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JUDICIAL TRENDS TOWARD TAX AVOIDANCE

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ABSTRACT

Understanding the journey of any statute provides us with a deeper understanding of the not just the path it paved but also, it gives us a deeper insight over the realised purpose of the statute. The interpretation of the statutes might vary from judge to judge, which seemingly provides us with a magnified scope of the law. The nitty-gritties of the law are explored with reason pertaining to the cases and the primary issues it holds. Taxation Act,1961 is legal bible of any matters concerning tax. Tax avoidance is a valid manoeuvring of sums of money which legally lie outside the bracket of taxable income. The main source of income of the government is taxes, and since it a socialist republic, it needs funds to carry out its basic functions. Therefore, understanding the judicial trends towards tax avoidance while gaining more knowledge about its purpose becomes critical.

Keywords: Interpretation, Tax Avoidance, Income of the government

I. INTRODUCTION

The diagram of the judicial trends toward tax avoidance diverges into two lanes- the strictly statutory lane and the explorative judicial interpretation of the judges. The manner of interpreting fiscal statutes is very different from interpreting non-fiscal statutes. One absolute principle that sticks is to take and apply the statute ina literal state. The manner numbers carry no potential of being understood differently by different people, they are read- as is, without a unique implication by everybody. In the case of Cape Brandy Syndicate vs. Inland Revenue,[2] it was held that "One just needs to consider what is explicitly stated in a taxation Act. There isn't any room for intention. A tax has no sense of equity. There is no underlying

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[2][1921] 1 KB 64, Cape Brandy Syndicate v. Inland Revenue.

assumption of a tax. Nothing is to be taken as suggested or read in. Only a fair examination of the terminology employed will do." The Supreme Court instead of a judgment stated that "what catches the tie of the administration is tax evasion, as it is illegal, it is more material from a jurisprudential point of view, and not the tax adjustment so made."[3]

The Supreme Court in a judgment declared that avoiding tax obligations by structuring business transactions in a way that interferes with tax collection is not banned. The device's effectiveness is determined by how the Income Tax Act operates, not by moral concerns. Legislative injunctions in taxing statutes may not be broken, save at the risk of a penalty, but they may be legally got around.[4]

The statutes as may be clear from the above discussion, have been interpreted quite literally. This doesn't leave room for a difference in application and implication. But one important characteristic of the cases looked upon by the courts is the difference in mostly each of them and the remedial assistance provided to the parties by applying certain portions of the statute itself. One might even argue regarding fairness or even so the scope of judicial growth if there is only one manner in the law that can be interpreted.

The onus of proving the mala fide treatment of the tax lies on the tax administration. It is undeniably accurate that while interpreting fiscal statutes and calculating a subject's tax liability, one must consider the literal letter of the law and not just the statute's spirit or its core provisions. The subject may be taxed if the Revenue persuades the Court that the case strictly complies with the legal requirements. However, if the scenario does not fall within the parameters of the requirements of the taxation act, no tax can be levied through deduction, analogy, or by trying to understand the legislative intent and the essence of the situation.

II. THE EXPLORATIVE JUDICIAL INTERPRETATION

A very important thing that needs to be noted is the very fact that the court is entitled to lift the corporate veil to ensure that the corporation has not partaken in an illegal maneuver to evade taxes. Also, the veil can be lifted to take into account the financial reality hiding beneath the legal guise. The Supreme Court gave its opinion that when there is a claim of deception, the court must investigate the conditions of the transfer to determine whether the

[3] (2008) 307 ITR 89 (SC), Commissioner of Income Tax v. Sarabhai Holdings Pvt.Ltd..
[4] (1967) 66 ITR 692 (SC), Commissioner of Income Tax v. Motors & General Stores (P) Ltd.

entity had made a false agreement to avoid paying tax. Investigate the motives underlying the transfer. If and when a time comes when an entity is trying to evade taxes but is hiding behind a façade of tax avoidance, the court can intervene by lifting the corporate veil to ensure that no offense is being committed.

