SEIZURE OR TAXATION OF ILLEGAL INCOME – EXAMPLE OF DRUG TRAFFICKING²,³

Abstract

The criminal offence of tax evasion is most frequently perpetrated by giving false data on the acquired income and failure to report acquired incomes, as defined in our criminal legislation. A linguistic analysis of the Criminal Code provision which defines this offence can lead to a conclusion that the income subject to taxation can be obtained either lawfully or unlawfully since the legislator does not take a stand regarding this issue. Namely, the 2016 amendments to the Criminal Code deleted the term ‘legal’ from the legal description of the criminal offence of tax evasion. However, this does not mean that the incomes acquired unlawfully can be subject to taxation, as the paper elaborates in detail. The author explores jurisprudence regarding the imposition of the security measure of the seizure of objects and the measure of seizure material gains in criminal matters related to the criminal offence of illegal production and circulation of narcotic as per Article 246 of the CC. In this way, we shall establish whether these measures are effectively implemented and whether they allow for seizing the incomes obtained from drug trafficking. A portion of this paper will be dedicated to the reasons for and against taxation of illegally obtained revenues. In addressing this problem, the author shall rely on the US practice, wherein proceeds from unlawful sources are subject to taxation.

Keywords: illegal income, legal income, tax evasion, drug trafficking.

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1. Introduction

There can be no doubt that the functioning of any state depends, among other things, on proper taxation, since the taxes provide funds for financing education, health services, social welfare, army, and other activities in the public interest. Taxpayers are obliged to pay various taxes: individual income taxes, taxes on corporal profits, value added tax, excise, property taxes, etc. When we speak about taxes on the revenues that the taxpayers have gained lawfully, there is no doubt as to whether there is an obligation to pay these taxes. On the other hand, the question arises whether taxation of illegal proceeds is also necessary and whether it is in accordance with the existing national legislation in our country. It is essential to find a solution to this dilemma for a number of reasons. A great part of the economic activity – and not only in our country – unfolds within the so-called grey area. Regarding this, the question arises whether the proceeds gained in that way can be taxed. Besides, certain criminal acts are perpetrated for gain and their perpetration can secure proceeds for the perpetrators or other persons which may amount to enormous sums of money. Can these proceeds be taxed or should they be seized from the perpetrators?

2. Tax evasion and illegal income in the national criminal legislation

The basic form of the criminal offence of tax evasion is defined in Article 229 paragraph 1 of the Criminal Code of the Republic of Serbia (hereinafter: CC): “Whoever with intent to fully or partially avoid payment of taxes, contributions or other statutory dues, gives false information on legal income, objects and other facts relevant to determination of such obligations, or who with same intent, in case of mandatory reporting (filing of returns) fails to report lawful income, objects and other facts relevant to determination of such obligations or who with same intent conceals information relevant for determination of aforementioned obligations, and the amount of obligation whose payment is avoided exceeds five hundred thousand dinars, shall be punished by imprisonment of six months to five years and fined (paragraph 1).”[^1] Until this year the legal description of the criminal offence of tax evasion implied that only lawfully obtained incomes could be taxed. The legislator incriminated giving false information on legal income in Article 229 of the CC along

with failing to report lawful income in case of mandatory reporting. However, the Law on Amendments to the Criminal Code of 23 November 2016 deleted the term ‘legal’ from the legal description of the criminal offence of tax evasion. Does this imply that it is possible to tax unlawfully obtained income in accordance with the existing legal regulations? In other words, is it possible to secure the substance of the criminal offence of tax evasion by giving false information on unlawful income and by failing to report unlawfully obtained income?

We shall commence the elaboration of this issue by analyzing the heretofore valid legal provision which brought about some dilemmas in court practice and in the theory of criminal law. Given that the legislator stipulated that the offender commits the alternatively envisaged criminal activity by giving false information on legally acquired income and by failing to report legally acquired income, a conclusion could be drawn that - according to the existing provision - tax evasion was possible only with respect to lawfully acquired income. However, in theory, and practice of criminal law, this standpoint is not universally accepted. According to one opinion, tax evasion does not exist in case of giving false information on unlawfully obtained income and failing to report unlawfully acquired income because in this way offenders would be required to report the crimes they have committed themselves. This view is acceptable, as in our country there is no regulation that would be a legal basis of the duty of any person to act against their own interest, i.e. to incriminate oneself, either directly or indirectly, of having committed a criminal act. In this respect it should be pointed out that “the right against self-incrimination

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J. Lazarević, M. Škulić, “Osnovne planirane novele Krivičnog zakonika Srbije”, Bilten Vrhovnog kasacionog suda, 2/2015, Beograd, 56; See also: The decision of the Appelate Court in Kragujevac, Kž. 3111/2012 of 27 September 2013 (“For the substance of the given criminal offence it is vital that the income in question is legal or else the citizens would be bound to report for taxation their unlawful revenues, thereby incriminating themselves for the acquisition of these unlawful revenues, although there is no legal obligation whatsoever for anyone to report themselves for a criminal offence or any other act sanctioned by law.”); E. Finestone, “Eliminating the Tax on Embezzled Funds: a Call for Reform”, Review of Banking & Financial Law, 2/2014-2015, 739.

