Journal of Contemporary Issues in Business and Government Vol. 28, No. 04, 2022
https://cibgp.com/
P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.04.160

# CHINESE IMPORTS UNDER-INVOICED FROM THE PERSPECTIVE OF THE TAXMAN

**Anand Kumar Singh[1], Pradeep[2]**
[1]Ph.D. Research Scholar, (NIT Silchar), Department of Management Studies.
[2]Ph.D. Research Scholar, Gautam Buddha University, Department of political science and IR.

**ABSTRACT**
This study focuses on the harm that inappropriate trade invoice utilisation does to the growth of the economy. Due to the fact that China is the primary trading partner, trade figures with China are emphasised, empirically validated, and exhibited. The findings of the study demonstrate that China is engaging in illicit trade practises, which is affecting India's economy. The research revealed that excessive and inadequate invoicing is a major cause of capital flight. Long-term global economic downturn prompts some economists and policymakers to demand for stricter regulations to safeguard their domestic economies. If put into practise, this might cause a high tariff and non-tariff system similar to the one that governed the pre-globalized world economy. Mismatched trade statistics between developed and developing nations point to significant misreporting of economic data, mostly by traders in developing nations. Due torigid exchange rate regimes, severe import limitations and export subsidies prevailing in less developed nations. This study specifically addresses the under-invoicing of imports as a result of high trade restrictions in a market where domestic companies compete with importers. The studyanalyses that how the levels of under-invoicing isimpacted by tariff levels, market structure, and government involvement (in the form of the extent of monitoring and the severity of sanctions).The information collected and reported from China and India showed a considerable discrepancy, and Indian tax authorities are now thoroughly investigating the issue to look for any instances of under-invoicing of Chinese business imports. A detailed review revealed that the country's invoiced imports were far less than China's exports to India.
**KEYWORDS**: Imports; Under-invoicing; China; Tax.

## INTRODUCTION

Exports and imports to other nations have given consumers a wide range of options in the present age of globalisation. Depending on their competitive advantage for a particular item, a country will import or export goods from or to another country.

For all countries, particularly developing nations, invoicing has become a serious problem. Every nation seeks trade that will help it to thrive economically. According to the World Trade Organization, which sets the rules for international trade between nations, pre-shipment investigation refers to hiring private companies to check the specifics of a consignment, which includes checking the price, quantity, and quality of goods that will be traded abroad. The General Agreement on Tariffs and Trade (GATT) regulations, which are founded on the goal of protecting a country's economic welfare, apply to Pre-Shipment actions, including capital flight and the fraud of under- and over-invoicing.Morgenstern (1963) used this approach for the first time to demonstrate that there were corrupt practices

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.04.160

among international traders. He then used partner country data for the European countries to quantify the degree of misreporting.
By attributing import misreporting to import tariffs and the black-market premium (BMP) on foreign exchange, Bhagwati (1974) explained import misreporting using the trade data of Turkey and the export data of its partner countries.
In an oligopolistic market with significant tariff and non-tariff barriers, where domestic manufacturers competed with imports in a welfare-optimizing framework under both flexible and fixed exchange rate regimes, Biswas and Sengupta (2011, 2015) place particular emphasis on import under-invoicing.

