregulated ethnic conflicts on Georgian territory and an ongoing military conflict to the North of the country – Chechnya. The stalled military conflict between Azerbaijan and Armenia should also be taken into account.

Besides above-mentioned crimes, criminal sources such as robbery, theft, prostitution and fraud also play a certain role in accumulating hot money.

4.2 Sources Created as a Result of Violations in Tax legislation

The mechanism of income declaration does not work properly in Georgia and hence income tax is only 15-17% of all taxable income, and even that is at the expense of government clerks (that is when this tax is the most significant filler of the state budget in Western countries). To put this differently, tax evasion is carried out by hiding income. Also, enterprises engage in artificially inflating their expenditures, deflating their income and minimizing their taxable income. As a result, the state shifts its attention to indirect taxes (VAT's), which become main fillers of the state budget. But tax evasion is prevalent here too, since taxable turnouts are artificially deflated and invoices are manipulated.

³ US State Department, 2001. Money Laundering and Financial Crime.

⁴ Janashia, Jemal: “*International Narcobusiness – Transnational Crime and The Issue of Perfecting subsequent Legislative Basis*”. Tbilisi, The Georgian-European Consulting Center on Issues of Economic Politics and Legislature” (2001): 41-44.

Furthermore, tax evasion manifests itself in hiding taxable income, fraudulent accountancy, untimely or partial submission of documents needed for tax calculations, and unlawful tax exemptions. It can be said, that taxpayers in Georgia use almost all theoretical aspects of methods of tax evasion stated in D.1 Section of the previous paper.

As far as goods are concerned, there are frequent instances of large-scale tax evasion with respect to contraband trade of oil products, tobacco and alcohol by declaring only small portion of their real quantities.

5. Methods of Money Laundering and Ways of Tax Evasion in Georgia

The formation of illegal income, or hot money, is always accompanied by tax evasion and these two processes are always interlinked and correlated.

Beside the fact, that the bank system in Georgia is well developed, legalization of illegal earnings always circumvents bank channels. Money laundering in Georgia is not carried out by such well established, modern methods as: the manipulation with structural deposits and bank accounts, exploitation of different monetary instruments (travelers checks and others), the usage of credit and debit cards, wire transfers, underground banks (e.g. system “Havala”), smurfing (manipulating with different deposits), parallel credit transfers, bank-to-bank transfers etc.

The “ignorance” of the above stated methods is not due to lack of skills on the part of Georgian criminals and money launderers, or the severity of bank monitoring. Rather, there is no need for extra expenditure of money and energy. In Georgia, there is basically no practice of investigating sources of income and any person can engage in any kind of trade or transfer without establishing the source of the money or the accountability of its owner.

Deliberately or not, well-established technologies of money laundering are used in Georgia too. For example, falsifying credit guarantees and customs declarations on import and engaging in barter of stolen goods (e.g. antiques and cars) on the border or within the country. It should be noted, that this is common practice in Georgia and stolen cars are moved to Samachablo and Pankisi, where they are either cashed, exchanged for narcotics or weapons.

Hot money in Georgia is frequently legalized through construction. Low paid government clerks and “bankrupt” business-owners build luxury houses and thus legalize their illegal income.

The privatization of state-owned property provides beneficial ground for money laundering. There is an ongoing privatization of strategically important enterprise sectors. Specifically, it is foreseeable that capital accumulated illegally will be invested in communications, energy and transport (railway system) sectors, ports etc.

It is possible to launder money at any money exchange location in Georgia. Just in Tbilisi, there are more than 400 functioning money exchange locations and it is impossible to establish their real turnovers.

The international practice of laundering money through casinos is successfully carried out in Georgia too. The geopolitical situation of the country also makes the existence of this practice easier, since in the neighboring Muslim countries casinos are banned. Currently, there are 22 licensed casinos in Tbilisi (16-17 of these are fully operating), which, judging by the permanent rows of expensive cars parked in front of them, are working full time.

As tax inspectors claim, it's very difficult to expose facts of legalization of illegal income in casinos, since the customer can change any sum of money into casino tokens, then, after spending some time in a casino, or after making some stakes in a game, he/she can change counters back to cash at a cashier's desk, claiming it to be the money gained during the game, or transfer the money directly to his/her account. This method is thought to be reliable, since the “money launderer” really was at a casino, really made stakes and can claim witnesses, in the form of the casino personnel. Everything in this scenario is close to the truth, except for the actual gained sum.

