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Legal Aperture and Tax Avoidance Strategies in India: An Analysis

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ABSTRACT

The taxation system in India, specifically in the context of the tax avoidance and evasion techniques are the two extremely substantial practices in the Indian system of taxation cornering is regulation and policies This system preserves the Indian economy from involving and engaging in any sorts off illegal methods in order to avoid the payment of the taxes and its governance in India. These concepts initially affects in the government in terms of causing losses in their entire revenue of the government. Which become hindrance in the required evolvement and spending of the government programs. The tax evasion implies to the curtailing or exploiting the lacunas of the tax laws to decrease the liabilities of the tax payer in the country in order to furnish some amount of relief. The unqualified and unbalanced distribution of income also a major concerns and worsened the taxation system. The ineffective administrative role and its compliance give opportunity to the offenders, which put servers concerns and losses to the government of the country with respect to their revenue and put hurdles in the public activities and investments of the government.

In the present paper author tends to discuss the techniques and policies strengthens the taxation system, concerning categorising the sufficient techniques with respect to the methods with evolve the system to maintain the balance between the adequate techniques and establishing procedure to boosting the economic growth of the country. This analysis examines the multi-dimensions of tax evasion and tax avoidance in the observations of present stance of the governmental policies, statues, laws and preventive techniques, how it has given rise to the effects of the Indian growth pertains to the economy and the judicial pronouncements interpretation of tax evasion and avoidance laws and policies concerning its evolving processes.

Keywords*: Taxation system, tax evasion, governmental policies, foreign investments, tax avoidance.*

I. INTRODUCTION

Tax is the backbone of every country as it is only source of income to the Government and this

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leads to the reformation of the country. It is the most prominent source of revenue to the government. Collection of tax came into existence from the establishment of human civilisation. With the development tax was started to be imposed on capital, assets or income. The imposition of tax on the people at large of the country is a burden on them. Due to the imposition of huge taxes people, firms, corporates try to find out solutions to minimize their tax liability. There are majorly three ways by which a person, firm, corporate can minimize their tax liability by Tax Evasion, Tax Avoidance and Tax Planning. The growth of a nation depends upon the collection of taxes, the decrease in the collection of taxes forces the government to reduce their public spending. Tax evasion means when a person, firm or corporate tries to lower their tax liability in an unfair, illegal manner. It is knowingly misinterpreting their true condition of their affair to reduce tax liability and to avoid taxes by showing fewer incomes, profits or gains from what they have actually earned. Corporates and individuals hide these things from the authority. Tax avoidance means using legal methods to lower their tax liability, these are methods provided by the law. Even though tax avoidance is a legal method but it is advised not use to use tax avoidance as it is for a shortcoming and reduces the revenue of the government which ultimately results in a hurdle in the growth of the country. The tax collection is used for upliftment of society, infrastructural development and better financial stability of the country. Tax planning is the most essential way of analysing one’s financial situation. Tax planning can be done by using various exceptions and deductions provided by the government to the people. The major reason behind this imposition of huge taxes is because people and corporates try to reduce tax liability because of which is the government is forced to impose huge taxes. The government with the change in technology and advancement in the AI (Artificial Intelligence) are trying to cope with the people who are trying to reduce their tax liability.

II. Brief background history of corporate tax in India

In the developing regime of the 21st century. The role and the functioning of the nations with respect to their taxation system is changed. The involvement of the government in the policy making is heightened and interference concerning the regulation and governance is majorly recognized.

As the interference of the government in the modern times has given rise to inevitably in its economy has boosted to prevent and preserve their traditional taxation system of their nation for development and the maintenance of their law and order, to protect the need of their people. In the socio-political development of its citizens it is required to have the strong and effective taxation system of their country with respect to collecting the finance from private hands to public.

III. Corporate tax framework in India

Corporate tax also known as super tax is a direct tax that is levied by the central government on the income of a corporation. The power to collect corporate tax by the central government is provided under the constitution of India. The companies and firms are taxed by the central Government in accordance to Income tax Act, 1961. For the imposition of corporate tax it is important during the assessment the residential status of the corporate. It has to be incorporated in India or its POEM (Place of effective Management) has to take place in India. If in case of management outside India or Non-resident then corporate tax is levied on income earned in India. Corporate tax prevails at a flat percentage but the amount of payment of corporate tax may vary depending upon the rebates available and used by the corporate.

