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UNDERSTANDING AND COUNTERING THE CHALLENGES OF TAX EVASION AND AVOIDANCE IN INDIA: A FRAMEWORK-BASED APPROACH

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Abstract

The current study presents a framework for understanding the consequences of tax evasion and avoidance in India. The purpose of this study is to investigate the impact of direct tax avoidance and evasion in India, the motivations for such avoidance and evasion, and the issues produced by such avoidance and evasion. Tax evasion is the deliberate attempt of a taxpayer not to pay tax, whereas avoidance is the endeavour of a taxpayer to lower his tax liability in order to pay as little tax as possible. This move has an impact on revenue generation in India, causing the tax's intended goals to be missed. Despite all of the government's attempts to combat the problem of tax evasion and avoidance, there is still a slowing in the economy's growth. Government revenue declines as a result of tax evasion, which lowers the amount of public funds available for investment in vital industries like infrastructure, healthcare, and education. Contrarily, tax evasion skews the distribution of resources and deters foreign investment, which lowers economic development overall. The study emphasizes the grave harm that tax evasion and tax avoidance due to India's economic growth. It offers proof in Favor of taking decisive action against these practices in order to advance India's sustainable economic growth. So, this study is concerned with overcoming those challenges and finding an appropriate solution.

Keywords: *Tax Avoidance, Tax Evasion, Economic Development, Government Revenue.*

I. Introduction

Taxation is a source of revenue for the government of a country, which it utilises to develop infrastructure, living standards, and security for its population. These taxes, however, can impede an individual's or a company's subjective development, encouraging individuals and large corporations to investigate ways to avoid them by exploiting loopholes in the rules and norms

that govern taxation.

The terms "tax avoidance" and "tax evasion" are used in the Income-tax Act of 1961. Tax evasion, on the one hand, is unlawful, and penalties are outlined in Chapter XXII of the Income Tax Act of 1961. Individuals who attempt to avoid paying income taxes face a number of penalties under the Income Tax Act. The consequences for such activities are high, with penalties ranging from 100% to 300% of the tax for undisclosed income.

Whereas, on the other hand, tax Avoidance includes any activity performed to avoid tax while complying with all tax regulations and without any illegal intention.

II. The History behind the concept of Tax evasion & Tax Avoidance

In India, tax avoidance and evasion are serious problems that have an impact on the growth of the economy. Tax evasion and tax avoidance continue to be commonplace despite government efforts to promote tax compliance; this results in revenue losses and impedes economic growth. The purpose is to look into how tax evasion and tax avoidance affect India's economic growth, specifically how they affect foreign investment, government revenue, and economic stability. We will look into the history from the colonial period where this was the started.

Since the colonial era, tax evasion has been a common practice in India for a long time. The Indian aristocracy engaged in widespread tax avoidance during British rule, employing a variety of strategies to evade paying taxes. Following its independence, India introduced a progressive tax system where wealthy taxpayers pay higher rates, and tax evasion increased in frequency. The tax regulations of the nation were intricate, with several opportunities for both people and corporations to take advantage of in order to lower their tax obligations. The government imposed a wealth tax in 1984, requiring people to pay taxes based on their net worth. The goal of this was to lessen tax evasion by those with large assets but low taxable income. When India's economy opened up in the early 1990s, global businesses began making investments there. Multinational corporations increased their use of transfer pricing and other tax evasion strategies as a result. As a result, the Indian government unveiled a number of initiatives to address transfer pricing and enhance tax compliance.

III. Direct Tax

A direct tax is one that is paid directly to an imposing authority by an individual or organisation. A tax payer pays direct taxes to the government for a variety of reasons, such as Income Tax, real estate taxes or asset taxes. Direct taxes differ from indirect taxes in that they are placed on a single entity, such as sales tax paid by the customer in a retail establishment. A direct tax cannot be transferred to another person or entity. The individual or organisation taxed with the tax is responsible for the payment of the tax.

In contrast, indirect taxes can be transferred from one taxpayer to another. A direct tax, as opposed to a transaction tax, is one placed on an individual person (juristic or natural) or property (i.e., real and personal property; animals; harvests, wages, etc.).

The ability to pay principle governs direct taxes. This is an economic concept that means that individuals with more resources or a higher income should pay more taxes. The ability to pay taxes is one way for a country's wealth to be redistributed.