The sports bookies, which have greatly increased in number recently (especially during the aftermath of the 2002 World Cup) present classic means for money laundering.

From the aforementioned we can infer that there are many ways of laundering money in Georgia. If the fight against money laundering becomes tougher in Georgia and criminals find themselves in serious trouble, the “regional factor” should be taken into account beforehand. That is,

in the neighboring countries (Azerbaijan, Armenia, Russia, Turkey), like in Georgia, there is an unfavorable and unstable environment for fighting money laundering.

The parallel between money laundering and tax evasion can be clearly seen by observing the process of manipulation with phony companies. In this case, criminal elements and other interested entities manipulate invoices and exchange illegal income in the form of cash into stocks (at a certain interest rate). The analysis of these kinds of phony companies, which off course don't pay any taxes, enables us to single out following characteristics accompanying their registration and functioning:

- ◆ They are never found at their registered address and have nothing to do with it;
- ◆ The owners of such companies are random people (homeless, retirees, students), or people using stolen identity documents;
- ◆ They have no accountancy;
- ◆ Most of the time, for the sake of evading taxes, these companies function only for 1-2 months in a year;
- ◆ As a rule, the turnover of these companies increases during the last days of the week or / and of the month;
- ◆ The phony invoices, contracts and agreements are signed not by company directors, but their subordinates. These documents are partially filled out when passed on to clients;
- ◆ As a rule, these kinds of transactions are carried out by circumventing bank channels, but usually, phony companies change banks and bank accounts on regular basis.

Not only do these phony companies claim bankruptcy at their first tax inspection, but they also claim to reorganize themselves by changing the owner or by merging with another company.

It is also possible to launder money through the usage of different charity and non-commercial foundations.

Georgia, like other developing countries or countries in transition, is a beneficial place for laundering money for a certain category of foreign businessmen and criminals. It is even more challenging to fight money laundering in the country engulfed in economic crises, corruption,

contraband trade, criminality and unfavorable investment environment. On the one hand, it is difficult to reject foreign investment which, in reality, is the means of laundering money for foreigners with suspicious profiles and their local business representatives. However, it should be realized, that after completing their money laundering operations, the departure of these “investors” will be as notorious as their entry into the country.

6. Mechanisms for Laundering Hot Money

For the purposes of this paper, which aims at outlining taxation tools in the process of fighting money laundering, it is appropriate to divide mechanisms of hot money laundering in two different groups:

6.1. General Methods Which Can Be Used Against Legalizing Hot Money

Georgia, as a member of the European Council, has taken the responsibility to harmonize its legislation with the legislation of European countries. Besides, one of the most important responsibilities assumed by Georgia in 1990 about “*Tracking, Extracting and Confiscating Income Received from Money Laundering and Criminal Activities*” serves as a basis for ratifying the Strasburg Convention.

In the context of current world events and geopolitical order, Georgia is obliged to cooperate with the civilized world and engage in fighting against money laundering and terrorism financing. The starting point in this process should be the activity of such international organization, as *Financial Action Task Force* and its 40 recommendations.

First of all, Georgian legislative authority should ensure a legislative basis against money laundering. Currently, the Georgian Ministry of Finance and the Georgian National Bank are working on the bill on “Prohibition of Legalization of Illegal Income.” Appropriate changes should be administered in the criminal law legislation and other normative acts.

It is necessary, that the legislation should establish a clear basis for identifying, blocking, arresting and confiscating income received from criminal sources. At this moment, the article 194 of

the Georgian Criminal Law, which includes the definition of “Legalization of Illegal Income”, is not adequate to today’s demands.

Despite hindrances, the Georgian National Bank should come up with the initiative for state financial authorities to implement:

- Control and reporting of large and unusual transactions to appropriate competent authorities (in other words, implementing the administration of financial monitoring);
- Tougher control of activities of money exchange points;
- Regulation of the mechanism of identifying bank clients (under the legislative amendments made this year, it is prohibited to open anonymous bank accounts, but because of the feedback factor, there still are anonymous accounts which were opened before this amendment was made, hence it is necessary to control such accounts);
- Saving of the information for 5 years after closing the bank account etc.

