

CHAPTER-18

THE EFFECTS TAX EVASION AND TAX AVOIDANCE ON INDIA'S ECONOMIC PROGRESS

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ABSTRACT

Tax evasion and tax avoidance pose substantial challenges that detrimentally affect the economic development of India. These issues diminish the government's capacity to collect revenue, thereby limiting its ability to fund crucial public expenditures necessary for economic advancement. Tax evasion involves the intentional non-payment or under-reporting of taxes, while tax avoidance entails the use of legal methods to minimize tax liability. Both practices have adverse effects on economic growth, investment, and government revenue. This research utilizes secondary data from diverse sources to scrutinize the impact of these practices on key economic indicators, such as GDP growth, investment, and government revenue. The findings underscore that tax evasion and tax avoidance significantly and negatively impact economic development. The study emphasizes the substantial adverse effects of tax evasion and tax avoidance on the economic development of India. It provides evidence supporting the implementation of effective measures to counteract these practices, promoting sustainable economic development in the country.

1. INTRODUCTION

The economic growth of a nation, such as India, faces significant challenges from two widespread practices: tax evasion and tax avoidance. The Indian government heavily depends on tax revenue to fund social programs, infrastructure improvements, and other initiatives aimed at fostering economic growth. When individuals or businesses engage in tax avoidance or evasion, it diminishes the government's revenue collection, potentially leading to budget deficits, reduced public services, and an overall deceleration in economic development.

2. 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.

3. OVERVIEW OF TAX AVOIDANCE AND TAX EVASION

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.

4. 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. 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:

- a. **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.
- b. **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.

- c. **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.
- d. **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.

- a. **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.¹
- b. **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.

5. TAX EVASION

History

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

¹ Income Tax Act 1961

increased cross-border trade and investment. 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:-

- a. **Underreporting income:** This involves not reporting all income earned, such as cash transactions, tips, or income from side businesses.
- b. **Overstating deductions:** Taxpayers may claim deductions or credits that they are not eligible for or overstate the value of their deductions.
- c. **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.
- d. **False invoices:** Taxpayers may create false invoices to show higher expenses and lower profits, reducing their tax liability.
- e. **Unreported offshore income:** Taxpayers may not report income earned from offshore accounts or investments to avoid paying taxes on that income.
- f. **Cash transactions:** Cash transactions can be difficult to trace, making it easier to underreport income earned in cash transactions.
- g. **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:

- a. **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.
- b. **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.

- c. **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.
- d. **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. 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.

- a. **PAN-Aadhaar linking:** The government has mandated linking the unique identification number (Aadhaar). 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. 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.
- b. **Digital payment promotion:** 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.
- c. **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.
- d. **Project Insight:** Launched by the Income Tax Department, Project Insight employs advanced data mining and analytics tools to analyze taxpayer

information, identify tax evaders, and detect discrepancies in income declarations. The project helps the government monitor high-value transactions, detect patterns of tax evasion, and take corrective action. By leveraging big data, Project enhances the efficiency and effectiveness of tax administration.

- e. **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. 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.

6. CONCLUSION

After all of this thorough discussion, we can now conclude that our nation currently requires a better legal system. 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.

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