7 J. Lazarević, M. Škulić, “Osnovne planirane novele Krivičnog zakonika Srbije”, Bilten Vrhovnog kasacionog suda, 2/2015, Beograd, 56; See also: The decision of the Appelate Court in Kragujevac, Kž. 3111/2012 of 27 September 2013 (“For the substance of the given criminal offence it is vital that the income in question is legal or else the citizens would be bound to report for taxation their unlawful revenues, thereby incriminating themselves for the acquisition of these unlawful revenues, although there is no legal obligation whatsoever for anyone to report themselves for a criminal offence or any other act sanctioned by law.”); E. Finestone, “Eliminating the Tax on Embezzled Funds: a Call for Reform”, Review of Banking & Financial Law, 2/2014-2015, 739.
is the right which belongs not only to the suspect but also to other subjects in criminal proceedings (e.g. witnesses), although it is not explicitly provided for in Article 6 of the European Convention on the Protection of Human Rights and Fundamental Freedoms, set as an international standard and it represents a basis for the right to a fair trial."^8

On the other hand, the implementation of this provision reduced efficiency in the administration of justice because it was necessary to establish, in any given case, that the offender had given false information on lawfully acquired income or failed to report lawfully acquired proceeds. This task was not simple so it resulted in lengthening proceeding and reducing the efficiency of the judicial system.

Clearly, it is not always easy to establish whether the income in the specific criminal case has been acquired in a lawful way. For instance, the judicial practice has been faced with the question whether lawful income includes proceeds from lawful sales of goods supplied in an unlawful way. Given that the income was acquired through lawful sales of goods, it could be concluded that it constituted legal income. However, it should be borne in mind that the said goods were supplied unlawfully. This fact influenced the court decision, according to which illegally purchased goods could not be legally sold. Hence the income was unlawful.\(^9\)

On the other hand, part of the literature on criminal law raises the question of what should be regarded as illegal income. An opinion argues that distinction should be made between two types of illegal income: 1) incomes from “a permitted activity for which permission is required” and 2) proceeds from crime. The advocates of this opinion find that all incomes from category one should be taxed, i.e. all the incomes from activities for which permissions of relevant authorities are required. They find that taxpayers are obliged to report for taxation all revenues, even the incomes gained by violating legal regulations provided that they have not committed criminal acts.\(^10\) In our opinion, this view is unacceptable because it would, among other things, allow for legalization of incomes gained in unlawful ways (through infringements).

Accordingly, the rationale of each court decision convicting an offender of the criminal act of tax evasion must list reasons which indicate whether the incomes of the taxpayer on which tax has not been paid was gained lawfully, as implied in the decision of the Court of Appeal in Niš: “It is rather unclear why the trial court has accepted withdrawing money from the current account without reserve as lawful income and even

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9 The decision of the Court of Appeal in Novi Sad, Kž. 3392/2011 of 22 November 2012.

more unclear why it finds that there were two types of income involved. Regarding the money for the purchase of firewood, the trial court finds that it falls among all other revenues as per Article 85 of the Individual Income Tax Law on which the tax is 20%. Regarding the withdrawal of cash amounting to 816,550.00 dinars for the alleged material expenses, it is unclear why the court now accepts that it is lawful capital gain, the taking from the assets of the company as per Article 61 para. 1 item 4 of the Individual Income Tax Law on which there is also the tax rate of 20%. Any given income has to be lawful in order to be taxed. The first-instance court, therefore, had to establish whether the withdrawal of ready money from the current account of the company was legitimate. Article 61 para. 1 item 4 of the Individual Income Tax Law provides that taking from the assets of a commercial society by the owner of the commercial society for their private use must be performed in accordance with the law if it is to be regarded as taxable capital gain. In the given case, it was obvious that the accused performed cash withdrawals from the company’s account within the specified period, which he admitted, but tried to make it appear lawful by representing it as the purchase of firewood, i.e. as the material expenditure. Therefore the trial court was required to establish whether the cash withdrawal was the defendant’s lawful income bearing in mind the provisions of the Companies Law and based on the established facts.”

The view of the court should be accepted because the legal description of the criminal offence of tax evasion valid at the time of making the decision required that the commission, as a special element of the offence, is undertaken by giving false data on legally acquired income. This means that the commission of tax evasion was not undertaken if the offender gave false information on incomes which were acquired unlawfully. It follows that the courts could not have proceeded from the assumption that the incomes were earned in a legal way but had to prove in each specific case that there was a legally earned income. For example, according to the case law: “if the income is lawful but adequate taxes have not been paid, then we can speak about the criminal offence of tax evasion as per Article 229 of the Criminal Code, whereas if the income was not lawful, it would constitute another criminal offence, in which case the income cannot be taxed but rather confiscated.” Hence the revenues from the sale of drugs or ‘sales in the black market’ cannot be regarded as lawfully earned.

11 The decision of the Court of Appeal in Niš, Kž. 431/10 and the ruling of the decision of the Municipal Court in Niš K. 2 768/07, Bilten Apelacionog suda u Nišu, 1/2010, 30. See also: The ruling of the Court of Appeal in Kragujevac, Kž. 362/2013 of 6 February 2014.