IV. Tax evasion and tax avoidance mechanism in India.

Tax evasion occurs when someone fail to present their true income on their income tax return. This is prohibited, and the defaulter who conceals the actual income may face legal consequences. You can save taxes by legal techniques that require investing in various schemes and plans, but engaging in unfair practises is a crime.

The Indian government has recognised the need to prevent tax evasion and has taken several initiatives to accomplish this. Under the Income Tax Act of 1961, tax evasion is penalised by fines and penalties. The statute also grants tax authorities the authority to conduct searches and seizures in order to gather proof of tax evasion.

Tax avoidance tactics used by large corporations around the world result in significant revenue losses for various countries around the world, including India. It can only be avoided by closing loopholes in tax laws. Through the Income Tax Act of 1961 and the Finance Act of 2015, the Indian government established specific rules and guidelines to regulate and limit tax evasion.

According to a study, tax avoidance by major companies costs the government approximately

INR 50,000 crore every year. Reliance Corporation of India, Tata Group, Google, and others are famous instances of global companies that do business in India and have mastered the techniques of tax evasion and tax avoidance.¹

V. Tax Evasion by Corporations.

Large companies in India use a number of tax-avoidance strategies. These schemes heavily rely on tax-free nations and subsidiaries. A "tax haven" is a country that grants foreign individuals and businesses limited tax liability in a politically and economically secure environment, with little or no financial information exchanged with foreign tax authorities.

The most popular and advantageous strategy among India's top companies is to transfer assets, shares, transactions, and money from India to these tax havens via subsidiaries. Since 2005, several Indian and multinational corporations that have set up shop in India have used tax havens and subsidiaries to avoid paying taxes.

The implementation of the Goods and Services Tax (GST) has reduced tax avoidance. GST is a value-added tax (VAT) imposed on the provision of goods and services. The GST has simplified the tax code and made tax evasion more difficult. The entire GST system is online, and all transactions are recorded in real time. As a result, tax avoidance has become more difficult.

VI. A conceptual mechanism of Black Money.

In general, Black Money refers to money obtained through unlawful means and kept hidden and unaccounted for. There are other synonyms for underground economy, such as parallel economy, shadow economy, unofficial economy, unaccounted economy, and so on. As a result, black money is not reported to public authorities at the time of its creation and is not disclosed at any point during its possession. Black money can be formed by illegal drug trafficking, terrorism, corruption, or legitimate failure to pay taxes to the government, resulting in the production of unaccounted wealth. Certain sectors and activities, such as land and real estate transactions, bullion and jeweller dealings, complex financial market transactions, charitable activities, informal sector and cash economy, self-employed professionals, external trade, and transfer pricing, give rise to black money generation.

¹ Cobham, Alex, and Petr Janský. "Global Distribution of Revenue Loss from Corporate Tax Avoidance: Re-Estimation and Country Results." *Journal of International Development*, vol. 30, no. 2, Mar. 2018, pp. 206–232.

Tax evasion is an illegal attempt to decrease one's tax liability by purposefully under-reporting or failing to declare taxable income or concealing one's true position from tax authorities. In a developing country like India, this is an issue. Global economic circumstances deteriorated drastically in 2008, with several industrialised economies facing their steepest decline since the post-World War II period. The associated negative shocks that extended throughout poorer countries exacerbated the global recession.

VII. Tax Havens

The phrase 'Tax Havens' is commonly used to designate any country or region that imposes very low or no taxes on foreigners. The most prevalent strategy is to use a tax haven solely as an intermediary for transactions, with the real economic impact occurring elsewhere. Internationally, two high-tax-rate countries can be channelled through a tax haven firm so that any resulting profit in the haven is tax-free.

According to a large number of research on tax havens, tax havens are often small countries or jurisdictions with minimal or no taxation for foreigners who choose to come and settle there. They normally maintain strict confidentiality or secrecy regarding their money and accounts, making them very appealing venues for hiding unaccounted income and, as a result, highly valuable for multinational corporations looking to cut their global tax loads. Multinational corporations comprised of multiple corporate and non-corporate bodies developed tax haven organisations and intentionally transferred their profits to such conduit organisations in order to construct low tax regimes.

VIII. Ways to evade tax.

Tax evasion is a frequent practise among Indian businesses. They make a lot of money and use various illegal tactics. Most people engage in these unethical practises in order to avoid taxation.

1. Filing fake tax returns.

In rare situations, when an individual files their taxes, they may provide misleading or erroneous information in order to reduce or avoid paying the tax. This is also tax evasion because complete information is not provided, and they may pay less than they should.