**LITRATURE REVIEW**

According to Biswas, von Hagen, and Sarkar (2019b), hidden capital inflows happen through the FDI channel while invisible capital outflows occur through the trade channel. Over the long term, the outflow has a beneficial impact on the influx. They note that as China's relative real interest rate, inflation, or forward value on foreign exchange increase, so do illegal inflows. Fisman & Wei (2004) discovered a connection between the occurrence of import tax rates and Chinese import underreporting (missing imports).
According to Cheung and Qian (2010), China's capital flight may have a major impact. Capital flight could, for a few years, exceed official figures for foreign direct investment or changes in external debt.
Cheung et al. (2016) examined the illicit capital movement in China and found that its pattern has changed. They specifically noted that, in the post-2007 period, China's capital flight, particularly the one assessed by trade mis-invoicing, showed a weaker reaction to the covered interest difference, which is a theoretical predictor of capital flight.
According to Kar and Spanjers (2014), China dominated the flows coming from Asia and was the main source of illicit cash flows among emerging nations.
Kessler and Borst (2013) draw attention to Hong Kong's function as a middleman for Chinese exporters. They claim that rather than fraudulent billing, Hong Kong's participation in Chinese commerce serves as the primary cause for the trade deficit among both China and the US. Re-exports from Hong Kong are thought to diminish estimates of trade mis-invoicing by Chinese traders by around a factor of four once they are taken into account in the analysis.
The present study focuses on the fraud of under-invoicing, which weakens the economies of developing nations. The authorities have made numerous attempts to eradicate the evil of under-invoicing, butthey have been ineffective so far. Trading firms manufacture false bills in order to transfer money abroad because developing countries ban capital transfers. Underbilling has a negative impact on the economy in the form of inflation, unemployment, a current account deficit, and a false impression of the state of the economy given to policymakers.
When an item's price on an invoice is lower than the price paid, this is known as under-invoicing. An invoice is a bill of costs and is a detailed list of the goods or services provided by a seller to a customer, usually stating the cost and conditions of the sale. In the business world, an invoice is a written statement that details the quantity and price of the items that were purchased or sold and is sent from the exporter or seller to the purchaser or importer.
Consider a scenario where a financially transacted item is described as being sold by a Chinese merchant for $10 a unit in Wuhan, but it is discovered to value $5 at an Indian port of entry. That would be a $5 per unit under-invoicing, which would result in an undervaluation and ultimately result in a loss of tax since it is levied on the landing worth of the products. Therefore, if a certain item had a 50% tax rate, 100% under-invoicing or undervaluation would result in 100% tax loss to the state exchequer.

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.04.160

So, the never-ending game between the state establishment and some dishonest businessmen and exporters in India's (much-heralded private sector) begins (constantly targeted for inefficiency). The worst aspect is the fact that Chinese are engaged in the game with pleasure because they are eager to earn by providing certain opportunistic Indian importers and buyers with under-invoiced paperwork to show to the officials at Indian airports and ports.

Therefore, it is unlikely that an investigation to establish that a specific imported transaction is under-invoiced and consequently undervalued, leading to a loss of state revenue, will produce any results in the majority of cases because lack of evidence on the part of the officials of the importing country, followed by orders to pay tax on "under-invoiced/undervalued" goods, won't pass the vigilance of the judiciary and the law of the land.

Due to an influential group of traders' growing reliance on Chinese-made consumer goods, which have a sizable customer base in the hinterland of India where the desire for upscale goods and "affordability" have supplanted all other options, the situation is getting more and more complicated by the day. According to Abhijit Bhattacharyya. (2022), communist China has developed into an oppressive exporter to India's virtual monopoly of over one billion consumers and Indian governments' adoption of "free market" thinking and its supporters at the turn of the 20th century.

Over and under invoicing has become a major problem for all economies of the developing nations and this subject have been covered by many researchers around the world and different ways have been suggested to curb it. The United States Government will likely punish anyone who engages in the practise of underbilling because it is a scam. This fraud is primarily carried out by exporters in one nation with the assistance of an importer in another. As a result, their governments are duped by both importers and exporters. The United States government has encountered this issue of under invoicing, and the government has created the Pre-shipment Inspection policy to do away with the fraud of under invoicing, Reynolds,2003, p. 146.

According to Mehta2005, p.74, The misappropriation of invoice settings by importers and exporters results in trade bills being prepared for more or less than the initial amount of trade invoices. Misappropriation in invoicing settings is primarily an issue for all developing nations. Furthermore, given the circumstances of fraudulent trade records, it is challenging to determine the genuine state of the economy.

The over- and under-invoicing trend in Pakistan has been severely harming the nation's finances for many years. Although it is challenging to quantify the harm caused by overbilling and underbilling owing to a poor inspection system in trade. With the intention of preventing the fraud of under and over invoicing, the Pakistani government adheres to the pre-shipment inspection policy. Pre-shipment inspection aims to minimise this harm and prevent money escape. Due to Pakistan's inadequate tariff system and overbilling of imports, capital flight happens, Redge, 2001 p. 136

Due to its immediate advantages, under-pricing of import is likely the most common type of trade misreporting. Undervaluation immediately affects tax payments because customs taxes are often calculated based on the claimed value of the item, which can be challenging to check in practise. Yang (2008) gives an example to illustrate how importers may be engaging in tax avoidance.

According to the findings of Yang (2008), Chalendard, Raballand, and Rakotoarisoa (2016), and Chalendard, Raballand, and Rakotoarisoa (2016), under-invoicing imports to avoid paying import taxes is a regular and popular kind of trade mis-invoicing.

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.04.160

The economic growth of a nation is significantly influenced by this study. It offers useful advice to policymakers on how to end the over- and under-invoicing scam and boost a nation's economy.