12 The decision of the Court of Appeal in Niš, Kž. 431/10 and the ruling of the Municipal Court in Niš K. 2 768/07, Bilten Apelacionog suda u Nišu, 1/2010, 30.
income and cannot be taxed: „for the criminal offence of tax evasion to occur, the income must be lawfully acquired and false information given in order to avoid paying taxes; as it was established in the course of the legal proceedings that there was an instance of the so-called ‘sale on the black market’, i.e. proceeds from crime, there can be no discussion about tax evasion or tax offence, and the actions of the defendant were properly qualified as criminal offence of abuse of official position.”

Regarding the unlawful sale of goods, the appellate court has taken the view that tax evasion is present where a taxpayer purchases goods in a legal way and thereafter proceeds to commit a criminal offence. In the given case, the defendants sent the invoices that were not followed commodities. It follows that the proceeds gained in this way were not lawful, i.e. that there was no criminal offence of tax evasion. Therefore, the essence of the criminal law provision which was valid until recently for the criminal offence of avoiding payment of taxes was that it provided for the duty to pay taxes on lawfully acquired income. On the other hand, proceeds from crime have to be seized, provided that criminal proceedings result in a final court decision and prove that these were acquired from the commission of criminal acts.

In support of the viewpoint which prevails in the national literature on criminal law, it should be pointed out that the payment of taxes on income acquired in an unlawful manner would legalize those revenues. This would be convenient for offenders, as they would, by paying the taxes, legalize the wealth they have acquired through criminal activities.

To eliminate dilemmas in case law and the literature on criminal law and to ensure that the judicial proceedings are more efficient, the legislator introduced amendments to the Criminal Code which erased the word ‘legal’ from the legal description of the offence. Accordingly, the alternatively prescribed action of the commission of this criminal offence can, according to our positive law, be perpetrated, inter alia, by giving false data on the earned income and by failing to report earned income. This raises a question as to whether unlawful proceeds can be taxed since the legislator no longer insists on the lawfulness of income on which false data are given and/or which remains unreported. In our opinion, following the specified amendments to the national criminal legislation, the offender has no obligation to report illegal income. However, we believe that the introduced changes to the legislation are justifiable because they will

allow for greater efficiency of criminal prosecution. Deleting the term ‘legal’ from the legal description of tax evasion means that the courts will no longer be bound to establish for each specific criminal case whether the revenues falsely reported or unreported have been legally acquired. On the other hand, this does not mean that taxpayers are obliged to report the illegal income and that the taxation of illegal income is possible. The view on the unacceptability of taxation of illegal revenues has already been explained above. In short, no one is obliged to incriminate themselves by reporting unlawful income; the taxation of illegal income would allow for their tacit legalization.

3. Illegal income from drug trafficking

Certainly, this does not mean that the offender is entitled to withhold the income earned in an unlawful manner. Income earned by illegal means may be seized through the implementation of the provisions of the CC.\(^\text{15}\) Proceeds from crime can also be seized based on the provisions of the Law on Seizure of the Proceeds from Crime.\(^\text{16}\) The paper does not aim to offer an analysis of provisions of the said law, but it should be noted that this law specifies the conditions, procedures and authorities responsible for detection, seizure and management of proceeds from criminal offences listed in the statute. The authorities in charge of detecting, seizing and managing the proceeds from criminal acts include the public prosecutor, the court, the Financial Investigation Unit, and the Directorate for Seized Property Management. The Financial Investigation Unit is a specialized organizational unit within the Ministry of the Interior which detects assets derived from criminal acts \emph{ex officio} or based on a warrant issued at the behest of the public prosecutor or the court.\(^\text{17}\)

The security measure of object seizure allows for the confiscation of object intended or used for the perpetration of an offence or resulting from the commission of a criminal offence. Items resulting from the criminal

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15 The security measure of object seizure from Article 87 of the CC and the measure of seizure material gains from Articles 91-93 of the CC (Article 92 paragraph 1 of the CC provides that: „Money, items of value and all other material gains obtained by a criminal offence shall be seized from the offender, and if such seizure should not be possible, the offender shall be obligated to hand over other assets corresponding to the value of assets obtained through commission of criminal offence or deriving there from or to pay a pecuniary amount commensurate with obtained material gain.”).

16 Law on Seizure of the Proceeds from Crime \textit{Official Gazette of the Republic of Serbia} no. 32/2013 and 94/16. The provisions of this Law apply, inter alia, to the criminal offences of organized crime and illegal production and circulation of narcotic (Article 246 paragraphs 1-3 of the CC).

Offences are the ones “that are the result of an undertaken criminal offence, brought about by the commission of the criminal action.” However, the author advocating this opinion finds it unacceptable that the part of judicial practice according to which the items resulting through the commission of criminal acts should be regarded as items obtained from the commission of a criminal act and therefore represent the proceeds from crime. Accordingly, the measure of seizure of material gain should be applied in respect of the items obtained through the commission of criminal acts. This view is accepted in solving the criminal cases relating to the offence of illegal production and circulation of narcotic as per Article 246 of the CC.

