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IMPACT OF TAX EVASION AND TAX AVOIDANCE ON INDIAN ECONOMY

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ABSTRACT:

Taxation plays a very important role in the development of Indian economy. Tax evasion and Tax avoidance occur when individuals fail to comply with Tax obligations. Tax avoidance is the legal way of escaping from paying tax by using the loop holes in the law. Taxing evasion is involving in illegal activities to avoid paying the tax. Both tax evasion and tax avoidance lead to the loss of revenue to the government. It affects the tax burden and it leads to the disproportionate tax liability on the honest tax payers and low economic families. The disruption of tax system will not encourage the voluntary compliance of tax and pay a way to inefficiency.

Though there are various policy measures to curb tax evasion and tax avoidance still it is more prevalent in India. Tax which is being collected from people is used for the welfare of the people in the country. If there is no proper tax collection it eventually affects the Indian economy and further affects the welfare of the people. This study deals with the causes, effects of these two and the legal measures taken by the government to prevent them. It also includes how Indian economy is being affected and my suggestions to overcome it.

KEY WORDS: Tax evasion, Tax avoidance, Indian economy, Loop holes, Tax burden.

INTRODUCTION:

A tax is a fee collected by the Government from individuals and business entities to provide public service. Tax is the Government's main source of income. Tax evasion is the illegal

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way to avoid paying tax. Tax avoidance is the legal way to avoid paying tax using loopholes in the statute. Both of these are dangerous to our Indian Economy. The impact of it leads to the loss of sustainable amount of income that the Government is generating. This leads to budget deficits and increased rate of borrowing by the country from the World Bank. The Indian economy mainly depends on the tax revenue to execute social welfare policies and the infrastructural developments of the country. Tax majorly divides into two categories direct tax and indirect tax. A direct tax is levied directly to the individuals' income/ wealth. An indirect tax levied directly to the individuals who consume goods/services.

AIM AND OBJECTIVE :

AIM:

The primary aim of the study is to analyse the impact of tax evasion and tax avoidance on the Indian economy and the legal measures available to curb them. The study seeks to explore the causes and the ways of tax evasion and tax avoidance occurs.

OBJECTIVE:

The objective of the study is to focus on the disparity created among tax payers, the voluntary compliance and public awareness. It overall covers the reasons and effect of tax evasion and tax avoidance and its preventive measures.

HYPOTHESIS:

H1 The effective implementation of existing laws and the new reforms in taxing system lowers the impact of tax evasion and tax avoidance in the Indian economy.

H2 Tax avoidance mechanisms benefit the high-income groups and thus shifts tax burden on the low-income groups.

LITERATURE REVIEW:

Gupta, P., & Sharma, A. (2017)-*Estimating the Size of the Shadow Economy in India. Economic and Political Weekly*- It discuss about how the India's economy impacted by the tax evasion and unreported income.

Sandmo, A (2005) - *The Theory of Tax Evasion: A Retrospective View*. National Tax- This paper focuses on the theoretical framework of the tax evasion and it explains the poor enforcement mechanism.

International Monetary Fund (2018) - *Illicit Financial Flows and Tax Havens: Impact on developing economies*-This paper talks about the global tax evasion and tax haven. It emphasizes on the urgent need to make legal framework

Kumar, A (2018) - *Tax Evasion in India: A Legal Perspective*. Journal of Financial Crime-It focuses on the enforcement challenges in curbing tax evasion and tax avoidance. It also discusses the corruption and the importance of transparency in taxing system.

OECD (2021) *Addressing Base Erosion and Profit Shifting (BEPS): Implications for India*-It explains how Base Erosion and Profit Shifting used by the multinational companies to avoid tax liability.

RESEARCH METHODOLOGY:

This paper inculcated doctrinal research methodology. It is the descriptive analysis of the impact of tax evasion and tax avoidance on the Indian Economy. In order to examine the hypothesis, data are collected from secondary sources like books, articles, journals and websites. The secondary sources are discussed in order to comply with the objective of the research study.