## OBJECTIVE OF THE STUDY

The present study aims to identify the reasons of under-invoicing of import and their impact on the economy from the taxman's perspective.

## METHODS AND DATA SOURCE

In order to identify the reasons and impact the secondary data of China import, export and tax revenue has been used. The descriptive analysis method has been used to analyse the data.

## REASONS FOR UNDER-INVOICING OF IMPORTS

If import tariffs and premiums on items that are subject to quantitative restrictions are more than the premiums on international currency that an importer has to buy from the black market in order to make full payment to foreign sellers, the importer may be tempted to under invoice the value of the imports. There is certainly a reason to under-invoice imports if there are no foreign currency exchange restrictions but there are trade barriers. However, there is some risk associated to both under-invoicing of importsand executing unlawful foreign exchange transactions. Therefore, under-invoicing would not happen unless the gap between import duties and the premium on black market exchange is bigger than the estimated risk factor.

Normally, one would expect statistics from a trading partner country to show the surplus of carriage, insurance, and freight import values over the equivalent unrestricted onboard export values of a similar trade commodity. However, if the observed disparity is in the opposite direction and there is another cause for the disparity, one may draw the conclusion that imports were under-invoiced. If we can demonstrate that tariff rates for certain commodities are more than that of the black-market premium on exchange rates and (ii) that these products are such that it is simpler to under-invoice due to the diverse nature of the product, the inference will be more solid.

To transfer capital and escape tax through the trade channel, dealers make the trade bill less or more than the initial price. Under invoicing is the process of preparing a trade bill less than its original price. Over invoicing is the practise of creating a trade bill that costs more than its original price. (Reynolds, 2003, p. 146)

This increasing trading activity can occasionally also provide a number of difficulties, one of which is trade mis-invoicing. The overall picture of illegal financial flows as well as the worldwide shadow financial system includes trade mis-invoicing. Commercial bills and customs declarations are often used to conceal the true cost, but the transfers and reasons behind them are related to tax evasion, beneficial ownership, and international tax avoidance or evasion.

Import under-invoicing is typically done to avoid regulatory obligations for imports exceeding a particular value as well as customs charges and GST. India has observed a significant number of trade mis-invoicing occurrences involving imports from China as a result of the limits and enhanced scrutiny placed on such goods. For instance, the importer can make arrangements for the invoice to show US$50 per unit rather than US$100 per unit to avoid paying the customs charges and GST which would have been due at the increased unit price. The importer must also have a different way to transfer money abroad in order to carry out the transaction, which is mainly done using unaccounted money. After paying the

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.04.160

invoice in full at $50, the importer will still owe the original producer the remaining $50 in another country.
Import under-invoicing is sometimes done to shift untaxed funds from the country and to pay the real amount owed. Under-invoicing of imports is other common technique for escaping capital controls. Import under-invoicing causes unlawful inflows of money into a country since more wealth is being brought in than is actually being declared under the pretext of trade. Import underbilling costs the government a large amount of money.

**DISCRIPTIVE ANYLYSIS**

There have been numerous press reports in recent months of huge under-invoicing of imports entering India from China. Tax authorities in India are investigating potential cases of under-invoicing by companies importing products from China after seeing a significant discrepancy between the data obtained from the two nations. The value of imports into the nation is significantly lower than the value of exports from China to India. 32 importers have received notifications from customs authorities for under-invoicing tax fraud of around Rs 16,000 crore between April 2019 and December 2020.
The representative claimed that metals, electronic goods, and devices like mobile make up the majority of these imports. In recent years, under-invoicing has been practised to save customs duties. To promote domestic production, the government has placed import taxes on items like mobile phones and electronics. In the context of our country, the greater charge has encouraged duty escape through under-invoicing.
Global Financial Integrity report from June 2019 indicates probable revenue losses of US$13 billion, or roughly 5.5 percent of India's 2016 overall tax revenue contributions. Presently, the news of mismatch of trade data of $11 billion between China and India, with China revealing its exports to India at over $103 billion compared to $92 billion revealed by India. This discrepancy is attributed to "under-invoicing" by Indian importers for imports coming from China. This asymmetrical data initially points to under-invoicing, which could account for some of the $11 billion gap, but it could also be due to a number of other causes.
According to government statistics, India imported products worth $79.16 billion in the initial 9 months of 2022. China's general customs administration, on the other hand, showed that exports to India were $89.33 billion during the same time period, a difference of amount to roughly $10 billion in 2021.

