

## TAX AVOIDANCE IN INDIA: A GATEWAY OF ECONOMIC PREVARICATION

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### ABSTRACT

Taxation has ever been an important policy field throughout history and will stay a crucial aspect in future politics since it creates the basis for the state to work. The edifice of modern market oriented economy is focused on its money-making strength and the gusto for mammon worship. This pursuit for economic wealth and capital formation often leads to misfeasance, fraud, and unfair practices, indulged in by individuals or corporate giants, commonly known as socio-economic or white-collar crimes. White-collar crimes have expanded vertically, as well as, horizontally to include, embezzlement, false advertising, bribery, unfair competition and above all tax evasion. An incessant global effort is on to contain the subversive effects of white-collar crimes especially in the field of tax evasion or tax lately tax avoidance. The present-day economic milieu based on liberalisation, open market access and trans-border transaction, though aim at reducing the tariff and non-tariff barriers, including rationalization of international taxation, stumble at the gate of phenomenal growth in tax evasion. Besides, the astonishing reality is that tax avoidance which is treated legal by almost all the countries, has turned out to be a camouflage to conceal wealth and thereby liability. There is a need to understand the basic pitfalls in the tax regime to ascertain the menacing effect of this growing phenomenon in the rubric of tax jurisprudence especially in context of India purporting to emerge as a growing economy in the 21<sup>st</sup> century. India has come up with a New Tax Code in order to decipher the tax maneuvering and tax avoidance by corporate sector given her burgeoning role at the international level. How far the new tax regime is going to arrest the menacing effect of tax evasion or avoidance shall form the general theme of this paper.

**Key words:** tax evasion, white-collar crime, economic offence, international taxation, cross-border transactions, GAAR, Tax Code.

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## INTRODUCTION

Taxation and fiscal policy of a nation is the reflection of its resilience and vigor that act as a catalyst to its economic health. The edifice of modern market oriented economy is focused on its money making strength and the gusto for mammon worship. This pursuit for economic wealth and capital formation often leads to misfeasance, fraud and unfair labor practices, indulged in by individuals or corporate giants, commonly known as socio-economic or white-collar crimes.<sup>1</sup> Edward Sutherland who coined white-collar crime term for nonviolent crimes committed by corporations or individuals invoked this idea to demonstrate the ugly face of capitalism and so-called symbolic Inter-actionism.<sup>2</sup> White-collar crimes have expanded to include embezzlement, false advertising, bribery, unfair competition and tax evasion.<sup>3</sup> An incessant global effort is on to contain the subversive effects of white-collar crimes especially in the field of tax evasion or lately tax avoidance. The present-day economic milieu based liberalisation, open market access and trans-border transaction, though aim at reducing the tariff and non-tariff barriers, including rationalization of international taxation, stumble at the gate of phenomenal growth in tax evasion. Tax evasion and its condoning by the nations in one form or the other is a glaring example of “the small fish get caught in the net but the bigger one sets it asunder.”<sup>4</sup> Besides, the astonishing reality is that tax avoidance which is treated legal by almost all the countries, has turned out to be a camouflage to conceal wealth and thereby liability.<sup>5</sup> At the London G20 Summit on 2 April 2009, G20 countries agreed to define a blacklist

<sup>1</sup> In U.S.A. alone about 300 billion US \$ are siphoned off by tax evasion annually. About 75% of it is caused by offshore transactions. The U.S. government and Swiss banking giants UBS announced that they had reached an agreement settling the dispute over whether the Internal Revenue Service can enforce a “John Doe summons” against the bank. Some Americans will continue to evade taxes by using offshore financial institutions and hope that, when the bank gets prosecuted, their names will be among the 80% that aren’t turned over to the IRS. See UBS Reaches Agreement with U.S. on Disclosure of American Customers, available at: <http://www.ctj.org/tax/justicedigest/archive/2009/08/> visited on December 14, 2013.

<sup>2</sup> The term white-collar crime only dates back to 1939. Professor Sutherland was the first to coin the term and attributed different characteristics and motives to this genre as against the typical street criminals. Mr. Sutherland originally presented his theory in an address to the American Sociological Society in attempt to study two fields, crime and high society, which had no previous empirical correlation. He defined his idea as “crime committed by a person of respectability and high social status in the course of his occupation”. See Sutherland et al, *White Collar Crime*, New York, Dryden Press, 1949.