The corporate tax in India is as defined under with this chart.

Type of Company	Corporate Tax Rate	Surcharge on Net Income Less than Rs. 1 crore	Surcharge on Net Income greater than Rs. 1 Crore and less than Rs. 10 Crore	Surcharge on Net Income greater than Rs. 10 Crore
Domestic with annual turnover upto Rs 250 Crore	25%	Nil	7%	12%
Domestic Company with turnover more than Rs 250 Crore	30%	Nil	7%	12%
Foreign Companies	40%	Nil	2%	5%

The corporate tax rates in India vary based on the type of company and its turnover. Here's a breakdown:

1. Domestic Companies with Annual Turnover up to Rs 250 Crore:

- Corporate Tax Rate: 25%
- Surcharge on Net Income:
- Less than Rs. 1 crore: Nil
- Greater than Rs. 1 Crore and less than Rs. 10 Crore: 7%
- Greater than Rs. 10 Crore: 12%

2. Domestic Companies with Turnover more than Rs 250 Crore:

- Corporate Tax Rate: 30%
- Surcharge on Net Income:
- Less than Rs. 1 crore: Nil
- Greater than Rs. 1 Crore and less than Rs. 10 Crore: 7%
- Greater than Rs. 10 Crore: 12%

3. Foreign Companies:

- Corporate Tax Rate: 40%
- Surcharge on Net Income:
- Nil for income less than Rs. 1 crore
- 2% for income greater than Rs. 1 Crore and less than Rs. 10 Crore
- 5% for income greater than Rs. 10 Crore

These rates and surcharges are applied to determine the tax liability of companies operating in India, contributing to the government's revenue and fiscal policies. Corporate tax is an important source of revenue for the government as development and growth depends on it.

DIRECT TAX COLLECTIONS (In ₹ Rs Cr)

Financial Year	Corporate Tax	Personal Income Tax*	Other Direct Tax	Total	YoY growth
2018-19	6,63,572	4,73, 179	967	11,37,718	13.5%
2019-20	5,56,876	4,92,717	1,088	10,50,681	-7.7%
2020-21	4,57,719	4,87,560	1,897	9,47,176	-9.9%
2021-22	7,12,037	6,96,604	3,781	14,12,422	49.1%
2022-23	8,25,834	8,33,307	4,545	16,63,686**	17.8%

*includes Securities Transaction Tax **Provisional
Source: CBDT

TAX BUOYANCY

Financial Year	Direct tax-GDP ratio	Buoyancy factor
2018-19	6.02%	1.29
2019-20	5.23%	-1.21
2020-21	4.78%	-*
2021-22	5.97%	2.52
2022-23	6.11%	1.18

*As both GDP growth rate were negative, tax buoyancy has not been computed for FY 2020-21

NUMBER OF RETURN FILERS

Financial Year	Individual	Firm	HUF	Company	Total*
2018-19	5,95,44,767	13,18,828	11,66,432	8,47,860	6,33,18,586
2019-20	6,11,30,366	12,98,406	11,58,601	8,40,511	6,48,65,888
2020-21	6,31,71,013	14,10,154	12,01,502	9,24,296	6,72,08,614
2021-22	6,54,61,868	14,51,576	12,26,587	9,71,319	6,96,35,446
2022-23	6,96,90,925	15,10,551	12,46,413	10,27,200	7,40,10,269

*Total includes AOPs, local authorities and others Source: Ministry of Finance

This data above shows the data from FY2018-19 to FY2022-23 where there has been a YoY growth in collection of tax excluding the FY 2020-21 as all the countries were facing the Global Pandemic COVID-19. After the FY 2020-21 there has been an increase in collection of corporate tax, Direct income tax and various other taxes. The other table shows the tax buoyancy which can be explained as "Tax buoyancy is the relationship between the changes in government's tax revenue growth and the changes in GDP. It refers to the responsiveness of tax revenue growth to changes in GDP. When a tax is buoyant, its revenue increases without increasing the tax rate".