**A wide gap on trade data can be seen between India and China in following table:**

| Figures in $ Billion | 2019 | | 2020 | | 2021 | |
|---|---|---|---|---|---|---|
| | MOC | GACC | MOC | GACC | MOC | GACC |
| Exports to China | 17.12 | 17.97 | 18.95 | 20.87 | 23.04 | 28.03 |
| Imports from China | 68.35 | 74.92 | 58.71 | 66.78 | 87.65 | 97.58 |

*MOC-Ministry of Commerce, India *GACC – General Administration of Customs, China
There may be numerous causes for this disparity in the reported trade data, with under-invoicing being just one of them. Firstly, the High Sea Sale (HSS) transactions, in which an Indian importer may purchase specific items from China and export the same to, say, Indonesia, even without items ever reaching the Indian customs territory, may be somewhat

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.04.160

to blame for the mismatch. China may record this transaction as a sale to India, but as the commodities never entered Indian customs jurisdiction, they will not appear in India's trade data. Similar to this, an Indian importer may engage in Merchanting Trade Transactions (MTT), in which imported products are sent to a third nation using a bill to-ship to model, never entering Indian customs.

Secondly, Indian importers may avail foreign trade zones or free-ports to import goods from China in that place and export the goods to other countries, with that location serving as its warehouse without the intervention of the customs authorities. Since, these goods would never enter Indian territory, they wouldn't be accounted as imports into India but they may be reported by the Chinese as its exports to Indian customer.

Under-invoicing of imports can also be used to reduce the competition of domestic manufacturers of a given good because dumping of the items in this way lowers the prices of local produce and hampers its continued expansion.

**Steps taken by government to curb under-invoicing**

Global Financial Integrity has created a tool called GFTrade that customs officials can use to compare declared prices on import and export invoices in real time (i.e., while products are still in the port) against costs for the same item traded within the same two business partners over the past 12 months. This tool was created to assist governments in reducing the degree of trade mis-invoicing. Using the comparison, customs authorities can identify any bills with costs that might be understated or overstated and that might be signs of trade mis-invoicing for further investigation.

Many developing countries impose high import tariff barriers to protect their domestic industries and precious foreign exchange reserves by restricting imports to the domestic economy. This induces importers in developing countries to underreport or 'under-invoice' their imports in order to evade tariffs. Governments in these countries respond by putting in place monitoring mechanisms to detect and penalize such importers.

The government has made numerous attempts to stop under billing but has been unsuccessful. Dumping of Chinese goods into the domestic market, including tyres, auto components, footwear, faux leather, cooling and heating equipment, etc., has a negative impact on local manufacturers. The United States study on the exports and imports between China and Pakistan in 2004 reveals the disparity in the trade histories of the two nations. According to Pakistan's trade statistics, the country imports footwear worth $16 billion, although China's trade statistics for exports place the value at $33 billion. Therefore, Pakistani imports and exports are being defrauded of billions of dollars in this manner, (Ahmad, 2011).

## CONCLUSION

The huge trade disparity between India and China suggests that instances of evasion of import taxes are much more common than previously believed. While India's tax department occasionally uncovers examples of under-invoicing, this discrepancy is much wider than previously anticipated. Studies have also demonstrated a connection between evasion and high import duties.

Professor Biswajit Dhar of Jawaharlal Nehru University claims that increasing profits is the main reason importers submit false invoices. "Traders misrepresent the figures on invoices presented to the customs officials to escape taxes that should be imposed in order to maximise profits. Empirical studies also shown that businesses underreport imports when tariffs are high, the author noted.

Both policymakers and economists have shown a rising interest in recent years in understanding trade misinvoicing practises. The investigation of trade under-invoicing is

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.04.160

discussed in this work, with an emphasis on developing nations. It is suggested that the wide range of incentives to fabricate customs declarations presents a significant difficulty for the factual assessment of the degree of trade under-invoicing. This is done by examining numerous motivations for the misdeclaration of trade operations.
According to the study, unlawful trade operations harm a trade theorist's conventional policy package in addition to the utilisation and accuracy of foreign trade statistics. Any package that ignores fraudulent invoicing would present difficulties throughout the entire foreign exchange black market operation. Black marketing false trade must be made easier in the typical trade policy prescription to help with this.

