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# LOOPHOLES IN LAW: A CASE THAT CHANGED HISTORY

-Pranav Bhondve<sup>1</sup>

## INTRODUCTION

What if war criminals were set free just because of a poorly drafted law?

The word "Loopholes" was given by "William Garrard" in the late 1500s and in the early 1600s, "Loophole was formed within English by compounding."<sup>2</sup>

A loophole in law refers to a situation when a small mistake in agreement or law gives someone a chance to legally escape or avoid having to do something, due to imprecise language in law or regulations and divergence between the text and purpose of a law. Universally, laws are brim-full of loopholes. Loopholes showcase the inefficiency in a system that defeats the law's intention. Loopholes are used by people as a way out of something, to avoid something like taxes, etc.

There are many kinds of loopholes, but a few main loopholes are Legal Loopholes, Tax Loopholes, and Corporate Loopholes. But this blog primarily focuses on Legal loopholes and real-life cases that led to consequences in law, politics, and the economy. As time has progressed, the lawmakers and policymakers have closely worked together to minimize these loopholes by amending the laws and making the drafting more equitable and precise in law.

This blog delves into what exactly these loopholes are, their effect on the justice system, examines how they arise, what the courts have done about the loopholes, real-life cases that have played an important role, and possible reforms in law to ensure they serve their purpose with minimal loopholes. To address the issue more effectively, we have to understand "The Mismatch Theory."<sup>3</sup> This theory answers the question, why the law is filled with loopholes. Why do they exist even

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<sup>2</sup> 'Home : Oxford English Dictionary' (*Oxford English Dictionary*) <<https://www.oed.com/>> accessed 08 May 2025

<sup>3</sup> Katz L, 'A Theory of Loopholes' (2010) 39 The Journal of Legal Studies 1 <[https://www.jstor.org/stable/10.1086/649046?read-now=1&seq=1#page\\_scan\\_tab\\_contents](https://www.jstor.org/stable/10.1086/649046?read-now=1&seq=1#page_scan_tab_contents)> accessed 05 May 2025

after being identified? And what should lawyers do about them- ignore them or exploit them for their own benefit?

## **THE MISMATCH THEORY**

This theory is based on the simple logic that human creations are unavoidably imperfect. Laws and regulations that are created by the legislators are doomed to have imperfections.

The two types of mismatches have been called type 1 and type 2 errors. There are two main reasons why loopholes exist in the legal framework. First is limited foresight, which is impossible for the drafters to look into the future possibilities and implications that a certain law may have on society. There is possibly no practical way through which the drafters can predict every misuse of the law. Second is the limited hindsight, which talks about even if the drafters imagine every trick situation, it would still be impossible to recognize the genuineness of the situation at the grassroots.

We can look at an example where people who are seeking asylum, it would be difficult to tell whether they are acting or are really in need of asylum. No matter how technical the asylum law may have been framed.

Another question that this theory answers is what lawyers should do about the loopholes present in the legal system. There are two views in this regard, the strict view and the lenient view. A strict view says that using loopholes is completely useless to society and even harmful to some extent. Whereas the Lenient view says that it is the job of the lawmakers to close the loopholes, the lawyers are simply using their rights under the law.

## **COURTS' RESPONSES TO LOOPHOLES AND WHY THEY STILL EXIST**

Courts have taken three approaches, as mentioned below, for the cases

### **1) THE FORM-VERSUS-SUBSTANCE APPROACH**

This is the approach in which the courts believe in what is happening inside rather than simply believing in how something looks from the outside. Consider an example when an employee gets paid mostly in kind (i.e., company car, apartment) instead of salary. This is done so that he or she could avoid taxes on larger income. However, this approach falls short, as people aren't breaking the law or pretending to do something; they are just being clever with the use of loopholes.

## **2) THE INTENT-TO-EVADE APPROACH**

This approach believes that only if someone did something because they wanted to avoid a law, then it should not be allowed. For example, when someone knowingly wired their business transaction in such a way that it could benefit them in avoiding taxes, then the courts would cancel such acts. However, this approach is a little too strict to be applied in all areas of law, for instance, criminal law, where someone cannot be merely punished because they fear punishment for the act of stealing, which would make no sense.