<sup>3</sup> See The Guardian, 2 march 2008; The Daily Telegraph, 27 February 2008; Der Spiegel; 25 February 2008 Denmark’s tax minister, Kristian Jensen, said: “I think it’s a moral problem to reward a criminal for some information that he stole....I don’t like this and I don’t think this ethic is the best way to ensure that taxes are paid correctly”.

<sup>4</sup> On July 24, 2009 three organizations, Global Financial Integrity, the Tax Justice Network, and Citizens for Tax Justice, briefed Congressional Hill staff on proposals to crack down on offshore tax abuses. The speakers from the three organizations explained the types of offshore tax abuses that are costing Americans billions in tax revenue. See <http://www.answer.com/topic/corporate-crime> visited on December 19, 2013.

<sup>5</sup> The US Senate recently voted to Include Offshore Transfers to Avoid Tax in Money Laundering Criminal Statute; the Senate passed the Fraud Enforcement and Recovery Act of 2009 (S. 386). The bill makes several amendments to the International Money Laundering Statute, including one, which places steep criminal penalties on transfers of money offshore for the purpose of evading federal income tax or committing tax fraud. See for general discussion on

for tax havens, to be segmented according to a four-tier system, based on compliance with an “internationally agreed tax standard”.<sup>6</sup> There is need to understand the basic pitfalls in the tax regime to ascertain the menacing effect of this growing phenomenon in the rubric of tax jurisprudence<sup>7</sup> especially in context of India purporting to emerge as a growing economy in the 21<sup>st</sup> century. India has come up with a New Tax Code in order to decipher the tax maneuvering and tax avoidance by corporate sector given her burgeoning role at the international level.<sup>8</sup>

### 1. TAX EVASION: A WHITE-COLLAR CRIME

Tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade the payment of taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting, under declaring income, profits or gains; or overstating deductions etc.<sup>9</sup> Tax avoidance is generally the legal exploitation of the tax regime to one’s own advantage, to attempt to reduce the amount of tax that is payable by means that are within the law whilst making a full disclosure of the material information to the tax authorities.<sup>10</sup> Modern criminology generally rejects a limitation of the term by reference to type of crime and the type of offence,<sup>11</sup> type of offender,<sup>12</sup> or organizational culture now determines the crime. Some crime is only possible because of the identity of the offender, e.g., transactional money laundering requires the participation of senior officers employed in banks. But the Federal Bureau of Investigation has adopted the narrow approach, defining white-collar crime as “those illegal acts which are characterized by deceit, concealment, or violation of trust and which are not dependent upon the application or

tax evasion in USA, John A. Townsend, tax Obstruction Crimes: Is Making the IRS’s Job Harder Enough, 9 HOUS. BUS. & TAX L.J. 260 (2009).

<sup>6</sup>“G20 Declares Door Shut on Tax Havens”, The Guardian, April 2, 2009 see also [www.guardian.co.uk](http://www.guardian.co.uk) visited on December 11, 2013.

<sup>7</sup> Carol D. Leonnig “Report Finds Major U.S. Companies Have Offshore Tax Havens”. Washington Post, January 16 2009, available at:

<http://www.washingtonpost.com/wpdyn/content/article/2009/01/16/AR2009011602602.html?hpid=topnews> visited on November 26, 2013.

<sup>8</sup>The then Financial Minister Mr Pranab Mukherjee (presently President of India) while presenting the budget for current fiscal announced that in order to reform tax laws in India an innovative method of Direct Tax Code will be launched in August 2009 so as to streamline the tax regime in India. The Direct Tax Code, 2009, proposes to introduce General Anti-Avoidance Rule (GAAR), which would erase the thin line between tax avoidance and tax evasion. See Shefali Goradia & Sriram Seshadri, “Difference Between Tax Evasion And Tax Avoidance”, available at: <http://eeconomictimes.indiatimes.com/opinion/money-banking/differeciating> visited on December 08, 2013.

<sup>9</sup>Kanga, Palkhivala and Vyas, *The Law and Practice of Income Tax*, Lexis Nexis Butterworth’s (2005) at 62.

<sup>10</sup>*CIT v. Raman & Co*, 67 ITR 11, 17 (SC) per Shah J.

<sup>11</sup> E.g., property crime, economic crime, and other corporate crimes like environmental and health and safety law violations.

