

Tax Evasion and its Consequences

Mrs. Chhaya Rai

Shri G. P. M. Degree College, Vile Parle (E), Mumbai, Maharashtra, India

Abstract: *Tax evasion and tax avoidance are significant problems that have a detrimental effect on the economic development of India. These issues reduce the government's ability to collect revenue, which in turn reduces its capacity to finance public expenditures that are essential for economic development. Tax evasion involves deliberate non-payment or under-reporting of taxes, while tax avoidance refers to the use of legal means to reduce tax liability. Both practices have negative consequences for economic growth, investment, and government revenue. The research uses secondary data from various sources to analyze the impact of these practices on key economic indicators such as GDP growth, investment, and government revenue. The findings reveal that tax evasion and tax avoidance significantly negatively impact economic development. Tax evasion results in a decline in government revenue, which reduces the availability of public resources for investment in critical sectors such as education, healthcare, and infrastructure. Tax avoidance, on the other hand, distorts resource allocation and discourages foreign investment, leading to a decrease in overall economic growth. The study highlights the significant negative impact of tax evasion and tax avoidance on the economic development of India. It provides evidence to support the implementation of effective measures to combat these practices to promote sustainable economic development in India.*

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

I. INTRODUCTION

The economic growth of a nation like India can be significantly impacted by two prevalent practices: tax evasion and tax avoidance. Tax avoidance is the use of legal strategies to lower tax liabilities, whereas tax evasion involves people or corporations avoiding paying taxes in an illegal manner. Each of these actions can have severe repercussions for a nation's economy.

The impact of tax evasion and tax avoidance on India's economic growth is a key issue for consideration because of the substantial amount of revenue that is generally lost because of these practices. The Indian government mainly relies on tax revenue to pay for social programs, infrastructure improvements, and other efforts to promote economic growth. When individuals or businesses avoid paying taxes, it reduces the amount of revenue that the government can collect, which in turn can lead to budget deficits, reduced public services, and an overall slower pace of economic development. Tax evasion and avoidance have become pervasive in India's economy, affecting the country's fiscal stability and hindering its economic development. One study by the National Institute of Public Finance and Policy (NIPFP) estimates that India loses around Rs. 9.6 trillion annually due to tax evasion and avoidance¹. The study also suggests that the issue of tax evasion and avoidance has become more prevalent in recent years, leading to a decline in tax revenue, a widening fiscal deficit, and a reduction in public investment. Another study by the International Monetary Fund (IMF) highlights the adverse effects of tax evasion and avoidance on economic growth. The study suggests that tax evasion and avoidance lead to a decline in public trust in the government, reduced investment, and a decline in the quality of public services. These factors, in turn, lead to a decrease in economic growth and development. Further research has also revealed that tax evasion and avoidance have several underlying factors. These include inadequate tax administration, weak legal frameworks, and low taxpayer compliance. The lack of political will and corruption are also significant factors that contribute to tax evasion and avoidance in India. STATEMENT OF PROBLEM Tax evasion and tax avoidance are significant issues in India that affect the country's economic development. Despite efforts by the government to increase tax compliance, tax evasion and tax avoidance remain widespread, leading to revenue losses and hindering economic growth. This problem statement aims to investigate the impact of tax evasion and tax

avoidance on the economic development of India, including the effects on government revenue, foreign investment, and economic stability.