In every country the big corporations use to find loopholes in the taxation system to avoid huge taxes, this can also be stated as tax havens. The companies use their subsidiary to avoid taxes. Before the year 1995, Reliance was known as the Zero tax company as it hardly paid any corporate tax. The corporations use to show their income lesser than what they have actually earned during that financial year.

IV. Crucial tax avoidance techniques

There are four basic tax avoidance techniques practiced, though numerous variations and subtleties exist:

1. Postponing the payment of tax obligations.
2. Reclassifying income or expenses in order to be taxed at a lower or zero rate.
3. Permanently eliminating tax liabilities.
4. Transferring income from a high-tax individual or entity to someone with a lower tax burden

The implementation of these techniques typically involves the following strategies:

a) Utilizing tax treaties for transactions involving related parties, commonly known as "Treaty Shopping."

b) . Making use of international tax shelters by using intermediary companies, also referred to as "CFCs."

c) Excessive reliance on debt rather than equity, a practice known as "Thin capitalization."

d) Engaging in non-arm's length transactions, which involve manipulating transfer pricing.

e) Changing one's place of residence for tax purposes.

f) Establishing branch entities for tax advantages.

g) Taking advantage of tax havens. In summary, all tax avoidance techniques exploit inconsistencies and gaps within tax systems through various forms of tax arbitrage.

V. Sources of anti-avoidance measures

(A) Legislative solutions: The Governments mostly are dependent on the anti-avoidance statutes made and passed by the Parliament. These statutes can be of the two following ways:

1. Specific anti-avoidance rules focused on specific tax avoidance measures (hereinafter "SAAR").
2. General anti-avoidance rules which are, catch-call system for tax avoidance (hereinafter "GAAR").
3. Bilateral measures are also pursued through treaties or Double Taxation Agreements (hereinafter "DTAAs").

    (i) This can be done with the help of various clauses inserted in them. Examples are the "Beneficial Ownership" and "Limitation on Benefit" clauses in many Treaties.

(ii) The treaties may have specific anti-treaty shopping rules.

(iii) The use of the Articles pertaining to Exchange of Information in Treaties are also used to counter tax avoidance.

Judicial solutions: The Courts across the world have been very effective in finding and making various judicial doctrines to curb tax avoidance.

Administrative solutions: To find out tax avoidance has taken place and to get information on such practice is priority; administrative measures are a useful tool for governments to both curb and detect tax avoidance practice.

(B) Judicial anti-avoidance measures: The Courts have the option to approach statutory interpretation in two ways: a literal or strict view, or a purposive view. Many Courts worldwide have played a significant role in the development of SAAR and GAAR principles and laws. In judicial anti-avoidance, there are two guiding principles:

(a) Business purpose rule (motive test)

(b) Substance over form rule (artificiality test)

- The "Business Purpose" rule states that a transaction must have a legitimate business purpose, beyond simply avoiding taxes. Tax advantages alone cannot be the primary reason for the transaction. In the significant case of Helvering v. Gregory, the US Supreme Court ruled that a corporate reorganization solely for tax purposes does not qualify for tax benefits. It is important to note that the term "business purpose" is not clearly defined in statutes, and courts rely on a common-sense interpretation. Numerous UK rulings have made efforts to define the concept of "business purpose."
- The substance versus form principle refers to the legal or social reality over the literal wording of legal provisions. It is a topic of debate, with various cases involving this principle. Legal vs. Economic Substance: This applies when a tax payer has the economic power over taxable income without tax liability. The Duke of Westminster case demonstrates this, where the House of Lords accepted the legal form of covenanted payments, which could be treated as the economic equivalent of wage. Aiken Industries v. Commissioner of Internal Revenue is another significant case involving economic substance. In this case, Aiken was liable for withholding taxes on interest paid. Northern Indiana Public Service

Company v. Commissioner of Internal Revenue was another landmark case involving economic substance, where Northern Indiana USA raised debt in Europe with lower interest rates.

VI. Impact of tax evasion and tax avoidance on national economy

Tax evasion and avoidance not only diminish government revenue but also have cascading effects on society and the economy. First and foremost, they shrink the pool of funds available for crucial public services like healthcare, education, and infrastructure. This shortfall in revenue can force governments to scale back on essential programs, hampering social welfare efforts and infrastructure development.