<sup>12</sup>E.g., by social class or high socioeconomic status, the occupation of positions of trust or profession, or academic qualification, researching the motivations for criminal behaviour, e.g., greed or fear of loss of face if economic difficulties become obvious.

threat of physical force or violence".<sup>13</sup> On the other hand, Shover and Wright point to the essential neutrality of a crime as enacted in a statute. Thus, the only way that one crime differs from another is in the backgrounds and characteristics of its perpetrators.<sup>14</sup>

The courts have generally recognized the fact that a subject has the legal right so to dispose of his capital and income as to attract upon him the least amount of tax.<sup>15</sup> Thus, courts have invariably observed that avoidance of tax is not tax evasion and it carries no ignominy with it, for it is sound law and, certainly, not bad morality, for anybody to so arrange his affairs as to reduce the brunt of taxation to a minimum.<sup>16</sup> In the context of payment of tax, 'evasion' necessarily means 'to try illegally to avoid paying tax'; therefore, 'tax planning' is not tax evasion.<sup>17</sup> Ignoring the legal position and regarding 'the substance of the transaction' as the basis of chargeability cannot be employed to tax the subject. The supposed doctrine that in revenue cases 'the substance of the matter' may be regarded as distinguished from the form or the strict legal position, was given its quietus by the House of Lords in *McDowell*<sup>18</sup> wherein according to the noted tax expert late Palkhivala, the three house of lords decisions have been compounded by the indiscriminate manner in which the judgment has been sought to be applied to genuine and legitimate cases of tax avoidance<sup>19</sup>.

According to him the Indian courts had been circumspect and cautious against the judicial verdict in *Ramsay's* case<sup>20</sup> but Chinappa Reddy J forced himself to find, in his own words, an excuse for inflicting this extra opinion'. His opinion, according to Palkhivala, meant only 'to supplement' the main judgment delivered on behalf of the full bench by Ranganath Mishra J, with which Chinappa Reddy J entirely agreed. In that main judgment it has been categorically ruled: 'tax planning may be legitimate provided it is within the framework of the law'. What the court frowned upon was only 'colourable devices', 'dubious methods' and 'subterfuges' under the guise of tax planning.

Another Supreme Court judge, Subyasachi Mukerjee J, demonstrated the opposition to Chinappa Reddy J's solitary extreme view who in his prompt and lethal retort in *CWT v.*

<sup>13</sup> While the true extent and cost of white-collar crime are unknown, it is estimated to cost the United States more than \$300 billion annually, according to the FBI. See for example:

[http://www.answer.com/topic/federal\\_bureau\\_of\\_investigation](http://www.answer.com/topic/federal_bureau_of_investigation) visited on November 28, 2013.

<sup>14</sup> Shover, Neal & Wright, John Paul, *Crimes of Privilege: Readings in White-Collar Crime*, Oxford, Oxford University Press, 2000.

<sup>15</sup> *Duke of Westminster v. IR* 19 TC 490 (House of Lords); followed in the catena of cases in India for example, *Jiyajeerao v. CIT* 34 ITR 888 (SC); *CIT V. AbhayanandaRath* 255 ITR 436 etc. see for details, Kanga, Palkhivala and Vyas, *The Law and Practice of Income Tax*, Lexis Nexis, Butterworth's, 2004, at 62.

<sup>16</sup> Per Jagadisan J, *Aruna v. State of Madras* 55 ITR 642.

<sup>17</sup> *CIT V. AbhayanandaRath* 255 ITR 436.

<sup>18</sup> *McDowell v. CTO* 154 ITR 148.

<sup>19</sup> See Palkhivala et al, *Supra* note 9 at 64.

<sup>20</sup> *Ramsay v. IR* 479.

*ArvindNarotam*<sup>21</sup> remarked...no amount of moral sermons would change people's attitude to tax avoidance..and thereafter in *UOI v. Playworld Electronics* stated: one should avoid subverting the rule of law'. As a matter of law, the Supreme Court in these two latter cases reiterated that where the true effect of a transaction is clear, the appeal to discourage taxavoidance is not a relevant consideration.<sup>22</sup>

The principles set out represent the correct state of the law, today as in the past. Shah J stated this phenomenon in *CIT v. Raman & Co*<sup>23</sup> as under:

Avoidance of tax liability by so arranging commercial affairs that charge of tax id distributed is not prohibited. A tax payer may resort to a devise to divert the income before it accrues or arises to him. Effectiveness of the devise depends not upon considerations of morality, but on the operation of the Income Tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented.