By contrast, the courts have, in certain cases, seized, for instance, the money resulting from drug trafficking and stated in the rationale of their decision that it constituted “the money and objects used for or resulting from the commission of a criminal offence.” It is questionable whether the money obtained by drug trafficking can be regarded as the object for which there is a danger that it may be reused for the commission of a criminal act. The quoted ruling of the Higher Court in Čačak K.2/2016 illustrates how the Court emphasized, in the rationale of the imposed security measure of object seizure that, among other things, “there is a danger that these objects could be used again for the commission of a criminal act.”

In our opinion the view of the Court can be accepted as the convict admitted that he had sold drugs and that “he needed the money to subsequently buy drugs for himself”. Although the defendant stated that he would buy the drugs for himself from the money earned by pushing narcotic drugs, it can be assumed that he would sell drugs again, as he had done in the past and as established in this decision. Accordingly, there was a risk that the money would be used again for the commission of a criminal offence in terms of Article 87, paragraph 1 of the CC. However, this does not mean that the courts can automatically, in any given case, seize the money found on the offender because there is a danger that it will be used for the commission of a criminal offence. The seizure of money based on the implementation of the security measure of seizure of objects from offenders of criminal acts related to illegal drugs is possible

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19 The ruling of the Higher Court of Čačak K. 15/2013 of 22 May 2013.
21 Article 87 paragraph 1 of the CC: „The security measure of seizure of objects may be imposed with regard to an object which was intended for or used in the commission of a criminal offence or which resulted therefrom when there is a danger that a certain object may be reused to commit a criminal offence or when it is so required for the purpose of ensuring public safety or for moral reasons.”
only where there are reasons which – as in the aforementioned case – indicate that it would be justified. We believe that these reasons should be explicitly stated in the part of the court decision which justifies the imposition of the sentence of security measure of object seizure, which was not the case in the aforementioned ruling. However, the question that arises here is why the court did not permanently seize the money from the defendant, applying the provisions of the criminal legislation pertaining to seizure of material gain (Article 91-93 of the CC). In our opinion, the priority in similar cases should be given to the provisions on the seizure of material gain if there is evidence that the money has been obtained by selling illegal drugs.

However, this does not mean that the implementation of the security measure of the seizure of objects should be excluded with respect to money related to the criminal offence of unlawful production and circulation of narcotic drugs (Article 246 of the CC). The imposition of the security measure is justified where the offender has lawfully secured (e.g. as revenue or gift) a certain sum of money which he intends to use for purchasing illegal drugs for further sale. If police officers arrest such an offender while trying to buy drugs, the money could be seized through the implementation of the security measure of object seizure because there is a danger that the money will be used to commit a criminal offence. The seizure of money, in this case, would not be possible by the implementation of the measure of seizing material gains (Articles 91-93 of the CC) because the money would not be obtained through the commission of a criminal offence.

In some rulings, the imposition of the security measure of seizure of objects (money – 10 euro) from the perpetrators of the criminal offence of illegal production and circulation of narcotic (Article 246 of the CC) is explained in the following way: “it is the money obtained through the commission of a criminal offence and it is so required for the purpose of ensuring public security and for moral reasons in terms of Article 87 paragraph 1 of the CC.”22 It has already been explained that the view of the author here is that the items obtained by the perpetration of criminal acts should be seized by imposing the measure of the seizure of material gain (Articles 91-93 of the CC), rather than the security measure of object seizure (Article 87 of the CC). In addition to this, it is true that the interests of public security and moral reasons are grounds for the imposition of the seizure of objects according to Article 87 paragraph 1 of the CC. On the other hand, we are of the opinion that this provision cannot be broadly interpreted in the way the Court does in the decision.

regarding this criminal matter. Protection of public security and moral reasons are inherently vague concepts. Besides, we find that the money obtained by drug trafficking does not directly jeopardize public security and ethics in our society. It is indisputable that it should be seized, but only by imposing the measure of the seizure of material gain (Articles 91-93 of the CC).

Finally, we conclude that our jurisprudence is not uniform when it comes to confiscation of money obtained by selling drugs, which does not contribute to legal certainty. We also suggest that the courts include in the rationale of their decisions the reasons which indicate why it is justifiable to seize the money by imposing the security measure of the seizure of objects (Article 87 of the CC) or by imposing the measure seizure of material gain (Articles 91-93 CC). At this point, we shall mention a commendable example from judicial practice which should be used as a model: “Pursuant to Articles 91-92 of the CC, the money amounting to the total of 385 euro and 48,200 dinars, which was found in his jacket on the critical occasion, was seized from the defendant, because the aforementioned legal provisions stipulate that no one may keep material gains obtained by a criminal offence and that, inter alia, the money obtained through criminal offences shall be seized; the submitted evidence proved that the defendant was unemployed, that in the relevant period his income consisted of the monthly rent of 75 euro and the money that his parents gave him, amounting to 50 to 100 euro per month, which did not correspond to the total money found on his person. This implies that the seized money actually represented the material gain from the illegal sale of narcotic drugs.”