II. OVERVIEW OF TAX AVOIDANCE AND TAX EVASION

Tax avoidance refers to the use of legal methods to minimize or reduce tax liability. In India, tax avoidance is a common practice among individuals and businesses. Some of the most common methods of tax avoidance in India include the use of tax deductions, exemptions, and credits, transfer pricing, and setting up shell companies. One of the primary reasons for tax avoidance in India is the high tax rates. The tax rates in India are among the highest in the world, making it an attractive destination for those looking to avoid taxes legally. The Income Tax Act, 1961, provides several exemptions, deductions, and credits, which individuals and businesses can use to reduce their tax liability. Though tax avoidance is legal, it is seen as a form of unethical behaviour that reduces the amount of revenue that the government can collect, ultimately leading to reduced spending on infrastructure, education, and healthcare. Tax evasion refers to the illegal practice of avoiding or underpaying taxes by not reporting or understating taxable income or hiding assets or transactions from the authorities. In other words, it is a deliberate attempt to deceive tax authorities by individuals or businesses to reduce their tax liability or avoid paying taxes altogether. Tax evasion is a serious offence that undermines the government's ability to provide essential services and public goods by reducing the revenue available to fund them. When individuals or businesses evade taxes, it can also create an uneven playing field, where honest taxpayers end up bearing a higher tax burden. Governments around the world have implemented various measures to prevent tax evasion, including criminalizing tax fraud, improving tax collection and enforcement systems, and increasing penalties for tax evasion. They also encourage voluntary compliance by providing incentives for taxpayers to report their income and assets accurately and timely.

TAX AVOIDANCE

HISTORY Tax avoidance has been prevalent in India for many years, and it can be traced back to the colonial period. During British rule, tax avoidance was a common practice among the Indian elite, who used various methods to avoid paying taxes. After independence, India introduced a progressive tax system with higher tax rates for higher-income groups, and tax avoidance became even more prevalent. The country's tax laws were complex, and there were several loopholes that individuals and companies could use to reduce their tax liability. In 1984, the government introduced a wealth tax, which required individuals to pay taxes on their net wealth. This was aimed at reducing tax avoidance by individuals who had significant assets but little taxable income. In the early 1990s, India opened up its economy, and foreign companies started investing in the country. This led to an increase in transfer pricing and other forms of tax avoidance by multinational companies. In response, the Indian government introduced several measures to tackle transfer pricing and improve tax compliance.

METHODS

Here are some of the most common methods of tax avoidance used by individuals and companies:

- 1) **Deductions and exemptions:** One of the most common methods of tax avoidance is to claim deductions and exemptions. The Income Tax Act allows for several deductions and exemptions, such as those for charitable donations, medical expenses, and home loan interest, which can be used to reduce taxable income.
- 2) **Transfer pricing:** Transfer pricing is a method used by multinational companies to shift profits from high-tax jurisdictions to low-tax jurisdictions. This is done by setting up subsidiaries in countries with lower tax rates and then transferring profits to those subsidiaries.
- 3) **Setting up shell companies:** A shell company is a company that has no real business activity and is set up only to channel funds to other entities. These companies are often used to evade taxes by transferring money to them and then transferring it to other entities to avoid detection.
- 4) **Offshore accounts:** Offshore accounts are bank accounts held in a foreign country. These accounts are often used to avoid taxes by hiding income from the tax authorities.
- 5) **Capital gains tax:** Capital gains tax is a tax on the profit earned from the sale of assets such as stocks, bonds, and real estate. One way to avoid capital gains tax is to hold on to assets for the long term, as the tax rate decreases over time.

LEGAL PROVISIONS

There are certain provisions related to tax avoidance in the Income Tax Act, 1961 related to tax avoidance which ensure that taxpayers pay their fair share of taxes. They provide the tax authorities with the necessary powers to investigate and prosecute cases of tax avoidance.

1. General Anti Avoidance Rule (GAAR): Section 96 of the Income Tax Act, 1961 provides for GAAR. It allows the tax authorities to declare any arrangement or transaction as an 'impermissible avoidance arrangement' if they are satisfied that the arrangement was entered with the main purpose of obtaining a tax benefit. The tax authorities may then disregard such arrangement and assess tax as if the arrangement had not been entered into.
2. Transfer Pricing Regulations: Section 92 of the Income Tax Act, 1961 deals with transfer pricing regulations. It requires that transactions between related parties be conducted at arm's length prices, i.e., the price that would have been charged if the transaction was between unrelated parties. If the transaction price is not at arm's length, the tax authorities may adjust the price to the arm's length price and assess tax accordingly.
3. Thin Capitalization Rules: Section 94B of the Income Tax Act, 1961 deals with thin capitalization rules. It disallows the interest paid on excessive debt as a deduction for tax purposes. Excessive debt is defined as debt that exceeds twice the amount of equity capital in the company.
4. Tax Avoidance Schemes: Section 97 of the Income Tax Act, 1961 covers tax avoidance schemes. It allows the tax authorities to disregard any transaction or arrangement that has no commercial substance and is entered into solely for the purpose of obtaining a tax benefit.