Some tax evaders see their efforts to evade taxation as based upon novel legal theories: these individuals and groups are sometimes called tax protesters. US tax protesters are an example of this kind of approach to tax evasion that has generally ended in failure for those making such claims. Tax resistance is the refusal to pay the tax for conscientious reasons (because they do not want to support the government or some of its activities), while others take creative "deductions" such as not paying a percentage of tax equal to the defense budget. In either case, they typically do not take the position that the tax laws are themselves illegal or do not apply to them (as tax protesters do) and they are more concerned with not paying for what they oppose than they are motivated by the desire to keep more of their money.

## 2. TAX EVASION AND TAX AVOIDANCE – A BASIC DIVIDE

Within the field of criminology, white-collar crime has been defined by Edwin Sutherland as "a crime committed by a person of respectability and high social status in the course of his occupation". Sutherland was a proponent of Symbolic Interactionism, and believed that criminal behaviour was learned from interpersonal interaction with others. White-collar crime therefore overlaps with corporate crime because the opportunity for fraud, bribery, insider trading, embezzlement, computer crime, and forgery is more available to white-collar employees. Tax avoidance is generally the legal exploitation of the tax regime to one's own advantage, to attempt to reduce the amount of tax that is payable by means that are within the law whilst making a full disclosure of the material information to the tax authorities. Example of

<sup>21</sup>173 ITR 479.

<sup>22</sup>SeePalkhivala et al, *Supra* note 9 at 64.

<sup>23</sup>67 ITR 11, 17(SC)

tax avoidance involves using tax deductions, changing one's business structure through incorporation or establishing an offshore company in a tax heaven<sup>24</sup>.

By contrast tax evasion is the general term for efforts by individuals, firms, trusts and other entities to evade the payment of taxes by illegal means. Tax evasion usually entails taxpayers deliberately misrepresenting or concealing the true state of their affairs to the tax authorities to reduce their tax liability, and includes, in particular, dishonest tax reporting, such as under-declaring income, profits or gains; or overstating deductions<sup>25</sup>.

Over several decades, legal sophistry and judicial exposition have endeavored to discover the spectre of the unique dividing line between tax Evasion and tax avoidance. OECD broadly defines tax avoidance as arrangement of the taxpayer's affairs to reduce his tax liability, which could be strictly legal, but is usually against the intent of tax laws.

### 3. TAX EVASION: A GLOBAL PHENOMENON

White-collar crime is steadily on the rise, thanks to our technologically advancing society, which relies on the increased use of cellular phones and computers to access personal and financial information. The National White Collar Center (NW3C), a nonprofit agency that supports state and local police in their efforts to prevent, investigate and prosecute economic and high-tech crime, reports that while arrests for violent crimes have decreased in recent years, arrests for white collar crimes-especially fraud and embezzlement-have increased<sup>26</sup>. The rise in white-collar crimes incidents has also contributed to a rise in cost to the nation. According to National Fraud Center statistics, the cost of economic crime has risen from \$5 billion in 1970 to \$100 billion in 1990, and is only expected to increase as occurrences become more frequent<sup>27</sup>. Statistics from NW3C also approximate that one in three households is the victim of white-collar crime, yet of these, only 41 percent report the incident. Of the small number reported, only 21 percent are handled by a law enforcement or consumer protection agency<sup>28</sup>.

Traditionally, white-collar criminals were prosecuted sporadically, if at all, and were rarely subjected to jail sentences or any meaningful sanctions. A major obstacle to effective

<sup>24</sup> Shover, Neal & Wright, John Paul. *Crimes of Privilege: Readings in White-Collar Crime*, Oxford: Oxford University Press, 2000.

<sup>25</sup> OECD broadly defines tax avoidance as arrangement of taxpayer's affairs to reduce his tax liability which could be strictly legal, but is usually against the intent of tax laws.

See [http://eeconomicstimes.indiatimes.com/opiion/money-banking/differciating\\_tax\\_evasion\\_and\\_taxavoidance](http://eeconomicstimes.indiatimes.com/opiion/money-banking/differciating_tax_evasion_and_taxavoidance) visited on December 06, 2013.