OVERVIEW OF TAX EVASION AND TAX AVOIDANCE:

Tax evasion is an illegal practice carried out by an individuals or firm. It is dealt under the chapter XXII of the IT Act 1961. It is the avoidance of the payment of tax liability intentionally. The history of tax evasion dating back to thousands of years with evidence of tax evasion found in very ancient civilizations such as Greece, Rome and Egypt. It continued in the medieval period where the feudal lords impose vassal tax and tax exemption received by Catholic Church.³ In the modern period, the development of concepts like tax havens and international trade and finance gives new opportunities to tax evasions.⁴ Tax avoidance refers to the legal method of minimizing the tax liability by an individual or a business. It is

³ Parthasarathi Shome, *Tax Policy Handbook for Developing Countries* 35–42 (International Monetary Fund ed., 2d ed. 2019)

⁴ Vikram Kapur, *Tracing the Historical Evolution of Tax Evasion and Avoidance: A Comparative Analysis*, 58 Indian Tax J. 120, 123–127 (2022)

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basically done through deductions and credits and exemptions allowable. As like tax evasion, tax avoidance has its history tracing back to ancient civilization. These strategies found in ancient Greece and Rome. During the middle ages, this is common among the wealthy people who can use complex strategies to minimize their tax liability.⁵ In the modern era tax avoidance became easier due to globalization and emergence of tax havens, growth of international trade and commerce. At present government takes serious action against tax evasion and tax avoidance to ensure the country's economic growth.

METHODS OF TAX EVASION AND TAX AVOIDANCE:

Tax deductions and exemptions: Tax deductions and exemptions are the easiest way to Tax avoidance. In Income Tax act there are many deductions and exemptions available such as medical expenses, loan, interest etc.

Tax haven: It is the shifting of profit from high taxing jurisdiction to low taxing jurisdiction in order to avoid tax liability.⁶

Offshore Accounts: Offshore account is a bank account in a foreign country. By hiding the income received in the offshore account it led to tax evasion.⁷

Shell Companies: These companies are formed for not running the business but to hide the profit alone.⁸

Non –disclosure of assets: Taxpayers are not disclosing their assets to avoid paying tax.

Cash transactions: If the transaction is done through the cash, then it is not necessary to report the income earned.⁹

False Invoice: Taxpayers prepare their invoice containing low profit and high expenses to reduce their tax liability.

⁵ Vito Tanzi, *The Impact of Tax Havens on Global Tax Evasion and Avoidance Strategies*, in *Globalization and Its Discontents: Tax Systems and Economic Development* 155, 158–162 (Oxford Univ. Press ed., 2021)

⁶ Vikram Kapur, *Tracing the Historical Evolution of Tax Evasion and Avoidance: A Comparative Analysis*, 58 Indian Tax J. 120, 130–132 (2022)

⁷ Vito Tanzi, *The Impact of Offshore Accounts on Tax Evasion*, in *Globalization and Its Discontents: Tax Systems and Economic Development* 190, 192–195 (Oxford Univ. Press ed., 2021)

⁸ Neha Sharma, *The Role of Shell Companies in Tax Evasion: A Critical Analysis*, 45 Tax L. Rev. 234, 236–240 (2023)

⁹ Ashok Kumar, *Cash Transactions and Their Role in Tax Evasion: Challenges for Regulators*, 12 J. Tax Policy & Admin. 58, 60–63 (2022)

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Double Taxation Abuse: Some taxpayers using the double taxation avoidance scheme, they manage not to pay for the both countries.

Corruption: By involving in corruption, they pay less tax or no tax.

LEGAL PROVISIONS:

Income Tax act 1961, deals with tax evasion and tax avoidance. The provisions dealing with them are:

Section 220(1)- This section deals with if any tax, interest, penalty, fine or any sum payable for the order passed, then assessing officer shall serve notice and demand the prescribed sum.

Section 221(1)-If the taxpayer fails to pay the tax amount on the prescribed time, then the assessing officer can impose the penalty up to 3% of the unpaid tax per month.

Section 270A- It deals with the penalty for the underreporting or misreporting of income.

Section 271A- It deals with the penalty for failure to maintain books of accounts or documents as required under section 44AA.

Section 271(B)-It deals with the penalty for failure of auditing of accounts as required under section 44AB.

Section 271(H)-It deals with the penalty for providing inaccurate information while filing the statement of Tax Deducted at Source (TDS) or Tax Collected at Source (TCS).

Section 276C- It deals with the penalty for the willful attempt of tax evasion.

STEPS TAKEN TO CURB TAX EVASION AND TAX AVOIDANCE:

General Anti Avoidance Rule (GAAR):

GAAR stands for General Anti-Avoidance Rule; it aims to prevent tax avoidance by denying tax benefits obtained through artificial or abusive transactions. It became effective from April 1, 2017.¹⁰

¹⁰ M.P. Jain, *General Anti-Avoidance Rules in India: Implementation and Challenges*, 42 Int'l Tax & Pub. Fin. 123, 125–128 (2020)

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Good and Services Tax- GST subsumes various indirect taxes like excise duty, service tax and VAT. Input Tax Credit mechanism ensures transparency since, businesses claim credits only if the supplies pay tax and thus curb the tax evasion.¹¹