Similarly the Higher Court in Belgrade stated in the rationale of its decision that the sum of money found on the defendant was disproportionate to his monthly income, which is why the measure of seizure of material gain was imposed to seize 4000 euro, as “the Court found no doubt that the money came from previously sold narcotic drugs”. Sometimes the location in which money is found can also indicate that it originates from drug trafficking. In one case, money was found next to a precision weighing device used to measure drugs and it was seized in keeping with the measure of the seizure of material gains obtained by criminal offences as per Articles 91-93 of the CC. Money can be seized by imposing this measure where the convict confesses that it was acquired by selling drugs.

Analyzing judicial practice, we have found 48 sentences imposed on 50 individuals by the Higher Court in Čačak in connection with the

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24 The ruling of the Higher Court of Belgrade K. 334/12 of 28 September 2012.
25 The ruling of the Higher Court of Belgrade K. 444/12 of 29 August 2012.
26 The ruling of the Higher Court of Belgrade K. 677/11 of 14 September 2012.
illegal production and circulation of narcotics (Article 246 of the CC). The money from illegal trafficking of drugs was seized only from three convicted persons. According to Article 87 of the CC, the Court in one case imposed the security measure of the seizure of objects (350 euros) from the offender. In the other case, the money (250 euro) was seized from the convicted person based on Articles 91-93 of the Criminal Code providing the seizure of material gain. In the third case, 10 euro was taken from the offender based on Article 87 of the CC which regulates the seizure of objects. The paper has already explained our opinion with regard to the courts’ decisions in these cases.

It may be concluded that the seizure of illegal income from offenders who have committed the offence provided for in Article 246 of the CC in our judicial practice is an exception rather than a rule. In this connection, it must be pointed out that neither of the mentioned measures has been imposed on 47 individuals from our study. Furthermore, the value of the confiscated profit in the mentioned cases is so trifling that it makes the effects of the imposed measures, the seizure of the objects (Article 87 of the CC) and seizure of material gain (Articles 91-93 of the CC), insignificant. The paper also tries to explain why national courts do not seize more substantial gain obtained in illegal ways, primarily by drug trafficking from the individuals committing offences provided for in Article 246 of the CC.

First and foremost it should be emphasized that in particular cases courts do not obtain information on the offenders’ financial standing from independent sources (e.g. Tax Administration) but from the statements made by the offenders themselves. As expected, knowing that bad financial standing may be taken as a mitigating factor, the offenders stated that they were unemployed and that their monthly income was rather low. Thirty-one out of fifty offenders from our study stated that they were unemployed. It would be interesting to find out who those persons depended on if they were unemployed. Once, an offender stated that he supported his multimember family from occasional jobs. The court did not try to check the fact in any way. On the other hand, 681g of marihuana were seized from the

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28 K. 2/16.
29 K. 15/13.
30 K. 31/14.
offender, thus clearly indicating his intention to gain significant profit by drug trafficking. The question to which the court did not reply is whether the offender gained illegal profit by selling drugs that should be confiscated.

In one case when the offender stated that he depended on his mother the court did not try to find out whether his mother was alive, i.e. whether she (if alive) was employed, how much she earned and whether she supported her son.\textsuperscript{32} Since a significant amount of drug (125 g of heroin) was seized from the offender, the question is whether he obtained illegal profit by selling drug which should be seized in compliance with the law.

While giving personal data, offenders also state real property which is an important detail if illegal income obtained by drug trafficking is considered. Notwithstanding, this important detail was not checked from independent sources by courts. Only one convicted person from our study stated that he owned property in his name. According to his statement, he supported himself from occasional jobs and two houses he owned. The court did not establish relevant facts in order to find out whether the houses had been bought or built by the money obtained by drug trafficking, the value of houses, a time when they had been bought or built, etc.\textsuperscript{33} It cannot be denied that persons convicted of illegal production and circulation of narcotics based on Article 246 of the CC could own legal property (e.g. inherited property, gift property, or property purchased from legal income). However, we are of the opinion that the source of such property should be investigated, especially if certain circumstances should require so.

In one case the defendant declared that he was living in a 247m\textsuperscript{2} house owned by his wife.\textsuperscript{34} The court did not check whether the house was entirely owned by the defendant’s wife, when and how the house was purchased, its value or the wife’s income and other relevant details. It must be pointed out that 18 000g of marihuana were seized from the defendant. Accordingly, the defendant’s financial standing should have been carefully investigated in order to establish illegally obtained income that was to be seized. Similarly, in another case, the defendant declared that he supported himself by the sub-lease of the licensed premises owned by his grandparents.\textsuperscript{35}

The defendants declaring to be employed mostly had incomes of several thousand dinars. However, one of them declared that his average

\textsuperscript{32} The ruling of the Higher Court of Čačak K. 13/12 of 24 December 2012. Likewise: The ruling of the Higher Court of Belgrade K. 14/2012 of 10 September 2012; The ruling of the Higher Court of Belgrade K. 467/12 of 24 October 2012.
\textsuperscript{33} The ruling of the Higher Court of Čačak K. 31/14 of 11 September 2014.
\textsuperscript{34} The ruling of the Higher Court of Čačak K. 6/15 of 24 December 2015.
\textsuperscript{35} The ruling of the Higher Court of Čačak K. 12/16 of 8 September 2016.
income in the hospitality industry was 1000 euro.\textsuperscript{36} 30g of cocaine hidden in the car was seized from a defendant. The same defendant was prosecuted for another criminal offence provided for in Article 246 of the CC, illegal production and circulation of narcotics. Nevertheless, these circumstances were not enough for the court to check the defendant’s financial standing and establish whether there was any illegal income that should be seized.