<sup>26</sup> In US 500 billion dollars are lost every year from fraudulent tax refund claims by misuse of electronic filing. See the report by LanBurman, Billions in Tax Refund Fraud and - How to Stop Most of it, Forbes, 5/28/2012.

<sup>27</sup> For example, the Federal Bureau of Investigation's Economic Crime Unit reports that telemarketing fraud, one of the fastest growing types of white collar crime, has become an increasing problem in recent years, victimizing millions of people at a cost of \$40 billion annually.

<sup>28</sup> Appelbaum, Richard P. & Chambliss, William J., *Sociology: A Brief Introduction*, New York: Longman. et.al, 1997.

prosecution is said to be the complexity of the crimes. Enormous expenditures to prepare and try the cases are required<sup>29</sup>. Recently, however, due to the public's awareness of the huge social and economic cost of corruption in business and government, law enforcement agencies have made the prosecution of sophisticated white-collar crimes a top priority.

#### 4. TAX EVASION: INDIAN POSITION

In India, the law is settled that tax avoidance is legal and evasion is not<sup>30</sup>. The Supreme court in *Javali v. MahajanBorewell& Co*<sup>31</sup> has held that if the offence of tax evasion is committed by a company, the persons who are liable to be prosecuted against and punished are: (1) the company (which includes a firm); (ii) every person, who at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business; and (iii) any director, manager, secretary or other of the company with whose consent or connivance or because of neglect attributable to whom the offence has been committed<sup>32</sup>.

A taxpayer may create a device to arrange his commercial affairs to minimize his tax liability and its acceptance is based on operation of law. While revenue authorities are entitled to decipher the true meaning of a transaction, they cannot substitute its legal effect by a perceived 'substance of the transaction' without concomitant provisions under the tax legislation for Anti-avoidance rules. The new demand is for the rich to pay their fair share for the increased prosperity. It is alleged by many (too numerous to name) that tax compliance among the rich is very small. How often have we heard the argument that individual earning more than Rs 10 lakh (Rs 1 million) year low tax compliance? If CAG data are to be believed it clearly indicates that in 2004-05, there were only 122,000 taxpayers in the above Rs 10 lakh category. If one looks at car sales and other associated data, this does seem a shockingly low number. For example, just when 122,000 individuals were claiming to have incomes above Rs 10 lakh, sales of new cars in India numbered over a million. If you add expenditure on golden marriages, etc. it does seem that the analysts (and politicians) are right-the rich have been getting away with massive tax evasion.

**Table- A: Tax Evasion in India: Actual v. Potential**

Income range	% of income returns	Compliance
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<sup>29</sup>11 Amer. Crim. L. Rev. 959, 960.

<sup>30</sup>See Chapter XXI and Chapter XXII of Income Tax Act 1961 which impose civil and criminal liabilities for evading tax. Section 276C of Income Tax Act 1961, imposes penalty of imprisonment of 6 months minimum for deliberately evading tax. The explanation to this section, dealing with examples of willful attempt to evade any tax is only an inclusive one, and it does not catalogue all instances of willful evasion. See also *KA Khaja v. ITO* 196 ITR 357.

<sup>31</sup> 230 ITR 1, followed in *ITO V. Monoharlal* 236 ITR 357.

<sup>32</sup> Section 278 B impose penalty on companies for committing offences of tax evasion.

	(in millions)		
	Actual	Theoretical	%
0-2 lakh	24.36	67.59	36.0
2-5 lakh	1.83	15.21	12.0
5-10 lakh	0.47	1.45	32.2
➤ 10 lakh	0.12	0.25	49.1
Total	26.78	84.50	31.7

From a billion we are left with 80 million potential taxpayers. And if, as is alleged, there are several million with such large earnings, then India has the least disparity in the distribution of income in the world-even more than the welfare state of Sweden. NSS wage distribution data for 1999-00 indicate that the number of theoretical taxpayers numbered 84 million in 2004-05 – and only 250,000 were in the Rs 10 lakh plus category. This rich group appears to have the highest compliance rate of all groups – close to 50 per cent. The national average is a third, i.e. only one in three individuals filed tax return in 2004-05. The largest amount of non-compliance provided by the “missing middle” – those earning between Rs 200,000 and Rs 10 lakh, but primarily those earning between Rs 200,000 and Rs 500,000<sup>33</sup>. It is important that any policy, especially tax policy, be made with the right facts. What will help tax collection the most is a lowering of tax rates for the “missing middle” and an elimination of tax exemptions? A flat tax rate of 15-18 percent for everyone with above Rs 150,000 annual income does sound, and most likely is, an optimal policy.