Tax Amnesties- This helps to unearth the undisclosed income and attracting less penalty or no penalty. Thus, it increases tax compliance and increase revenue to the Government.¹²

PAN-Aadhaar Link- Linking PAN with Aadhaar ensures that there are no fraudulent activities carried out by the tax payers by having fake cards. It ensures tax compliance and helps Government to track the transactions.¹³

Digital payment promotion: It improves transparency, it curbs black money, reduce cash-based evasion. It promotes accountability through e-filing of returns.¹⁴

Demonetization- It helps to abolish the black money and unreported money in the cash form. It leads to the flow of unreported money into the formal financial system and regulate the taxing system.¹⁵

Country By Country Reporting (CBCR) - It demands Multi National Enterprises (MNE) to disclose financial information to the countries where it operates. Thus, it enhances transparency. It curbs Base Erosion and Profit Shifting (BEPS) and promote tax compliance.¹⁶

IMPACT OF TAX EVASION AND TAX AVOIDANCE ON INDIAN ECONOMY:

Loss of Government Revenue:

¹¹ Suresh Kumar, *GST: A New Era in Tax Transparency and Compliance in India*, 18 Asia-Pac. Tax J. 56, 58–61 (2021)

¹² Manoj Khanna, *Tax Amnesties and Their Effectiveness in Developing Economies: Evidence from India*, 29 Indian J. Tax Pol'y 72, 75–78 (2022)

¹³ Rekha Singh, *PAN-Aadhaar Integration: Strengthening the Indian Tax System*, 35 J. Empirical Tax Research 190, 193–195 (2020)

¹⁴ Rajesh Mehra, *The Impact of Digital Payments on Tax Evasion: An Indian Perspective*, 14 J. Econ. Pol'y & Admin. 43, 45–48 (2021)

¹⁵ Kavita Reddy, *Demonetization and Its Implications for Tax Evasion in India*, 21 J. Tax Pol'y & Admin. 98, 101–104 (2019)

¹⁶ Arjun Mathur, *Country-by-Country Reporting: Challenges and Opportunities for India*, 12 Int'l Tax Rev. 156, 158–161 (2021)

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It impacts the Government's revenue generated through tax. It leads to the less funding to other social well-being policies. It leads to the borrowing of money from external sources and increases national debt.¹⁷

Tax Burden on Honest Tax Payer:

It leads to the increase in tax burden to the honest tax payers. Thus, it may lead to discouragement of small businesses and individuals from formal economic activity by limiting their development.¹⁸

Encourage Corruption and Black Money:

Tax Evasion and Tax avoidance may increase the black money circulating in informal economic system and thus results in corruption.¹⁹

Increase in Inflation Rate:

As it results in the Government's low revenue, there is a chance in increase of the price of the commodities. Thus, the people who can afford will only afford the specific items; this has pressure on the Indian Economy.²⁰

Increase in Investments:

The black money can be converted into white money by investing in jewels, gold etc., Thus it may lead to the development on the Indian Economy.²¹

SUGGESTION:

The suggestion is to simplify taxing system and increase the penalties for the unethical practices. India needs to strengthen the international treaties related to tax to prevent profit shifting. The tax audit methods need to be strengthened. The public awareness needs to be created more for the positive impact of taxing and voluntary compliance.

¹⁷ Ministry of Finance, Government of India, *White Paper on Black Money* 48 (2012)

¹⁸ Amit Gupta, *The Impact of Tax Evasion on Honest Taxpayers: An Indian Perspective*, 17 Indian Tax Rev. 80, 83–86 (2020)

¹⁹ Rajagopalan, *Corruption, Black Money, and the Indian Economy*, 14 J. Transparency Studies 57, 60–62 (2019)

²⁰ Shalini Prasad, *Tax Evasion and Its Correlation with Inflation in Emerging Economies*, 19 Int'l Econ. Pol'y J. 91, 94–96 (2020)

²¹ Kavita Sharma, *Investment Trends and Black Money: An Analysis, in Economic Crimes in India* 192, 195–197 (Oxford Univ. Press ed., 2020)

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Tax reward mechanism could be developed. India can adopt the best methods of curbing of Tax evasion and Tax avoidance from other countries. The data on offshore accounts can be shared between the countries to present them. Updating the tax regulations pay effective way to curb Tax Evasion and Tax Avoidance.

CONCLUSION :

Tax evasion and Tax avoidance have impacted the Indian Economy. This significantly benefits the high-income growth and shifts the tax burden to low-income groups. This impact would be overcome by the effective implementation of existing laws and new reforms in taxing system. It lowers the negative impact of tax evasion and tax avoidance in the Indian Economy.

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