Similarly, 75g of cocaine hidden in Audi A6 were seized from a defendant.\textsuperscript{37} According to the defendant’s statement, he earned around 400 euro a month from a joint ownership in a coffee shop. The court neither received a confirmation from an independent source that the defendant was a joint owner of the coffee shop nor the record of his monthly income. Moreover, the sentence stated neither the value of the defendant’s car nor how he came into possession of it, which was a relevant fact for the potential seizure of illegal income.

Interestingly, courts do not take other defendants’ data but those referring to their real property. The part of the sentence regarding a defendant’s personal data states that “the defendant does not possess any real property in his name”.\textsuperscript{38} Courts do not establish whether defendants possess any property in the name of their close relatives. Additionally, courts do not establish whether defendants possess any personal property, such as cars, gold, papers (effects), works of art, etc. that may be more valuable than real property.

4. Taxation of illegal income in the United States

The USA has a long tradition of taxing illegal income. For instance, income obtained from illegal drug trafficking is taxed. Thus, the tax collection becomes a supplementary means for property seizure from offenders after being convicted.\textsuperscript{39}

The USA is not the only country taxing illegal income. The South African Republic, for instance, has also been facing the problems relating

\textsuperscript{36} The ruling of the Higher Court of Čačak K. 2/13 of 14 May 2012. Likewise: The ruling of the Higher Court of Belgrade K. 181/12 of 27 November 2012. (In this case, the defendant declared that his monthly income was 1000 euro and that he was the owner of a private business. Although 6098g of marihuana were seized from him, the court did not check his financial standing.).

\textsuperscript{37} The ruling of the Higher Court of Čačak K. 5/13 of 11 March 2012.

\textsuperscript{38} The ruling of the Higher Court of Belgrade K. 456/12 of 17 October 2012. The ruling of the Higher Court of Čačak K. 57/12 of 12 March 2013. The ruling of the Higher Court of Belgrade K. 263/12 of September 2012.

to the taxation of illegal income.\textsuperscript{40} The basis for taxing illegal income in the USA is the Sixteenth Amendment to the Constitution enacted in 1913 providing that the Congress had the power to regulate and collect taxes on income regardless of their source. A separate law provided the taxation of income from various sources including legal businesses. However, three years later the Congress removed the word ‘legal’ from the law regulating tax collection without explaining what the modification meant.\textsuperscript{41} Thus courts used to sentence offenders for tax evasion on the profit gained from illegal selling of alcohol. Yet, convictions in certain cases were critical toward such legal solutions since by taxing illegal income, the state thus became ‘a silent partner’ of defendants and legalized illegally obtained income.\textsuperscript{42} As mentioned before, tax collection on illegal income obtained by selling drugs or bribery results in the legalization of such practice. In other words, instead of punishing offenders for their crimes and seizing their illegally obtained proceeds, the state legalizes illegal activities.

The connection between taxing illegal income and the Fifth Amendment to the USA Constitution has been analyzed both in the US theory and judicial practice. If citizens are obliged to declare illegal income, it means that they are obliged to report themselves which is directly opposite to the Fifth Amendment to the USA Constitution protecting a person from being compelled to be a witness against themselves in a criminal case.\textsuperscript{43} The question is what should have advantage efficient tax collection or protection of civil rights and freedoms.

Both the US theory and judicial practice have dealt with the issue of tax computation on citizens’ income and whether the tax basis should include expenses of illegal businesses. Namely, income tax is paid only on net profit, i.e. establishment charges should be deducted from gross income.\textsuperscript{44} According to judicial practice (\textit{Commissioner v. Tellier}, 383 U.S. 687, 691 (1996)), the tax basis on income tax may be reduced for the expenses of illegal businesses.\textsuperscript{45} In this case, the offender claimed the current year tax basis to be reduced for the defence costs ($23 000). The Internal Revenue Service denied his claim, but the Court of Appeals reversed the judgment.

\textsuperscript{40} L.G. Classen, “Legality and income tax - is SARS ‘entitled to’ levy income tax on illegal amounts ‘received by’ a taxpayer”, \textit{SA Mercantile Law Journal}, 4/2007, 534.


\textsuperscript{42} \textit{Steinberg v. United States}, 14 F.2d 564, 569 (2dCir. 1926).

\textsuperscript{43} B. I. Bittker, 132; J.A. Goldstein, 802.


Eventually, the Higher Court confirmed the judgment of the Court of Appeals and ruled that income tax referred only to net income, not a criminal sanction. In other words, the aim of tax regulations is to collect tax on net income and not to punish individuals for breaching them. At first sight, the Court’s decision is unacceptable since the incurred expenses are not in connection with taxing net income but with defence costs of the offender in the criminal procedure. However, it must be taken into account that paying defence costs is in accordance with law although it is the result of the offender’s illegal activities.