Furthermore, the Georgian National Bank should monitor foreign bank accounts of Georgian nationals and residents, along with the foreign corresponding accounts of Georgian banks.

Law Enforcement and other appropriate authorities should coordinate a constructive discussion on the issue of illegal constructions in the context of countering money laundering.

It is necessary for competent authorities established in Georgia to cooperate with appropriate international authorities (for example, FATF, Interpol, World Trade Organization) for getting acquainted with international practice and innovations in this sphere. It is also necessary to exchange information on certain operations, by taking into account the factor of secrecy of information.

It is also important to conduct the ideological propaganda through the mass media, so that people are better informed about the meaning of money laundering, its detrimental effects, the necessity of countering it etc.

6.2. Using Taxation Tools Against Money Laundering

As it was stated above, tax evasion accompanies almost all kinds of legislative violations, be it criminal or taxation violations. Furthermore, Georgian legislation does not differentiate income based

on its lawfulness. More specifically, according to the article 218 of the Georgian tax legislation, income is taxed even when its source is controversial. That means that the Georgian legislation gives the Georgian law enforcement authorities the opportunity to track illegal, criminal income, tax it and charge these criminal elements at least for tax evasion. (Article 218 of the Georgian Criminal Law).

In the context of fighting tax evasion and money laundering, we can consider the issue of filing invoices only through bank transfers. That is, enterprise owners, who are registered as tax payers, should file the tax invoice only when the buyer transfers the VAT amount on the special VAT bank account opened by the provider in the entity which provides it with banking services. For filing taxes, the tax payer will need both the tax invoice and the document confirming the bank transfer. The result of this will be a multifold positive economic effect: reduction of illegal filings through the usage of tax invoices, promotion of the development of the banking sector and the accessibility of administering monitoring against money laundering.

In this context, it is interesting to mention Israel's experience in calculating and administering Value Added Tax. It's noteworthy, that Israel's law on VAT has actually been worked out based on the EU model on administering Value Added Tax.

In the tax declaration form, among other information, VAT payer declares its real turnover value and the VAT amount, which is due to either being paid to the state budget, or being paid back to the tax payer by the budget. If the VAT amount is below the lower cut rate (14,000 Shekels, which is approximately 3.5 thousand US dollars), then the VAT declaration form is not filed to the tax inspection authority but rather, it is filed directly to the bank, together with the tax order form.

If the payment or payback is above 14 thousand Shekels, tax declaration forms are filed not only in the bank, but also in the tax inspection department. In this case, tax authorities ask for documentations confirming the transaction, or for filing the information electronically in order to establish the common computer database. The information entered in the electronic database allows for reconfirming these transactions.

The same mechanism works for getting the tax payback from the budget. If the payback is below 14 thousand Shekels, then the payment is conducted by the bank, but if the sum is above 14

thousand Shekels, then the payback is made by tax authorities. If the tax is not paid back within 30 days, then the amount will be subject to 4 % interest rate annually, taking into account inflation.

Declarations of tax payments or paybacks are filed in specially authorized banks, which have a contract with Israel's Ministry of Finances for compiling these declarations. The state pays 1.1 US dollars for compiling one declaration. The tax payer has the right to file his declaration in any other bank of his choice, only in this case he himself is obliged to pay bank commission for compiling the declaration.⁵

The income and financial declaration forms of ranking officials should become the active tool in the process of fighting tax evasion since most of illegal earnings gathered from tax evasion and other criminal activities accumulate in the pockets of high ranking government officials.

According to the Georgian Law on "The conflict of interest and corruption in the public sector" the income and financial declaration forms of people of rank should be filed in the information bureau of income and financial status of people of rank. This bureau is regulated by the presidential decree #350 issued on the 24th of May, 1998 on "The activation of legislative decree on the information bureau of the income and financial status of people of rank." It's noteworthy, that the functions and the authority of the bureau is rather limited and consist only of accepting the income and financial status declaration forms of the people of rank, registering and saving them, filing them within a timeframe set by the law, providing their public accessibility and other insignificant and symbolic functions. According to the existing legislation, the bureau is not responsible for controlling the content and truthfulness of these declarations.