Tax evasion has a long history, dating back to ancient civilizations. In ancient Rome tax evasion was common, and wealthy citizens often found ways to avoid paying their taxes. Similar practices were observed in other ancient societies, such as Greece and Egypt. During the Middle Ages, tax evasion was prevalent in Europe, particularly among the wealthy nobility. Feudal lords often evaded taxes by underreporting their income or hiding their wealth in offshore accounts. In many cases, they also bribed tax collectors to avoid paying taxes. The rise of mercantilism and the development of modern nation-states in the 16th and 17th centuries led to the introduction of more sophisticated tax systems. In England, the government introduced a system of property taxes in the 17th century, which helped to fund the government's military and administrative expenses. However, tax evasion remained a problem, with many individuals and businesses finding ways to avoid paying their taxes. During the 20th century, tax evasion became more widespread, particularly as globalization led to increased cross-border trade and investment.

Today, tax evasion remains a significant challenge for many governments, with some estimates suggesting that it costs governments trillions of dollars in lost revenue each year. Governments continue to implement new measures to combat tax evasion, such as increasing penalties for tax fraud, improving tax collection and enforcement systems, and increasing international cooperation to crack down on tax havens and other forms of tax evasion.

METHODS

Here are some of the most common methods of tax evasion used by individuals and companies:

1. Underreporting income: This involves not reporting all income earned, such as cash transactions, tips, or income from side businesses.
2. Overstating deductions: Taxpayers may claim deductions or credits that they are not eligible for or overstate the value of their deductions.
3. Hiding assets offshore: This involves transferring funds or assets to offshore accounts or using shell companies in tax havens to hide income from tax authorities.
4. False invoices: Taxpayers may create false invoices to show higher expenses and lower profits, reducing their tax liability.
5. Non-disclosure of assets: Taxpayers may not disclose all of their assets or property, such as real estate, investments, or artwork, to avoid paying taxes on them.
6. Unreported offshore income: Taxpayers may not report income earned from offshore accounts or investments to avoid paying taxes on that income.
7. Cash transactions: Cash transactions can be difficult to trace, making it easier to underreport income earned in cash transactions.

8. Transfer pricing: Multinational companies may manipulate the prices of goods and services transferred between affiliated companies to shift profits to low-tax jurisdictions.

LEGAL PROVISIONS

Let us see how the law actually governs tax evasion and what the legal provisions related to it:

1. Section 271H: It deals with the late filing of the income tax return which can be classified as a type of tax evasion, this is a punishable offence under the Income Tax Act, 1961 with a penalty of Rs. 10,000 to 1,00,000 on the assessee.
2. Section 270A: This section deals with the concealment of income from the income tax department, which is a very serious issue in tax evasion. In this offence, the assessing officer should be convinced that the assessee has concealed any income.
3. Section 271B: It deals with a person who does not get his accounts audited as required under section 44AB of the Income Tax Act, 1961.
4. Section 234E: It deals with the non-compliance of the assessee with the TDS rules. If a business or institution fails to submit tax deducted at source or tax collected at source (TCS) returns on time, they must pay a penalty of Rs 200 per day. The punishment cannot be greater than the TDS total.
5. Section 276C: Under this, a person who intentionally tries to evade tax or understate their revenue in excess of Rs 25 lakh faces imprisonment for a minimum of six months and up to seven years, as well as a fine. When completing an ITR, it is illegal to provide false information, including PAN data.
6. Section 139A: When completing an ITR, it is illegal to provide false information, including PAN data. PAN card IDs are required by all tax deductors, including employers. This information is used to collect TDS from payments.