It is important to say that the Court’s attitude, in this case, is that income from illegal activities should be taxed at the same rate as legal income. Accordingly, taxing income from illegal activities may bring about a range of problematical legal issues which is one more reason in favour of the opinion that only legal income should be taxed. For instance, there is no single opinion in the USA whether tax basis on net income should be reduced because of the marihuana growing expenses. The problem arises from the fact that in some US states marihuana is legalized for medical use. Notwithstanding, under the US Federal Tax Law regulating income tax, tax basis reduction is not allowed to taxpayers who deal with the sale of controlled substances prohibited by federal or state law in which the sale takes place.

The advocates of taxing illegal income are of the opinion that individuals who obtain profit by illegal activities should pay tax on such profit as those who pay it on their legal income. Taxpayers who pay tax on their legal income should not be discriminated, because a hundred illegally obtained dollars can buy as much as a hundred legally earned dollars. Even though such reasoning has its weight, it is unacceptable. Namely, while analyzing this issue, we should not only take into account the common good and equity but legal solution, i.e. linguistic interpretation of the law as well. The problem becomes bigger if the legislator does not give its view as in the aforementioned latest modifications to the Criminal Code of the Republic of Serbia. Moreover, it is wrong to compare an embezzler or a drug dealer with a taxpayer who legally earns his income. Straightforwardly, in accordance with criminal justice regulations, illegally obtained profit will be seized from the offender and relinquished to its owner, if possible, while a taxpayer will keep legally earned income. Eugene James, prosecuted for tax

46 D. H. Gordon, 410.
47 Internal Revenue Code, 280E – Expenditures in connection with the illegal sale of drugs.
49 E. Finestone, 731.
evasion because he embezzled $738000 belonging to the union funds, used the same argument. Notwithstanding, he was sentenced to three years’ imprisonment. The Supreme Court took a stand that embezzled money was taxable although it would be seized from the offender and relinquished to the owner in accordance with criminal justice regulations (James v. the United States, 366 U.S. 213, 219 (1961)).

Judicial practice standpoint on this issue has evolved, i.e. there is no generally accepted opinion with regard to taxing illegally obtained income. In Wilcox case, for instance, the Court dismissed the possibility of taxing embezzled money (Commissioner v. Wilcox, 327 U.S. 404, 407, 410 (1946)). Wilcox embezzled the money of the company he worked for and gambled it away. He was convicted of embezzlement. The Court was not influenced by the fact that the embezzler gambled the money away. The Court was of the opinion that the relation embezzler – the damaged party can be compared with the relation debtor-creditor. Consequently, as a debtor’s insolvency cannot constitute an obligation to tax his credit, so the gambled money, as in this case, cannot be taxed. It is interesting that Eugene James in his defence referred to the Wilcox case, but that fact did not influence the Supreme Court’s decision in this case.

Nonetheless, this problem cannot be easily solved. For instance, in the case of embezzlement the question is: 1) whether embezzled money which technically does not belong to the offender should be taxed or 2) whether the offender should not be taxed, thus enabling him to keep illegally obtained income. The starting point of the US theory and judicial practice, while considering tax basis of illegal income, is the definition given by the Supreme Court in several cases: 1. income is any gain whether from capital or employment or the combination of both (Eisner v. Macomber, 252 U.S. 189, 207 (1920)); 2. income is any gain completely controlled by a taxpayer (James v. the United States, 366 U.S. 213, 219 (1961)). Both definitions enable taxation of illegal income obtained by embezzlement since such income is capital gain in case of embezzled money. On the other hand, the wrongdoer has complete control over the embezzled money.

The James case is a significant precedent for taxation of illegal income in the USA. However, we are of the opinion that the Court’s standpoint, in this case, is unacceptable because the offender had to repay the embezzled money and to pay tax on that money although he could not keep it. Does

51 J. B. Libin, G. R. Haydon, 426.
53 E. Finestone, 714.
54 Ibid., 714-715.
it mean that the offender will be sentenced twice for the same offence? This solution is wrong both for the offender and the injured party because the offender may use part of the stolen money to pay tax, thus reducing the possibility of repaying the money to the injured party. Additionally, the USA Internal Revenue Service takes priority over an injured party when taxing illegal income is in question. Oppositely, Serbian national legislation gives priority to an injured party with regard to the seizure of material gain (Article 93 of the CC), which is a fair solution.

However, in case the offender cannot relinquish the money for any reason (e.g. he spent or gambled it away), arguments in favour of taxing proceeds obtained from crime gain significance. One of the possible solutions is to tax the spent money, while the amount relinquished to the injured party would not be included in tax basis. Moreover, the advocates of taxing illegal income may argue that in case of drug trafficking, there is no injured party to whom the money should be relinquished, which is one more reason for taxing income acquired by unlawful activities.

5. Conclusion

Illegal income from selling drugs or other criminal offences cannot be taxed according to the existing law. In other words, the criminal offence of tax evasion does not exist if the offender gives false data on illegally acquired income or does not report illegal acquired income. If taxpayers were obliged to report illegally acquired income, it would mean that they should report themselves as lawbreakers. This is unacceptable since no provision of national legislation provides for the obligation of citizens to act against their own best interests. On the other hand, paying tax on illegally acquired income would imply the legalization of such income, which is unacceptable as well.