Under-invoicing of Chinese imports is significant from a taxman's point of view because, if quick action is not taken, India's current account deficit resulting from foreign trade will soon reach a worrisomely intolerable level. In fact, there are a number of interrelated issues that must be handled together rather than separately.
Today, one want to concentrate on perhaps the most concerning issues—reported "under-invoicing"—caused by a powerful group of dishonest Indian traders and importers working in concert with an equally ruthless bunch of "crafty" Chinese exporters who are motivated by money alone.

## RECOMMENDATIONS

The quantitative restrictions and taxes on a commodity should be imposed while taking into consideration the cost of smuggled goods, and the government should make substantial measures to enforce their strict application. Smuggling should be stopped with serious effort.
-The government should act right once to create a separate inspection department made up of senior members of the Federal Board of Revenue, auditors, and customs authorities who can carefully monitor the over- and under-invoicing scheme.
A check on the inspection department should be conducted as well in order to guarantee the strict monitoring. For the purpose of examining the trade records, the inspecting department must deliver quarterly or monthly inspection reports. These data should be made public along with comprehensive trade information between China and all trading nations.
-The government should take into account the need for imported goods and should encourage local businesses to grow their domestic production, which would generate employment and boost GDP.
Import taxes should be raised to protect domestic businesses from overseas competition.
In order to prevent capital flight, the government must closely supervise all traders who engage in imports and exports. The government should examine the trade reports on a monthly, quarterly, or annual basis and compare them to statistics on global commerce.
The perpetrators of the over-and-under invoicing scheme should face harsh punishment.

## REFERENCES


- Abhijit Bhattacharyya. (2022, November 17). Curbunder-invoicingofimportsfrom China. *The Tribune.*
- Anuradha Shukla.(2022, November 13). Under-invoicing of Chinese imports under taxman’s lens. *The Economic Times.*
- Bhagwati, J. N. (1974). On the underinvoicing of imports. In Illegal transactions in international trade, pages 138-147. Elsevier.
- Biswas, A. K. and Sengupta, S. (2011). Tariffs and imports misinvoicing under oligopoly. Economics & Politics, 23.2:254-270.

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.04.160

- Biswas, A. K., von Hagen, H and Sarkar, S. (2019b). Trade Mis-reporting, FDI Mismatch and Hidden Capital Movements: The USA - China Case. Mimeo. University of Bonn.
- Chalendard, Cyril, Gael Raballand, and AntsaRakotoarisoa. 2016. “The Use of Detailed Statistical Data in Customs Reform: The Case of Madagascar,” World Bank Policy Research Working Paper 7625.
- Cheung, Y.-W., Steinkamp, S., and Westermann, F. (2016). China's capital flight: Pre-and post-crisis experiences. Journal of International Money and Finance, 66:88-112.
- Cheung, Y. W., & Qian, X. (2009). Empirics of China's outward direct investment. Pacific economic review, 14(3), 312-341.
- Dhar, Biswajit & K S, Chalapati Rao. (2020). India’s Economic Dependence on China.
- Fisman, R. and Wei, S.-J. (2004). Tax rates and tax evasion: evidence from missing imports in china. Journal of political Economy, 112(2):471-496.
- Kar, D. and Spanjers, J. (2014). Illicit Financial flows from developing countries: 2003-2012. Washington, DC: Global Financial Integrity.
- Kessler, Martin and Nicholas Borst. 2013. “Did China Really Lose $3.75 Trillion in Illicit Financial Flows,” China Economic Watch, Peterson Institution for International
- Economics, 10 January, https://piie.com/blogs/china-economic-watch/did-chinareally-lose-375-trillion-illicit-financial-flows.
- Mehta, Deepa. (2005). *Economic crime in globalizing society. Its impact on sound development ofthe state- an Indian perspective.* Annual Report for 2004 and Resource material (Seriesno.66), UNFAEI, Japan. (pp.74).
- Morgenstern, O. et al. (1963). On the accuracy of economic observations. Princeton University Press.
- Redge, Vinod. ( 2001). *Preshipment Inspection: Past experiences and future directions,* Commonwealth secretariat, London. (p.136).
- Reynolds, Frank. ( 2003). *Managing Exports*: *Navigating the complex rules, controls, carriers, andlaws*. John Wiley and Sons, New Jersey. (pp.146).
- World trade organization, *WTO*: Retrieved fromhttp://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm9_e.htm#preshipment.
- Yang, Dean. 2008. “Can Enforcement Backfire? Crime Displacement in the Context of Customs Reform in the Philippines,” Review of Economics and Statistics. 90 (February): 1-14.