



The Indian Journal for Research in Law and Management

Open Access Law Journal – Copyright © 2025

Editor-in-Chief – Dr. Muktai Deb Chavan; Publisher – Alden Vas; ISSN: 2583-9896

This is an Open Access article distributed under the terms of the Creative Commons Attribution-Non-Commercial-Share Alike 4.0 International (CC-BY-NC-SA 4.0) License, which permits unrestricted non-commercial use, distribution, and reproduction in any medium provided the original work is properly cited.

LEGAL ASPECT OF TAX EVASION AND AVOIDANCE IN INDIA : A CLOSER LOOK

~ Muskan Kapoor

ABSTRACT

Economists have explored the issue of people not following tax rules — especially tax evasion — quite thoroughly in their research over the years. Lawyers generally do not pay much attention to irregularities in the fiscal system. One notable exception is tax avoidance, which often draws interest because it is typically seen as a matter of legal form versus actual substance. Tax avoidance is analysed as the strategic arrangement of financial affairs to minimise tax liability within the parameters of statutory law, whereas tax evasion is identified as the deliberate concealment or misrepresentation of information to unlawfully reduce tax obligations. In India, the distinction between these two practices has significant legal implications. This article set forth the statutory frameworks governing both phenomena, with particular emphasis on the operation of general and specific anti-avoidance rules [GAAR and SAAR] and the criminal sanctions applicable to acts constituting tax evasion in India. The purpose of this article is to explore judicial interpretations which plays an important role in demarcating the line between lawful tax planning and unlawful tax evasion. The article also delves into the wider social and political impacts of tax evasion and avoidance, particularly how they weaken public finances and compromise the principle of fiscal fairness. The article concludes by emphasizing on the urgent need for well - defined legal provisions and effective enforcement tools to uphold the credibility of the Indian tax system and to discourage both unlawful tax evasion and aggressive tax avoidance practices in India.

INTRODUCTION

Taxation is a fundamental mechanism for governments to generate revenue, enabling the provision of public services and infrastructure. However, during the last decades , there has been an increasing tendency for taxpayers, tax authorities, legislators and inter - governmental agencies to focus on the phenomenon of tax evasion, tax avoidance and tax planning. While all three of them

aim to reduce tax obligations, their legal standing, ethical implications and consequences differ significantly. This is not only a subject of growing importance of recessionary economic environment in most OECD jurisdiction, which has fostered a tendency on the part of taxpayers to reduce their tax payments as a source of new finance. It is also a consequence of the increasing globalisation that makes it easier for international operations companies and individuals to reduce taxation. While taxation is vital for the functioning of a welfare state, it is routinely challenged by taxpayers seeking to reduce their liabilities through unlawful means (evasion) or legal manipulation (avoidance).

The legal distinction between tax evasion and tax avoidance is pivotal for both prosecutorial action and policy development. Tax evasion is a punishable offence involving fraud, concealment, and misrepresentation. Tax avoidance, on the other hand, involves structuring transactions in a manner that minimizes tax liability without technically breaking the law.

CONCEPTUAL DISTINCTION : TAX EVASION AND TAX AVOIDANCE

Tax evasion is the wilful act of avoiding payment of taxes that an individual or an entity is legally obligated to pay. This typically involves fraudulent practices such as underreporting taxable income, inflating expenses through fictitious deductions, or concealing assets. Under section 276C¹ of the Income Tax Act, 1961, any person (individual, HUF, AOP, firm, company, etc) will be penalised for not paying taxes, penalties, interest deliberately. Tax evasion is criminal in nature and attracts both civil penalties and criminal prosecution under Indian law. Some examples include :-

- Failure to file tax returns
- Non - disclosure of foreign income and assets
- Fabricating or falsifying documents
- Using benumb (proxy) transactions to hide ownership

Whereas, Tax avoidance refers to the strategic arrangement of one's financial affairs to exploit ambiguities, gaps or inconsistencies within the tax statutes, with the objective of reducing or deferring tax liability. It is not illegal as it is not well - defined in tax laws. For example, many companies channel their funds through offshore branches to avoid paying taxes in their home country. By doing so, these entities lawfully minimise their tax obligations in their country of

¹ Income Tax Act, 1961, section 276C

origin, even though the underlying intent may be to secure a tax advantage. While such practices are technically permissible, they may attract scrutiny under anti - avoidance provisions if found to lack commercial substance or to be primarily motivated by tax benefits.

LEGAL FRAMEWORK IN INDIA

India has developed a robust legal framework to combat both tax evasion and aggressive tax avoidance. This includes statutory provisions under the Income Tax Act, 1961, judicial doctrines, anti - abuse rules, and international commitments. Some of the provisions governing Tax avoidance and Tax evasion are as follows :-

Tax Avoidance

- **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
- **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

- **Section 271B³** : It deals with a person who does not get his accounts audited as required under section 44AB of the Income Tax Act, 1961.
- **Section 234E⁴** : It deals with the non - compliance of the assessed 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.