Current modifications of the Criminal Code (cancellation of the word ‘lawfully’ from the legal description of tax evasion) have as an objective more efficient criminal procedure. Hitherto, courts in each case had to establish that taxed income was lawful, thus diminishing criminal procedure efficiency.

According to the Serbian Criminal Code, illegal income is seized based on Article 87 of the CC providing seizure of objects as well as Articles 91-93 of the CC providing seizure of material gain and provisions of the Law on Seizure of the Proceeds from Crime. Our research has analyzed the effects of the aforementioned measures on illegal income obtained by a criminal offence of illegal production and circulation of

narcotics provided for in Article 246 of the CC. The results of the research show that enforcement of these measures is not an effective means for the seizure of illegal income. Therefore, it must be pointed out that the court by legal duty must establish the existence of material gain obtained by a criminal offence (Article 538 of the CPC). Although a number of examples from judicial practice indicated that a potential causation link between the commission of a criminal offence and obtained material gain by an offender had to be established, courts did not respond adequately. Apparently, it is necessary to improve the cooperation and the share of information among police, public prosecution and courts on one side and the Tax Administration and other state organs on the other side (customs, real estate register, the Business Registers Agency, etc.). These state organs are key actors assisting the state to seize illegally acquired income from offenders. Prerequisite for the cooperation among these state organs is existence and updating of the citizens’ income and real property database in the Tax Administration. Additionally, an international cooperation as regards gathering data on material gain obtained by a criminal offence is of crucial importance. The cooperation among neighbouring countries based on signed agreements, as well as the cooperation with international organizations (INTERPOL, EUROPOL) is also of utmost importance.

The USA experience shows that taxation of illegal income is not an adequate solution which may ensure efficient seizure of material gain obtained by a criminal offence. Accordingly, a number of complex legal issues are opened to which judicial practice in this country does not have an answer. Moreover, state organs should above all see that an injured party is redressed for the damage caused by a criminal offence and not to worsen their situation by taxing an offender for illegally obtained income. Additionally, taxing illegal income is not fairly for the offender, because they would thus be “twice punished” for the same offence. We are of the opinion that illegal income can be seized by efficient enforcement of existing provisions of Criminal Code and Law on Seizure of the Proceeds from Crime, which make taxation of illegal income unnecessary.

The paper does not analyze the provisions of the Law on Seizure of the Proceeds from Crime since they were not applied in criminal cases included in this research. According to Article 16a of this Law, when the police file criminal information to the public prosecutor for an offence provided for in Article 2 of this Law, they must submit relevant data on the suspect’s and third party’s property which were gathered in the course of

the preliminary investigation. Bearing in mind that paragraph 6 of Article 2 of this Law sets forth illegal production and circulation of narcotics (provided for in paragraph 1 of Article 246 of the CC) as criminal offence referred to by provisions of this Law, the question is whether the police submit all relevant information to the public prosecutor with regards to the suspect’s property. If they do, then why do courts take statements from the defendants?

The Law on Seizure of the Proceeds from Crime empowers state organs since paragraph 2 of Article 3 of this Law provides that: „Proceeds from crime shall denote assets of an accused being manifestly disproportionate to his/her lawful income“. Basically, this means that it is possible to seize proceeds not obtained from crime even if it is disproportionate to his/her lawful income. Oppositely, seizure of material gain is a measure that is possible only if the decision of the court has determined commission of a criminal offence (paragraph 2 of Article 91 of the CC).

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ODUZIMANJE ILI OPOREZIVANJE NEZAKONITO STEČENIH PRIHODA – PRIMER PRODAJE DROGE

Rezime

Krivično delo poreska utaja se najčešće ostvaruje davanjem lažnih podataka o stečenim prihodima i neprijavljuvanjem stečenih prihoda, proizlazi iz našeg krivičnog zakonodavstva. Gramatičkim tumačenjem odredbe krivičnog zakonika koja propisuje ovo krivično delo može se zaključiti da prihodi koji se oporezuju mogu biti stečeni na zakonit i nezakonit način, jer se zakonodavac ne izjašnjava u pogledu ovog problema. Naime, izmenama i dopunama krivičnog zakonodavstva iz 2016. godine iz zakonskog opisa krivičnog dela poreska utaja brisana je reč „zakonito“. Međutim, to ne znači da se mogu oporezovati nezakonito stečeni prihodi, što će u radu biti detaljno obrazloženo. Izvršićemo istraživanje sudske prakse u pogledu izricanja mere bezbednosti oduzimanje predmeta i mere oduzimanja imovinske koristi u krivičnim stvarima koje se odnose na krivično delo neovlašćena proizvodnja i stavljanje u promet opojnih droga iz člana 246 KZ. Na taj način ćemo
utvrditi da li se efikasno primenjuju ove mere i da li se ovim merama mogu oduzeti prihodi koji su stečeni prodajom droge. Deo rada biće posvećen razlozima koji govore u prilog i protiv oporezivanja nezakonito stečenih prihoda. U razmatranju ovog problema autor će se osloniti na iskustva SAD koje oporezuju nezakonito stečene prihode.

**Ključne reči:** nezakonito stečeni prihodi, zakonito stečeni prihodi, poreska utaja, prodaja droge.