Steps taken by the Government to Curb Tax Evasion

There are many ways in which the Indian government took a step to stop Tax evasion in India which were going on since independence and nowadays even more, the Government of India took several steps to stop tax evasion. GST implementation: The Goods and Services Tax (GST) is a comprehensive, multi-stage, destination-based tax system that subsumes various indirect taxes like excise duty, service tax, and value-added tax (VAT). GST has brought about a significant change in the tax system by introducing a transparent, technology-driven structure. This system reduces the cascading effect of taxes, simplifies the tax filing process, and enables better tracking of transactions, making it harder for tax evaders to manipulate the system.

PAN-Aadhaar linking

The government has mandated linking the unique identification number (Aadhaar) with the Permanent Account Number (PAN), which is necessary for filing income tax returns. This linkage creates a comprehensive financial profile of individuals and businesses, enabling the government to monitor income sources, financial transactions, and tax liabilities more effectively. It helps identify discrepancies and under-reporting of income. Income Disclosure Schemes: The government has introduced various voluntary disclosure schemes, such as the Income Declaration Scheme (IDS) and the Pradhan Mantri Garib Kalyan Yojana (PMGKY). These schemes allow taxpayers to declare undisclosed income and assets, pay the required taxes and penalties, and avoid prosecution. Such schemes help increase tax compliance and bring unaccounted wealth into the formal economy.

Digital payment promotion: The government has been promoting digital payment methods like Unified Payments Interface (UPI), National Electronic Funds Transfer (NEFT), and Immediate Payment Service (IMPS) to reduce cash transactions. Digital transactions leave a trail that helps authorities track income sources and detect tax evasion. Incentives like discounts, cashback, and tax benefits are provided to encourage digital payments.

Demonetization: In 2016, the Indian government demonetized high-denomination currency notes (₹500 and ₹1,000) to curb black money, counterfeit currency, and tax evasion. This step forced people to deposit their unaccounted cash in banks, making it traceable and taxable.¹⁵ While the short-term impact led to cash shortages and economic disruptions, the long-term benefits included increased tax compliance and a shift toward digital payments.

Tax information exchange agreements: India has signed bilateral and multilateral agreements with various countries to exchange tax-related information, such as the Double Taxation Avoidance Agreements (DTAA) and the Automatic

Exchange of Information (AEOI). These agreements enable cross-border collaboration in identifying tax evaders and recovering undisclosed income and assets.

E-assessment: The Indian government introduced a faceless e-assessment system to minimize corruption, discretion, and taxpayer harassment during income tax scrutiny. This system employs artificial intelligence and data analytics to select cases for scrutiny, ensuring a transparent and unbiased process. E-assessment eliminates direct contact between taxpayers and tax officials, reducing the scope for corruption and promoting a more efficient tax administration system.

Project Insight: Launched by the Income Tax Department, Project Insight employs advanced data mining and analytics tools to analyse taxpayer information, identify tax evaders, and detect discrepancies in income declarations. The project helps the government monitor highvalue transactions, detect patterns of tax evasion, and take corrective action. By leveraging big data, Project enhances the efficiency and effectiveness of tax administration.

Harsh penalties: The Indian government has introduced stringent penalties for tax evasion, including substantial monetary fines and imprisonment. These penalties act as a deterrent, encouraging taxpayers to comply with tax laws and regulations. For example, under the Income Tax Act, 1961, tax evasion can lead to imprisonment for up to seven years and a fine. The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, imposes even stricter penalties, including imprisonment for up to 10 years and a fine of up to 300% of the undisclosed foreign income or asset's value. These stringent measures aim to discourage tax evasion and promote a culture of tax compliance. This forced people to deposit unaccounted cash in banks, making it traceable and taxable. Long-term benefits included increased tax compliance and a shift towards digital payments.

Simplifying tax laws: The government is continuously working to simplify tax laws²⁰ and procedures, making it easier for taxpayers to understand and comply with them. Efforts like the Taxation Laws (Amendment) Act²¹ and the Direct Tax Vivad Se Vishwas Act²² aim to reduce tax litigation, streamline the tax system, and improve tax compliance.