Net direct tax collections during first five months of the present fiscal (up to August 2009) stood at Rs 87,888 crore, up from Rs 84,409 crore in the same period last fiscal, registering a growth of 4.12 percent. Growth in Corporate Taxes was 1.84 percent (Rs 49,339 crore as against Rs 48,450 crore), while Personal Income Tax (including STT, and residual FBT and BCTT) grew at 7.40 percent (Rs 38,491 crore as against Rs 35,840 crore). Lower growth in net collection was mainly on account of higher tax refund outgo of 52.61 percent at Rs 24,639 crore as against Rs 16,145 crore last fiscal<sup>34</sup>. Net direct tax collections during first four months of the present fiscal (up to July 2009) stood at Rs 73,990 crore, up from Rs 71,648 crore in the same period last fiscal, registering a growth of 3.27 percent. Growth in Corporate Taxes was 2.61 percent (Rs

<sup>33</sup> See for details :[http://eeecomictimes.indiatimes.com/opinion/money-banking/differciating\\_tax\\_evasion\\_and\\_tax\\_avoidance/](http://eeecomictimes.indiatimes.com/opinion/money-banking/differciating_tax_evasion_and_tax_avoidance/) visited on December 06, 2013.

<sup>34</sup> Growth in Direct Tax collection (April-August, 2009) See:[http://www.incometaxindia.gov.in/archive/breakingnews\\_CBDTpressrelease\\_03992009-pdf/](http://www.incometaxindia.gov.in/archive/breakingnews_CBDTpressrelease_03992009-pdf/) visited on December 13, 2013.

42,685 crore as against Rs 41,598 crore). While Personal Income Tax (including STT, FBT and residual BCTT) grew at 4.33 percent (Rs 31,279 crore as against Rs 29,982 crore)<sup>35</sup>.

## 5. GENERAL ANTI-AVOIDANCE RULES (GAAR)

The Direct Tax Code, 2009, proposes to introduce General Anti-Avoidance Rule (GAAR), which would erase the thin line between tax avoidance and tax evasion. Section 112 of the code empowers revenue authorities to declare any arrangement as 'impermissible avoidance arrangement' if it results in certain tax benefits or it creates rights or obligations which would not normally be created between persons dealing at arm's length or it results in abuse of the provisions of the code, lacks commercial substance or lacks bonafide business purpose<sup>36</sup>. It allows revenue authorities to disregard, combine or re-characterise any step in any such arrangement, or re-characterise equity in to debt and vice-versa. The code allows revenue authorities to label a transaction as lacking commercial substance if it results in significant tax benefit to a contracting party without concomitant business risks or cash flows or if the legal substance is inconsistent with the legal form or it involves round trip financing<sup>37</sup>.

The code also makes a presumption in favour of the Revenue that an arrangement is entered into for the tax benefit alone, unless it is rebutted by the taxpayer. The tax benefit is defined, amongst other things, to mean a reduction, avoidance or deferral of tax arising as a result of a tax treaty<sup>38</sup>.

India is not isolated in enacting GAAR in its taxing legislation. It is an established trend among countries to legislate on GAAR to deny tax benefits for any arrangement structured with the sole objective of tax avoidance. In the UK, there is no General Anti-Avoidance Rule (GAAR), but certain provisions of the tax legislation (known as "anti-avoidance" provisions) apply to prevent tax avoidance where the main object (or purpose), or one of the main objects (or purposes), of a transaction is to enable tax advantages to be obtained. Judicial Doctrines, relying on a purposive construction of tax legislation, are being evolved to prevent tax avoidance involving circular, self-cancelling transactions (*IRC v. Ramsay*), or where steps with no commercial purpose other than the avoidance of tax are inserted into a transaction<sup>39</sup>.

<sup>35</sup> See for details: [http://www.incometaxindia.gov.in/archive/PressRelease\\_CBDTNetcollection/](http://www.incometaxindia.gov.in/archive/PressRelease_CBDTNetcollection/) visited on December 28, 2013.