## **3) THE LETTER-VERSUS-SPIRIT APPROACH**

The courts in this approach ask the question whether someone's action goes against the spirit of the law, even if they follow the exact words of the law. For instance, a company employee shares confidential business information with a friend, but instead of buying stock himself, he lets his friend buy on his behalf. Technically, he didn't violate any law, but he has defeated the purpose of the law by unfairly profiting from the insider information.

## **HISTORICAL CASES**

### **1) PANAMA PAPERS**

In April 2016, the International Consortium of Investigative Journalists (ICIJ) close to 11.5 million documents were made public from the Panamanian law firm Mossack Fonesca.<sup>4</sup> It is one of the biggest leaks of confidential papers in history. The case revealed how the law firm helped individuals, multi-national corporations in securing their money in offshore accounts to avoid taxes. The documents also showed how criminals used offshore accounts to launder their illicit earnings. The leak had far-reaching implications, it led to the resignations of Sigmundur Davíð Gunnlaugsson, Prime Minister of Iceland, and Pakistan Prime Minister Nawaz Sharif.

The core of the scandal wasn't just illegal activity, it was also the use of legal gaps in international finance laws. One of the ways by which these individuals and multinational corporations avoided taxes was through money laundering. The United Nations Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, published in 1988, defines money laundering in article 3.1(b) as "The concealment or disguise of the true nature, source, location, disposition,

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<sup>4</sup> Teague E, 'Panama Papers' (*Encyclopædia Britannica*, 9 April 2025) <<https://www.britannica.com/money/Panama-Papers>> accessed 8 May 2025

movement, rights concerning, or ownership of property, knowing that such property is derived from an offence or offences [...]” (UNODC, 1988)<sup>5</sup>.

In contemporary times, there are many ways through which criminals turn black money into legal assets. Cryptocurrency is one modern method because these transactions are often anonymous. Cash is still the most common form of money used for channelling crimes, for eg, buying weapons, drugs, or illegal items. Then there was the creation of shell companies to legally obscure ownership in the Tax havens islands or countries like Panama, British Virgin Islands and the Seychelles, which had minimum taxation.

The scandal had a deep impact on global tax reforms. European Parliament's Panama Inquiry Committee reports, 2-5% of the global GDP is connected to money laundering, which should be an unacceptable amount, calling for urgent action (Unger, 2017)<sup>6</sup>. It has created an ethical dilemma of allowing a certain group of the population to be exempt from contributing to the welfare of a nation. The EU, since then, has constantly been pushing for the registration of beneficial owners. India has also formed special multi-agency task forces like the Enforcement Directorate (ED) and acts such as the Foreign Exchange Management Act (FEMA), 1999, and the Prevention of Money Laundering Act (PMLA), 2002. Yet, the ultra HNIs have been successful in exploiting the legal loopholes in financial governance.

## CONCLUSION

Legal loopholes may look like a clever, harmless way out for individuals and multinational corporations, but history has shown us that they can lead to devastating consequences for any economy, for instance, political instabilities, global corruption, or escape from corruption. The entire legal system depends upon the language, interpretation, and enforcement of law. Hence, as society has progressed, so must our legal systems. Amendments in our legal system are needed for the hour. The strength of any legal system is not just in the law, but how well it foresees its misuse.

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<sup>5</sup> United Nations, ‘INCB’ (*UNDOC 1988 Convention*) <<https://www.incb.org/incb/en/precursors/1988-convention.html>> accessed 5 May 2025

<sup>6</sup> Unger B, ‘Offshore Activities and Money Laundering: Recent Findings and Challenges’ (*Directorate General for Internal Policies (of the European Parliament, 2017)*) <[https://www.europarl.europa.eu/RegData/etudes/STUD/2017/595371/IPOL\\_STU\(2017\)595371\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/STUD/2017/595371/IPOL_STU(2017)595371_EN.pdf)> accessed 8 May 2025