In the case of McDowell & Co. vs. Commercial Tax Officer[5] Justice Chinnappa Reddy highlighted the evil consequences of tax avoidance which are

a) Significant loss of revenue
b) Economic disturbance
c) Concealed loss to the economy midst of the tussle
d) Injustice to the individuals duly paying taxes
e) Ethical destitution

Justice ChinnappaReddy's disquisition put tax avoidance in the spotlight for judicial deliberations and signaled the beginning of a proactive judicial review of all arrangements seen to be questionable or intended to avoid paying taxes. His spurred the Indian judiciary to study tax avoidance arguments vigorously rather than dismissing them as a topic deserving of a merely legalistic answer.

In the case of the Union of India vs. Azadi BachaoAndolan,[6] the double tax treaty between India and Mauritius played a very significant role. This treaty, among other things, granted the resident nation of the taxpayer the sole authority to tax capital gains from the sale of shares. It was believed that the was flexible and that it was simple to qualify for tax-resident status under its provisions. To avoid capital gains obligation in India, it was claimed that a significant number of Foreign Institutional Investors with residence in third-party states invested in India through Mauritius. The Court opined that the legitimacy of the residential status of the entities needs to be looked over. The Supreme Courtruled that the tax administration had the authority to offer whatever instructions or guidelines required to conform with legal requirements and that all tax officers were required to do so.

[5](1985) 154 ITR 148 (SC), McDowell & Co. Ltd. v. Commercial Tax Officer.
[6] (2003) 263 ITR 1 (SC), Union of India vs. Azadi BachaoAndolan.

As per the opinion of Lord Tomlin, which is known as the Duke of Westminster principle "Every individual has the right to arrange his operations in a way that the tax attaching under the relevant Acts is less than it otherwise would be if he can do so."[7]

In the case of Vodafone[8] the Supreme Court stated that the tax administration has to establish the alleged abuse,and the Revenue should be able to prove, based on the events and scenarios encircling the transaction, that the contested transaction is a sham or a tax avoidance scheme, only then may the Revenue employ the "piercing the corporate veil" test. The Supreme Court introduced the "look at" test as a new standard to be used in certain situations. The Court must determine whether the operation is legitimate, and in doing so, they must examine the entire transaction as a whole without taking a piecemeal strategy.

Understanding the aforementioned cases, it is to be understood that the opinions of Justice Chinnappa Reddy J. aren't considered reliable to determine the acceptability of the manner the tax is treated by the taxpayer.

III. THE EVOLUTION OF GENERAL ANTI-AVOIDANCE RULES ('GAAR')

It becomes effective on April 1st, 2017. The Income Tax Act of 1961 has provisions related to GAAR. GAAR is a method for detecting extreme tax planning, particularly those corporate transactions or agreements engaged in with the intention of avoiding taxes. It is primarily intended to reduce business disruption to the government brought on by extensive tax avoidance techniques used by businesses.The GAAR is founded on the principle of material over appearance, according to which, regardless of the transaction's or agreement's legal framework, the true motivation of the factions is determined when they engage in an arrangement to establish the tax consequences.

The following four tests are listed:

1. The agreement establishes rights and responsibilities that are not mutually exclusive.
2. An arrangement or transaction leads to the exploitation or violation of a tax law mandate.
3. It's devoid of any commercialized component.
4. The transaction was not legitimately completed.

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[7] [1936] AC 1 (HL), Duke of Westminster v. Commissioners of Inland Revenue.
[8] (2012) 341 ITR 1 (SC), Vodafone International Holdings BV v. Union of India.

"Impermissible avoidance arrangements," or arrangements where the "primary objective" is to get a tax benefit, are subject to the GAAR. Since the facts must be taken into account, determining the principal aim is extremely individualized. Therefore, determining that an agreement is unlawful would be the first step in using GAAR in any tax audit.Application of the GAAR has important consequences. The tax authority is given the jurisdiction to examine the illegal setup in its entirety and eliminate the elements that were the source of the erroneous tax benefit under Section 98 of the Act. This effectively gives the tax administration the freedom to rearrange different parts of the arrangement however it sees fit. The section also mentions several negative effects, such as ignoring the company framework, recognizing debts as equity, and reclassifying any deductions or outlays.

The discussion above illustrates a division in judicial opinion where the judges appear to disagree on whether sanctimonious factors should be taken into account when deciding tax evasion issues. While judges drawn to the proper school dismiss them and advocate the use of objective norms to settle such disagreements, judges drawn to the sanctimonious school place this into the forefront of their deliberations. As much as constitutional principles call for the equality of all before the law, uniform judicial criteria are necessary.