² Income Tax Act, 1961

³ Income Tax Act, 1961, section 271B

⁴ Income Tax Act, 1961, section 234E

- **Section 276C⁵** : 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.
- **Section 139A⁶** : 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.

CASE LAWS : JUDICIAL APPROACH TO TAX EVASION AND AVOIDANCE

- Vodafone International holding v/s Union of India SC 2012⁷

Background - Vodafone acquired Hutchison's Indian operations through an offshore transaction. The Indian tax authorities sought to levy capital gains tax.

Ruling - The Supreme Court held that the transaction, structured offshore, was not taxable in India as per the law then in force, and the authorities could not "look through" the arrangement.

Impact - The case highlighted the limits of anti - avoidance measures prior to GAAR and led to significant legislative changes.

• Other Notable Cases -

1) McDowell and Co. Ltd. v/s CTO (1985)

This landmark case changed the judicial approach to tax avoidance. The Supreme Court held that "tax planning may be legitimate provided it is within the framework of law. Colorable devices cannot be part of tax planning."

2) Azadi Bachao Andolan v/s Union of India (2003)

In this case, the Supreme Court upheld treaty shopping through Mauritius to avoid capital gains tax, asserting the legality of tax avoidance through legitimate means. This was later balanced by GAAR.

⁵ Income Tax Act, 1961, section 276C

⁶ Income Tax Act, 1961, section 139A

⁷ Vodafone International Holding v/s Union of India 20 January, SC 2012

Government Measures to Combat Evasion and Aggressive Avoidance

Investigative Powers

- Tax authorities have broad powers to audit, investigate, and seize assets in cases of suspected evasion.
- Enhanced data analytics and information sharing between agencies have improved detection rates.

Recent Legislative and Administrative Steps

- GAAR Implementation : To target sophisticated avoidance schemes.
- Mandatory Reporting Requirements : For certain transactions and international arrangements.
- Increased Penalties : For non - compliance, misreporting, and failure to maintain records.

ETHICAL AND SOCIAL IMPLICATIONS

- 1) Complex Corporate Structure : Multinationals exploit complex entities and jurisdictions.
- 2) Judicial Interpretation : Varied court decisions sometimes provide inconsistent guidance.
- 3) Taxpayer Rights vs. State Interests : Balancing taxpayer rights with enforcement is a delicate task.
- 4) Information Asymmetry : Difficulty in tracing cross - border transactions.

CONCLUSION

The consistent challenges of tax evasion and tax avoidance highlights the fundamental principles of fair and efficient tax system in India. As tax legislation changes, businesses must ensure their tax strategies conform to both legal requirements and ethical business standards. The difference between tax avoidance and evasion is that tax avoidance is legally permissible by law while tax evasion is not. While Tax evasion is a blatant criminal offence, avoidance often tests the limits of legal interpretation. The predominant feature in deciding the nature of any transaction is not the underlying motive but the legality of such transaction. India's legislative and judicial responses have evolved significantly, especially with the introduction of GAAR and global cooperation frameworks like BEPS. However, continued vigilance, legal clarity, and administrative reforms are essential to ensure tax justice and fiscal sustainability.

REFERENCES

- 1) Paulus Merks, Ernst & Young and Vrije Universiteit, Amsterdam, Tax Evasion, Tax Avoidance and Tax Planning, INTERTAX, Volume 34, Issue 5, Page 272, Kluwer Law International 2006, <https://heinonline.org/HOL/LandingPage?handle=hein.kluwer/intrtax0034&div=43&id=&page=>
- 2) CA Mohammed S Chokawala, Understanding Tax Evasion and Penalties in India, <https://cleartax.in/s/tax-evasion-and-penalties-in-india>
- 3) Dr. Anil Kumar Dixit, Dr. Sarwar Rahman, Dr. Gayatri Yadav, The Effects Tax Evasion and Tax avoidance on India's economic progress, Chapter 18, Pages - 157, 158 and 159, https://noblesciencepress.org/chapters_pdf/Book_Draft-_181.pdf
- 4) Aishwarya.S, Tax evasion and Tax avoidance - Impact of Indian economy, Volume 11 Issue 12, December 2023, International Journal of Creative Research Thoughts (IJCRT), ISSN : 2320 - 2882, <https://ijcrt.org/papers/IJCRT2312064.pdf>

WEBSITES

- <https://cleartax.in/s/tax-evasion-and-penalties-in-india>
- <https://www.taxscan.in/tax-evasion-impact-and-incidence/407066>
- <https://www.jiraaf.com/blogs/tax-evasion-vs-tax-avoidance>
- <https://blog.ipleaders.in/tax-avoidance-vs-tax-evasion-all-you-need-to-know/>
- <https://www.wolterskluwer.com/en/expert-insights/tax-avoidance-is-legal-tax-evasion-is-criminal>
- <https://www.globalscienceresearchjournals.org/abstract/reality-and-myth-of-imbricating-ideas-of-assessment-evasion-and-avoidance-45419.html>