Furthermore, the loss of tax revenue contributes to widening budget deficits, leading to increased government borrowing and higher public debt. This financial strain can undermine economic stability and hinder long-term growth prospects.

The unfairness inherent in tax evasion and avoidance exacerbates income inequality, as those with the means to exploit loopholes pay lower effective tax rates compared to honest taxpayers. This disparity distorts the market economy by granting an unfair advantage to tax-evading entities, leading to inefficient market dynamics and hindering overall economic efficiency.

Additionally, widespread tax evasion erodes investor confidence, particularly among foreign investors who seek stability and transparency. A lack of confidence can deter foreign direct investment, stalling economic growth and job creation.

Honest taxpayers bear the brunt of the burden, as governments may respond to revenue losses by increasing taxes or introducing new levies. This places an undue strain on law-abiding citizens who already fulfill their tax obligations.

Moreover, the reduced fiscal space limits government capacity to invest in critical sectors like infrastructure and public services, constraining efforts to stimulate economic growth and improve living standards.

Overall, addressing tax evasion and avoidance is imperative to ensure a fair and sustainable fiscal system that fosters economic prosperity and social well-being.

VII. Specific legislation to guiding tax regulation in India

Tax evasion, distinguished by its illegality, involves deceptive practices such as concealing income, exploiting loopholes, or even resorting to bribery to evade taxes. Individuals or businesses engaging in tax evasion risk severe consequences, including penalties, fines, and imprisonment. An example of tax evasion includes falsifying income on tax returns, a direct violation of tax laws and ethical principles.

Tax avoidance, on the other hand, operates within the bounds of legality but may raise ethical concerns. This strategy involves leveraging legitimate means such as investing in tax-exempt instruments or structuring businesses for tax efficiency to minimize tax obligations. While not illegal, tax avoidance can still be contentious due to its potential to exploit legal loopholes. An example of tax avoidance is investing in tax-free bonds, which, while legal, may raise questions about fairness and equity in the tax system.

Tax planning falls within the realm of legality and is generally considered ethical. It entails strategic financial decision-making aimed at reducing tax liabilities through permissible means. This can include maximizing deductions, choosing tax-efficient investments, or selecting government benefits that offer tax advantages. Unlike evasion or avoidance, tax planning emphasizes compliance with tax laws while optimizing one's financial situation. For instance, choosing a health insurance plan with tax benefits demonstrates proactive tax planning to minimize tax burdens within legal boundaries.

In summary, while tax evasion involves illegal actions and tax avoidance may skirt ethical boundaries, tax planning operates squarely within the confines of legality and ethics. Understanding the distinctions between these practices is crucial for individuals and businesses to navigate tax obligations responsibly while optimizing their financial well-being.

VIII. Analysis of judicial development (precedents)

These are some of the crucial and substantial pronouncements of the Indian courts evolving the tax evasion system concerning the law and policies of the country.

Union of India v. Azadi Bachao Andolan (2003): In this landmark judgement the pronouncement concerning the applicability of Double Taxation Avoidance Agreement (DTAA) is came into existence between India and Mauritius, which is frequently unitise by the international entrepreneurs and investors to enhanced the capital gains within the country.

GE India Technology Centre Pvt. Ltd. v. CIT (2010): similarly, in this case, the court ruled out that the inflow transactions concerning the any technological or software development by the foreign corporation in india would not be considered as an royalty and hence would not be subject to the imposition of tax in this subject.

Cairn Energy Case: In this judgement of December 2020, in the matter of adjudicated by the arbitration council held that, in the conflict concerning the retroactive taxation system with the government of India of subject, would be in violation of the bailers investment agreement with reference to the UK-India.

Vodafone Case Verdict: In another evolvement of September 2020, the Delhi High Court upheld the international arbitration tribunal's verdict in favour of Vodafone Group Plc concerning its deal with respect to the matter in its Rs 20,000 crore retrospective taxation imposition matter of conflict with the government of India.