<sup>36</sup> See for details : [http://eeconomicstimes.indiatimes.com/opinion/money-banking/differciating\\_tax\\_evasion\\_and\\_tax\\_avoidance/articleshow/](http://eeconomicstimes.indiatimes.com/opinion/money-banking/differciating_tax_evasion_and_tax_avoidance/articleshow/) visited on December 19, 2013.

<sup>37</sup> It accords with the decision of *Mc Dowell & Co. v. Commercial Tax Officer*, (1985) 154 ITR 148 (SC).

<sup>38</sup> It is questionable if the attempt to override the tax treaties by invoking GAAR will stand the scrutiny of Indian judiciary. See for comments on tax avoidance, Gopalakrishnan K.C., *A Text Book On Tax Law, A Kaleidoscopic View*, NLSIU, Bangalore, at 56.

<sup>39</sup> *Furniss v. Dawson* 55 TC 324 (House Of Lords).

The South African revenue service released a 'Discussion Paper On Tax Avoidance' in November 2005 wherein it outlined the typical features of such arrangements as those lacking in economic substance or those accommodating tax avoidance with special purpose offshore entities or those where complex hybrids and synthetic instruments are used or those where tax heavens are effectively used. The Canadian Supreme Court examined GAAR provisions in the case of 'Canadian Trustco' and held that the GAAR can be invoked only where there is a tax benefit arising from an avoidance transaction, which defeats or frustrates the object, spirit and purpose of the tax law and where the transaction is abusive<sup>40</sup>.

While in general, introducing GAAR is a step in line with many of the mature economics, in India, it is apprehended that wide discretionary power provided to the tax officers may be used without a matured guiding principle. Trepidation lurks that GAAR could be used against even genuine transactions, thereby affecting the investment climate in the country. The introduction of GAAR must be coupled with suitable administrative and judicial reforms. The backlog of cases must be cleared to gear up for the new bout of litigation that may arise post-implementation of GAAR. Unless it is implemented judiciously along with a fast track 'Alternative Dispute Resolution' mechanism, the new regime will elevate India's position on the taxpayers' hardship index.

Initial findings reveal that the tax code has received an overwhelmingly positive feedback, particularly in the area of moderate corporate tax rate, probability of reduced litigation, pass through tax status for venture capital investments and overall, a stable and less complex tax regime. The tax code proposes a significant increase in the tax slabs for personal income tax, which, if implemented, will result in a meaningful increase in disposable income, especially benefitting FMCG and other domestic consumption stories. At the same time, the code proposes to do away with the distinction between long and short term capital gains and abolish the Securities Transaction Tax (STT), effectively taxing all capital gains at the applicable marginal tax rate for the taxpayers' total income. At present, the long term capital gains tax is nil on equity transactions on which STT is paid and 20% on all other assets, while the short term capital gains tax rate is 10% on equity transactions on which STT is paid and 30% on other assets. It also includes a substantial increase in tax slabs for personal income taxpayers.

**Table-B Proposed Tax Slabs for Personal Income tax**

Total Income	Tax Rate (%)
Up to Rs 1, 60, 000*	Nil

<sup>40</sup>*Mortgage Co Vs Canada* (2005) SCC 54' It may be noteworthy that the Federal Court of Appeal in Canada, in the case of '*Queen Vs MIL (Investments) SA*,' denied invoking GAAR in a treaty shopping situation and allowed the benefit of the capital gain exemption under the tax treaty between Canada and Luxemburg even though it resulted in double non-taxation of the gains.

Rs 1, 60, 000-Rs 10, 00, 000	10
Rs 10, 00, 000-Rs 25, 00, 000	20
Above Rs 25, 00, 000	30

\*senior citizens, minimum slab is: Rs 2, 50,000-5, 00,000 (10%); very senior citizens 5, 00,000-10, 00,000 (10%). Hopefully the proposed change may yield good results for otherwise tax innovations have been not been so encouraging in India<sup>41</sup>.

Generally speaking tax planning here has been faulty and ill conceived. According to eminent tax expert and lawyer, N.A. Palkhivala the said position can be described as under:<sup>42</sup>

The tragedy of India is the tragedy of waste-waste of national time, energy and manpower. Tens of millions of man-hours, crammed with intelligence and knowledge-of tax-gatherers, taxpayers and tax advisors-are squandered every year in grappling with the torrential spate of mindless amendments. The feverish activity achieves no more good than a fever.