2. Keeping Money in a Foreign Bank Account

The Indian Income Tax Department has no power over international bank accounts. Some people may maintain money in a bank account outside of the country. This is against the law because this income cannot be calculated when computing taxes. If government officials learn about the money in international accounts, the perpetrator may face criminal charges.

3. Financial statements that are misleading.

The taxes that an individual or organisation must pay may be determined by the financial transactions that occurred during the assessment year. If false financial documents or accounts books are submitted, showing incomes that are less than what was actually earned, the tax may be reduced.

4. Using forged documents to obtain an exemption.

Certain exemptions and privileges may have been granted by the government to certain members of society in order to ensure they have a bit more financial freedom to progress. In some situations, members who do not qualify for such benefits will have documentation manufactured to support their claim of being a member of such group, allowing them to claim exemptions where they are not qualified.

IX. Why Tax Avoidance and Tax Evasion is Prevalent in India?

Reasons for tax evasion are shared by all countries, whether developed and developing. The reasons for tax evasion in developed nations differ from those in developing countries because tax awareness in developed countries is higher than in developing countries, and progress in fiscal controls in rich countries has been made. One of the consequences of tax evasion is a drop in government revenue, which casts the tax system into disgrace. Tax evasion reduces government revenues, resulting in a higher deficit, compelling the government to borrow or create more money, causing inflation.

It is necessary to investigate its cases in order to propose strategies to eliminate or diminish them. The problem of tax evasion and its causes can be divided into economic, administrative, and legislative causes, as well as social and other factors. We have done our best to talk about all of the following causes:

- Level of tax rates
- Social psychology for taxpayers
- The complexity of the tax system
- Misuse or mismanagement of tax revenue
- Inequitable distribution of amenities
- Nature of the economy
- Complexity of Tax Laws
- Unwillingness of Taxpayers to Pay Taxes
- Corruption in Tax Administration

X. Recent Deterrent Policies by Government.

The Indian government has taken the following initiatives to combat tax evasion. Tax evasion is considered a crime in India. The government imposes prosecution and penalties under various acts. The Income Tax Department has implemented an income tax reward scheme that pays informants about tax avoidance. Recently, India and the United States reached an agreement to prevent Americans from evading taxes through Indian financial institutions. The Special Bearer Bond Scheme (Immunities and Exemptions Act, 1981) allows those who have black money to invest in special bonds. Another was the Voluntary Compliance Scheme (Amnesty Scheme).

The government raised the tax bracket, cut the deduction rate, and expanded lawful tax avoidance tactics. Recently, the government established the Tax Administration Reform Commission to make fundamental changes to tax concerns in order to simplify and streamline tax operations. Previously, India established many committees such as the Taxation Enquiry Committee, the Indian Tax Reforms Committee, and the Direct Taxes Enquiry Committees, among others. The Finance Bill included a provision for auditing hidden transactions in order to combat tax evasion. The Indian government has implemented a number of steps to discourage tax avoidance. Such measures are listed below.

- **Statutory Requirements**

Certain statutory provisions require everyone with taxable income to file tax returns; businessmen and professionals must keep accounts and have them audited if their income or turnover exceeds a certain limit; and transactions involving payments exceeding Rs.20,000 must be channelled through banks.

- **Surveys must be carried out.**

The income tax agency conducts surveys to bring new assesses into the tax net as well as to increase the information base for detecting tax evasion by current assesses.

- **Significant Measures**

The government has even utilised severe tactics such as tax raids and seizures at times.

- **Punishment and Prosecution**

To deter tax evasion, tax laws impose monetary penalties as well as the prosecution (and incarceration) of tax evaders.

- **Provisions for Door-to-Door Market Survey u/s 133 B**

In order to locate new assesses, the jurisdictional income tax office may gather specific information, including tax status of assesses. The person being surveyed must provide information on the prescribed form no 45 D. The income tax officials are prohibited from removing any valuables, books of accounts, or other items from such examined properties.

XI. Legal Implication.

In our country, the Income Tax behaviour establishes the punishment and sanctions for people who do any type of wilful behaviour involving taxes. Such as hiding their assets in order to avoid paying taxes on them, passing their properties to others in order to defraud the government, and smuggling items. The punishment for these acts is outlined in our income tax legislation, and if some criminal activity is involved, there are other activities that will assist us in punishing the perpetrators.

Tax evasion should be viewed as a penal offence in India, according to the Income Tax Act. This can lead to serious consequences. The degree of the fraud committed and the amount of tax owed may influence the penalty for tax evasion. As a result, it is advised to take income tax compliance seriously in order to avoid legal action by authorities.