Google India Digital Services Pvt Ltd vs DCIT: This crucial pronouncement by the Delhi High Court held that the in the questions pertains to the transfer pricing cases, that the payments conferred to the google Ireland were not be subject of taxation considering the royalty income in India.

Nokia India Sales Pvt Ltd vs ACIT: Now most significant ruling In February 2021, the Delhi High Court pronounced by upholding the stance of Nokia India Sales Pvt Ltd, concerning that the transaction perform by the parent company of the purchaser of the software would not be the subject matter of taxation considering the payment of royalty.

These landmark pronouncements of the Indian courts concerning the evolvement of the Indian taxation system pertains its legal policies and interpretation is reflects the present Stance of development, and requirement for the further strategies and police’s evolvement to converse effective regulation and governance of the tax system in India.

IX. Discussion and Recommendation

To combat tax avoidance effectively, a multifaceted approach is crucial. Firstly, strengthening legal frameworks is paramount to close loopholes exploited by tax avoidance schemes, ensuring a more robust regulatory environment. Collaboration between tax authorities and legal experts must be enhanced to swiftly identify and address emerging tactics. Stricter penalties for aggressive tax planning serve as a deterrent, while transparency in corporate tax reporting fosters accountability. Investing in technology and data analytics empowers tax authorities to improve compliance efforts. Specialized training for professionals enhances their ability to detect and address schemes. Voluntary disclosure programs incentivize taxpayers to rectify past practices, promoting compliance. Regular audits and risk assessments help identify high-risk areas, enabling proactive measures. Strengthening anti-abuse provisions prevents exploitation of loopholes. International cooperation is vital to combat cross-border evasion, while public awareness fosters support for anti-avoidance measures. Measures targeting multinational corporations ensure fair contributions. Streamlining tax administration reduces complexity, while incentives reward ethical practices. Dedicated task forces ensure swift action against offenders, supported by updated tax treaties and policy evaluations. Alternative dispute resolution mechanisms promote efficiency and fairness. Adequate resources empower tax authorities, while collaboration fosters holistic solutions, ensuring a fair and effective tax system.

X. Conclusion

The issue of legal apertures and tax avoidance strategies in India is multifaceted and requires a comprehensive approach to address effectively. It is evident that the existing legal framework, while robust in many aspects, still contains loopholes that allow individuals and businesses to exploit tax laws for their benefit. However, through proactive measures such as strengthening legal frameworks, enhancing collaboration between stakeholders, and investing in technology and enforcement capabilities, it is possible to mitigate the impact of tax avoidance and promote tax fairness. it is essential to recognize that combatting tax avoidance is not solely the responsibility of tax authorities or policymakers but requires a concerted effort from all stakeholders, including businesses, taxpayers, and civil society. By fostering a culture of compliance, transparency, and accountability, we can create an environment where tax avoidance is disincentivized, and all taxpayers contribute their fair share to support the common good. Ultimately, addressing legal apertures and tax avoidance strategies in India is not only a matter of fiscal policy but also a question of social justice and economic development. By taking decisive action to close loopholes, enforce tax laws, and promote a culture of integrity, India can strengthen its tax system, enhance revenue collection, and ensure that resources are allocated equitably to support sustainable growth and development for all. it's imperative to emphasize the importance of continuous monitoring and evaluation of tax policies and enforcement mechanisms. Regular assessments will allow policymakers to identify emerging trends in tax avoidance and adjust strategies accordingly. Moreover, fostering international cooperation and alignment with global best practices is crucial in addressing cross-border tax evasion and profit shifting effectively. promoting transparency and accountability in tax administration is essential to build trust between taxpayers and authorities. Providing clear guidance and communication channels for taxpayers to understand their obligations and rights can help reduce unintentional non-compliance and improve voluntary compliance rates. Investing in taxpayer education and outreach programs can empower individuals and businesses to make informed decisions and comply with tax laws proactively. By raising awareness about the consequences of tax avoidance and the benefits of contributing to public finances, we can foster a culture of tax compliance and responsibility. Lastly, it's essential to recognize that combating tax avoidance is a long-term endeavour that requires sustained political will and commitment. While there may be challenges along the way, the ultimate goal of ensuring a fair and equitable tax system that supports inclusive growth and development for all citizens is worth pursuing relentlessly.

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