PENALTIES FOR TAX EVASION IN INDIA

Tax evasion is a serious offence that can result in significant penalties and consequences, both civil and criminal. The penalties for tax evasion can vary depending on the severity of the offence, the amount of tax owed, and whether it was an individual or a corporation that committed the offence. Here are some common penalties for tax evasion:

Penalty for failure to file returns: If an individual or company fails to file their tax returns on time, they may be subject to a penalty of Rs. 5,000. If the return is filed after the due date but before December 31 of the assessment year, the penalty is Rs. 10,000. If the return is filed after December 31, the penalty is Rs. 10,000 plus interest.

Penalty for under-reporting of income: If an individual or company under-reports their income, they may be subject to a penalty of 50% of the tax payable on the under-reported income.

Penalty for concealment of income: If an individual or company conceals their income, they may be subject to a penalty of 100% to 300% of the tax payable on the concealed income.

Prosecution for tax evasion: In addition to penalties, tax evaders may also face prosecution under the Income Tax Act. If convicted, they may be subject to imprisonment for a period of up to 7 years, along with fines and penalties.

Blacklisting: The Income Tax Department may also blacklist individuals or companies who are found guilty of tax evasion. Blacklisting can have serious consequences, including difficulty in obtaining loans, contracts, or licenses from the government.

JUDICIAL RESPONSES TO TAX EVASION AND TAX AVOIDANCE

C.B Gautam v. Union of India (1992)²³: In this case, the petitioner submitted a civil writ case in the Delhi High Court challenging the provisions in the Income Tax Act, 1961 under the Finance Act 1986, saying that the petitioner intended to purchase a plot of land at B-7/108A, Safdarjung Enclave, New Delhi, totalling 253 square meters. So, the agreement was reached that the premises would be transferred from the proprietor to the petitioner, and the building would begin on the same day. However, Chapter XX-C was later challenged on the grounds that the property's worth was not suitable based on market or area assessment. Then, under Article 14, it was argued that leasehold privileges violated the right to equity. Then, under Section 269UD rules, it was specified that immovable property may not be transferred through the lease. The court observed that transfers of immovable assets in metropolitan regions were thought to entail a significant amount of tax evasion. The statement refers to the proposals of the Direct Taxes Inquiry Committee,

known as the Wanchoo Committee, which was headed by the Hon'ble Mr. Justice Wanchoo, former Chief Justice of India. In its interim report in 1970, the Wanchoo Committee concluded that understatement of prices in the sale deeds of immovable properties was a common method of tax evasion and recommended, as a drastic remedy, that the government empowers itself to acquire property where the consideration was found to be incorrect in the sale deeds. The rules of Chapter XX-A were inserted into the Income Tax Act in response to this suggestion. A landmark case on tax avoidance in India is the Cadbury India case. In 2010, the Indian tax authorities accused Cadbury India of tax evasion and transfer pricing manipulation, alleging that the company had under-priced its exports to its parent company in the UK, resulting in a loss of tax revenue for India. The tax authorities demanded that Cadbury India pay Rs. 2,500 crores in back taxes and penalties. The case went to the Bombay High Court, which in 2014 ruled in favour of Cadbury India, stating that the company had not engaged in tax evasion or transfer pricing manipulation. The court held that the tax authorities had not provided sufficient evidence to support their allegations and that Cadbury India had complied with the Indian tax laws. The Cadbury India case is considered a significant case on transfer pricing and tax avoidance in India. It highlighted the need for clear and consistent transfer pricing regulations and enforcement mechanisms in India to prevent tax avoidance and evasion by multinational companies

IMPACT OF TAX EVASION ON THE NATIONAL ECONOMY

As we have already seen, the techniques used for tax avoidance have a negative impact on the country. These are detrimental to the long-term growth and development of civilization and the entire country. Tax evasion favours the growth of illegal gains, which people attempt to cover up or evade tax by doing so, but as a consequence, the rich have grown wealthier, while the poor are losing greatly because the government fails to provide sufficient money to assist those who are in need because it fails to collect the correct tax. As the government fails to address such wrongdoing, it appears that more damage is being done to the nation's most vulnerable citizens. Tax evasion causes the government to halt development initiatives that were begun to benefit national security in some ways because it provides a complete lead to those who try to avoid taxes and dishonestly make unlawful money, as well as lead foes to downsize the nation's development. Numerous problems in society occur on minor scales but ultimately result in the avoidance of taxes. Taking bribes, defrauding papers, and so on.