1. **Failure to file Income tax Return:** The standard punishment for failing to file income tax returns on time is a fine of up to Rs. 5,000. The amount of the fine will be determined by the assessing officer based on the facts of the case. This penalty is imposed if the

taxpayer fails to file their returns by the due date and/or fails to comply fully with the relevant provisions of the Income Tax Act, 1961.

2. **Concealing the actual profits:** If the taxpayer seeks to conceal the original gains or income, the penalty imposed by Section 271(C) will be between 100% and 300% of the tax evaded. Income concealment is a serious violation that can result in heavy fines and perhaps prosecution.
3. **Under reporting the Income:** A taxpayer found guilty of deliberately attempting to avoid or under-report income in excess of Rs 25 lakh faces up to seven years imprisonment and severe penalties under Section 276C of the Income Tax Act.
4. **Inaccurate Information:** When completing an ITR, it is illegal to provide inaccurate information, including PAN details. Incorrect PAN results in a Rs.10,000 penalty, whereas not submitting PAN results in higher TDS deducted, i.e., 20% instead of 10%.

XII. Judicial Pronouncements

Union of India v. C.B. Gautam (1992)²

In this instance, the petitioner filed a civil writ case in the Delhi High Court, contesting the provisions of the Finance Act 1986 and the Income Tax Act, 1961. The petitioner claimed that the purpose of the case was to acquire a 253-square-meter plot of land at B-7/108A, Safdarjung Enclave, New Delhi. Thus, it was decided that the petitioner would become the owner of the property and that construction would start on the same day.

But later on, Chapter XX-C was contested on the grounds that the property's value was inappropriate according to market or regional appraisals. Then, it was claimed that leasehold privileges infringed upon the right to equity under Article 14. Then, it was stated that immovable property could not be transferred through a lease under Section 269UD regulations. The court noted that it was believed that transfers of real estate in urban areas involved a substantial degree of tax avoidance.

² C.B. Gautam v Union of India & Ors 1992(3) Suppl. SCR 12

The statement makes reference to the recommendations made by the Wanchoo Committee, a direct taxes inquiry panel led by the Hon. Mr. Justice Wanchoo, a former chief justice of India. The Wanchoo Committee concluded in its interim report from 1970 that understating prices in real estate sale deeds was a common way to evade taxes. As a drastic measure, the committee suggested that the government be given the authority to purchase properties where the consideration in the sale deeds was found to be incorrect. In response to this proposal, Chapter XX-A rules were added to the Income Tax Act.

The Cadbury India case is a seminal case concerning tax evasion in India. The Indian tax authorities claimed in 2010 that Cadbury India had undervalued its exports to its parent firm in the UK, causing India to lose tax revenue. They also accused the corporation of engaging in transfer pricing manipulation and tax cheating. Cadbury India was required to pay back taxes and penalties of Rs. 2,500 crores by the tax authorities.

The matter was taken to the Bombay High Court, which decided in 2014 in Cadbury India's favor, finding that the business had neither manipulated transfer pricing or participated in tax fraud. The court determined that Cadbury India had complied with Indian tax regulations and that the tax authorities had not shown enough evidence to back up their claims. One of the most important cases involving transfer pricing and tax evasion in India is the Cadbury India case. It made obvious how important it is for India to have uniform transfer pricing laws and enforcement protocols in place to stop multinational corporations from dodging or evading taxes.

XIII. Conclusion

The above explanation concludes that both the concepts of Tax Evasion and Tax Avoidance achieve a similar goal of tax reduction, however one achieves this goal through legal means and the other through unlawful means. The Indian government has made provisions for an individual or a legal body to limit income taxes, whilst the government has imposed numerous penalties for tax evasion. The government's revenue has been impacted since the current taxing structure allows for loopholes, dishonest tax officials, a lack of proper information, and other factors. Furthermore, lowering tax rates is not an optimal solution to the problem because some people will still try to evade or avoid taxes regardless of tax rates. The fact is that changing tax payers' mindsets is the primary remedy to tax evasion and tax avoidance.

We have an obligation to assist the government by adhering to tax procedures and making timely tax payments since we are aware of the detrimental effects of tax evasion. Rather than standing by and waiting for things to change, let's take the initiative and create the necessary changes. All it will take is timely completion of our assigned tasks. If we all speak the same language, there won't be much space for any group or authority to take advantage of us.