The proposed changes in the tax regime may augur well for the economic reforms in tax jurisprudence but it cannot change the mindset of a tax defaulter in a major way. The GAAR principles have been in operation in many countries of the world but tax evasion is rampant and on the rise. Companies have become a haven for tax avoidance and some of the best legal brains have been put in service for this purpose. Therefore, notwithstanding many anti-avoidance provisions, zero-tax companies flourish in India<sup>43</sup>. The treatment given to combat the evils of tax avoidance and evasion depends on the socio-economic ethos of each country. Some countries formalize tax saving opportunities as avoidance, others keep them more informal and they show it as evasion. The greater degree of 'honesty' that might be inferred from the smaller reporting gaps in the USA as compared with France, could really be rather, a greater degree of forth-rightedness in providing legal avenues for avoiding or moderating tax liability<sup>44</sup>.

Now is the time for India to think big and bring out the desired change in tax planning and tax rationalization. The most daunting being the challenge of meeting the deadline for rolling out

<sup>41</sup>The Tax Code is yet to be implemented; however, the tax rates have been fine-tuned somewhat. The income tax slab for the Assessment Year 2013-14 is : upto 2 lakh nil, upto 5 lakhs 10%, upto 10 lakh 20% and above 10 lakh 30%. Plus education cess of 3% of income-tax.

<sup>42</sup>See Palkhivala et al, *Supra* note 9 at vii.

<sup>43</sup>See Gopalakrishnan, *Supra* note 40 at 90.

<sup>44</sup> Holland AnOldman, "Measuring Tax Evasion", paper presented at the Fifth Annual General Assembly For Inter-American Centre Of Tax Administration (CIAT) Held In Brazil, May 1971.

the Direct Taxes Code and the Goods & Services Tax, the two big game changers on the taxation front. For the New Year, the battle lines have been drawn by the ParthasarathiShome Committee for direct tax and the empowered committee of state finance ministers for indirect tax.

## 6. CONCLUSION AND SUGGESTIONS

In summary, experience of matured jurisdiction on highly complex legislation does not achieve the purpose of stopping avoidance. The more detailed the rules, the more opportunity there may be for those wishing to find and exploit loopholes. If US is an example to go with; the recent sweeping changes in cracking the whip on revenue leakage is expected to result in huge tax battles.

This is besides the fact that US companies are getting into an uncompetitive position. Businesses are looking for stable, non-threatening environment and hence, caution is required for such monumental changes. However, without taking away the credit due to officials in North Block for a stellar performance, few anti-avoidance provisions require re-examination. I wish late Palkhivala were around us to witness the paradigm shift in the Indian tax law, as he did not mince words in labeling the 1961 Act as a national disgrace. Fundamentally, whereas the tax and business fraternity is not opposed to GAAR, the widely worded proposals require deeper reflection. The following suggestions may be kept in view while devising the road to GAAR provisions in India:

- I. Tax treaties with international community need to be protected, against the era of uncertainty, likely to emerge after the loss of taxpayer certainty;
- II. Witch hunting against some companies and MNC's because of unbridled powers vested with tax authorities may be tied over by simplifying the procedure;
- III. The doctrine of impermissible tax avoidance arrangement having commercial overtones may be misused by legalistic approach;
- IV. Besides wide administrative power, this would be amongst the strictest form of GAAR legislated by a country.
- V. A panel of GAAR similar to Australia to mitigate ill effects of GAAR is lacking;
- VI. The Australian and Canadian GAAR focus on taxpayers' behaviour and contentious issues, recognizing the fact that the tax administration has to exercise its discretion in a judicious fashion.
- VII. Canadian jurisprudence would lend lessons to avoid prolonged litigation.
- VIII. Failure to furnish tax returns and false statement in verification has been made non-bailable offences. There could be genuine reasons for failure to furnish tax returns

- or decay in payment of withholding tax. It is interesting to note that the specified non-cognizable offences override the code of criminal procedure, which is presently the case under the extant law.
- IX. The irony is that in tackling the menace of tax base erosion, the distinction between tax avoidance and tax evasion becomes blurred;
- X. In the final analysis, the menace of tax avoidance (using treaties) cannot be addressed unilaterally. It would otherwise have a tremendous ripple effect and adverse consequences. It is clear that issues like tax havens have to be dealt with as a coordinated effort either through the OECD or groups such as joint international tax shelter information centre.