To summarize the above paragraph of consequences faced by the Indian economy due to tax evasion and avoidance, the following points can be taken into consideration:

1. Tax evasion has hampered the country's economic development.
2. The immediate result of tax avoidance is income loss and a rise in inflation.
3. Corruption also increases.
4. Rising property and housing costs, the transfer of funds from India to foreign countries via illegal routes has harmed the country's image worldwide.
5. Tax evasion lowers the living standards of those in rural areas and people living below the poverty line because the government cannot implement national assistance programs.
6. It also causes inequality in the country's economic situation, with the wealthy becoming wealthier and the impoverished becoming poorer.
7. Due to the majority of the wealthy population's tax evasion, the government is compelled to raise tax rates every assessment year in order to increase income, resulting in an increased tax burden for those who pay taxes on time.
8. Tax evasion prevents the majority of development efforts from taking place.

RECOMMENDATIONS

Tax evasion and tax avoidance are major challenges faced by the Indian government. The prevalence of these practices has significant negative impacts on the Indian economy, including reduced tax revenue, increased income inequality, and reduced public trust in the government. The following aims to provide recommendations for addressing tax evasion and tax avoidance in India:

1. Strengthen the tax administration: The government should take measures to strengthen the tax administration to enhance its capacity to detect and prosecute tax evaders. This could involve investing in technology and human resources to improve tax compliance and reduce revenue leakages.
2. Improve tax policy: The government should review and reform tax policies to ensure that they are fair and transparent, and encourage tax compliance. This could involve reducing tax rates, simplifying tax laws, and broadening the tax base.
3. Increase public awareness: The government should engage in public education campaigns to increase public awareness of the importance of paying taxes and the negative effects of tax evasion and avoidance on the economy. This could involve using various media channels to inform and educate taxpayers on the benefits of paying taxes.
4. Encourage voluntary compliance: The government should adopt measures to encourage voluntary tax compliance by taxpayers. This could involve providing incentives such as tax rebates, tax credits, and other benefits to encourage taxpayers to comply with the laws.
5. Strengthen international cooperation: The government should strengthen international cooperation to combat tax evasion and avoidance. This could involve working with other countries to exchange information and best practices on tax administration and implementing international standards on tax transparency and exchange of information.
6. Enhance penalty and enforcement mechanisms: The government should impose severe penalties and strengthen enforcement mechanisms to deter tax evaders and avoiders. This could involve imposing heavy fines, criminal sanctions, and asset forfeiture to discourage them from these practices.

II. CONCLUSION

After all of this thorough discussion, we can now conclude that our nation currently requires a better legal system, as well as better rules and regulations, in order to reduce the number of offences committed by people whom we believe are harmless but are not legally allowed to be. As we have previously discussed, there are numerous methods by which people attempt to evade taxation, and these methods are so rigid that the government is unable to fully prohibit them. Tax-related crimes are like a dangerous disease that steadily eats away the country's income and is not easily halted by ineffective government laws. Similarly, citizens play an essential part because if they are conscious of these crimes and appreciate the laws and government, they can easily be halted and demolished. It is a curse that promotes the development of illegal funds. As we all know, it is not possible to fully eliminate such crimes in a brief period of time, but they can be reduced in number by simply making the government system more effective and creating more organizations that eventually achieve the goal of reducing tax fraud and associated crimes. Knowing the negative consequences of tax evasion, it is our duty to support the government by following tax processes and paying taxes on time.

Instead of waiting for change, let us be the change makers who can bring about significant progress by simply carrying out our duties on time. If we all share the same tongue, there will be little or no room for any organization or power to make use of us.