It should also be noted, that the existing legislation does not include any kind of sanctions for falsifying the declaration forms and for not fulfilling tax obligations. More specifically, in the case when enterprise owners and public officials do not fulfill their tax obligations, the existing law does not presuppose any disciplinary ramifications and does not provide a basis for administering any kind of disciplinary measures for punishing perpetrators.⁶

⁵ Vorobey, Y. L., "*Idiosyncrasies of tax exemptions and VAT paybacks in Israel*", "Nalogovi Vestnik # 4 (2000)

⁶ Rogava, Zviad. "*Taxes, Tax System and Tax Law*" Tbilisi: Bakmi, 2002.

As a result of the aforementioned, the tax declarations forms filed by ranking officials do not have any fiscal weight, are not subject to income and asset taxation and the information about their assets and income is subject only to discussions in the mass media.

The attitude towards declaration forms filed by ranking officials should change. The assets and plots of land mentioned in their declaration forms should be subject to appropriate asset and land tax and their untaxed income should be subject to income tax. Furthermore, for the purposes of exposing untaxed income and undeclared assets, the bureau should be given the authority for controlling the legitimacy of these declarations and for double-checking the information. For this, the working style of the information bureau on asset and financial status of ranking officials should change significantly. It's recommended to administer their reorganization, or their merger with tax authorities (according to the existing legislation, the bureau works in conjunction with the Ministry of Control) so that filing of declaration forms is not merely a formal act, but actually starts to carry real fiscal weight. The result will be the reduction of illegal earnings by the Georgian bureaucracy.

Money laundering through the usage of taxation means should be significantly reduced in casinos too. For the purposes of reducing artificially inflated gains, the actual gain sum should be taxed at its source, the casino cash desk. The appropriate amendments should be made to article 88 of the Georgian Tax Law and the casino should act as a tax agent, or the agent of the proprietor who is responsible for calculating the tax, for administering tax deduction and for transferring this sum to the budget.

E. Conclusions Drawn:

Money Laundering is an international problem and should be fought through close international cooperation.

One of the main sources of illegal income in Georgia is tax evasion. Furthermore, in the context of countering money laundering, little attention is drawn to the issues of tax evasion.

According to the international experience, “shadow economy” could be defined as the economy which is not subject to taxation. Besides, according to expert evaluations, taxation violations accompany practically all operations carried out by organized crime groups.

The sources of hot money formation in Georgia are: narco-business, kidnapping of people for ransom, weapons trade, robbery, ceasing property, prostitution, fraud etc.

Among the sources of hot money, formed as a result of violating the tax legislation, are artificially reduced or hidden incomes, undeclared assets which are subject to taxation, fraudulent accountancy etc.

Money laundering procedures are very liberal in Georgia, since there is no practice of identifying sources of income. Any proprietor can engage in any kind of purchasing activity or transfer without it ever being subject to any inquisition on the issue of its legitimacy.

The legalization of hot money happens through falsifying credit guarantees and customs declaration forms on income; through bartering stolen assets, through illegal construction activity, through privatizing state-owned enterprises, through money exchange points, through casinos, bookies, intermediary companies, different charity organizations, other non-commercial foundations etc.

It is recommended, that complex efforts and methods are used against mechanisms of legalizing hot money. These include the harmonization of the Georgian legislation with European legislations, the launching of collaborative activities together with financial institutions and the usage of taxations tools.

In conclusion, the fight against money laundering is one of the most significant factors for Georgian economic security and both legislative and executive governments in Georgia have a lot to do in this direction.

F. The importance of this research and its concluding remarks:

The main purpose of this paper was to emphasize the importance of taxations tools in the process of fighting money laundering. Numbers compiled by experts indicate that the Georgian state

budget loses the equivalent of 2 billion GEL through tax evasion, annually. Conducting actions against money laundering will lead to the legalization and extraction of this amount by the state.

Together with general recommendations, this paper discusses concrete taxation tools:

- ◆ Value Added Tax should be filed only through bank transfers;
- ◆ The financial and income declaration forms of ranking officials should carry a strong fiscal weight, not just a formal character;
- ◆ For the purposes of preventing the artificial inflation of gained amounts and money laundering in casinos, the gained amount should be taxed at its source, or at the casino cash desk.

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