## METHODS OF TAX EVASION - CAUSES AND EFFECTS

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"In the reform proposals for income tax and corporation tax there is concern to reduce the special reliefs and concessions—what the Americans call 'tax expenditure's, to stress the point that reliefs through the tax system make inroads on revenue similar to direct expenditures."

- Sedric Sandford
6.1 Importance of the study of 'Tax Evasion'

The study of tax evasion and analysis of unaccounted income is important to realise the gravity of the problem of Tax Reforms. It helps to find out –

i) Tax potential;

ii) Effectiveness of tax administration;

iii) Limits to the effectiveness of fiscal and monetary inbringing about the necessary changes;

iv) Inflation and the phenomenon of increase in prices particularly in items such as land prices and those of goods of conspicuous consumption;

v) The level of tax morality of the society etc.

From the data relating to the size of the unaccounted income, a measure of tax potential of the economy can be obtained. For example, if the size of unaccounted income in a particular year is Rs. 10,000 crore and the average rate of tax liability is 30%, then Rs. 3,000 crore represents tax potential. The data on tax potential are of particular significance to developing economies. Such economies require resources for development purposes and data on tax potential provide a measure of untapped resources, if there is an improvement.
in the conscience of people to pay taxes as provided under the law and also effectiveness of tax authorities in the administration of tax provisions. The media of publicity should increase the consciousness of the people to pay tax on their own. Just as in the case of family planning programme, there is a need of constant action to increase the awareness of people to social and economic responsibilities which would bring about change in the attitude of the people towards payment of income tax. Mere threats of penalties for non-payment of tax liability results in 'tax planning' to avoid taxes by legal or illegal means. Search for new loopholes in the ever-changing provisions of Income Tax law is continuous. To some extent, administration of tax provisions is also responsible for this purpose. Those who do not approach with clean hands cannot ask for equity or justice. Lack in effectiveness of tax authorities in the administration of tax provisions is ever growing. This has only culminated in self-assessment tax provisions. Lack of effective administration of the tax law, the heavy rate of tax and complicated provisions of the Act are some of the important reasons for tax evasion. The developmental programmes of the Government are ambitious and are full of revenue pilferage. This requires increase in tax revenue to fill up the gap in the resources and the expenditure. The intensive and extensive tax measures for the purpose, further lead to ineffective administration which in turn leads to Tax Evasion on the increased scale. The following vicious
circle, therefore, develops:

![Diagram](image)

Perhaps, none of the parties to the vicious circle are able to break the same. The common man who is under constant pressure of taxes, finds out alternative sacrifice to make both ends meet.

Data on unaccounted income are an indirect measure of ineffectiveness in the administration of taxes. Given an efficient system of tax administration, having necessary support facilities for collecting information and detecting defaulters, additional resources can be raised without any change in the rate structure. Thus, the data on size of unaccounted income provides an index of tonning up that can be introduced in tax administration.

Most economies are experiencing serious constraints in reviving their economies through fiscal and monetary policies. It is suspected that a part of these constraints are due to presence of unaccounted income. For example, if business community possesses liquid resources provided by unaccounted income, credit squeeze introduced by the Government, shall achieve a limited success in restricting expansion of certain industries.
6.2 **Extent of tax evasion and avoidance in India**

It is almost impossible to ascertain correctly the extent of tax evasion and avoidance in the country because of numerous difficulties involved in the process. Any such estimate can only be a guess and would involve element of subjectivity. Certain attempts have, however, been made from time to time to estimate tax evasion in the country. In the view of National Planning Committee such estimate varied from Rs. 200 crores to Rs. 800 crores. In 1956, Professor Kaldor estimated that a non-salary income of Rs. 576 crores evaded tax annually and that the amount of income tax lost through tax evasion was of the order of Rs. 200 - 300 crores for the assessment year 1953-54, even though before the Direct Taxes Administration Enquiry Committee he stated subsequently that this estimates included loss due to tax avoidance as well.

The Wanchoo Committee has estimated that "the extent of income tax evaded during 1968-69 would be of the order of Rs. 470/- crores being one-third of Rs. 1400 crores.

Recently, the Finance Minister Madhu Dandwate estimated the unaccounted money or 'black money' at Rs. 40,000 crores.

There is considerable tax evasion in the case of self-employed persons, professionals like lawyers, doctors, chartered accountants, producers and manufacturers at all levels, businessmen both wholesalers and retailers, contractors, transport agencies, mine-owners and others.
A major part of the income tax is evaded by the persons belonging to the higher income groups. There is also considerable tax evasion in the case of small traders.

In spite of the fact that the income tax Act is being made stricter year after year, our legislative provisions could not produce the desired effect. The Income Tax Officers have extensive powers of search and seizure. In addition to the penal interest and penalty provisions, provisions of prosecution have now been added to stop evasion of tax. Tax due has to be deposited within one month of the submission of the return under self-assessment failing which the assessee is liable to a substantial penalty. There is a penalty for concealment, which shall not be less than a sum equal to the amount sought to be evaded and the maximum penalty may be twice the amount of tax sought to be evaded. Penalty is also imposed for not paying advance tax or for filling a wrong estimate. Then, there is also the provision of search and seizure under Section 132 of the Income Tax Act. Provision also exists for prosecution if the tax payer has concealed income or if he furnishes inaccurate or wrong particulars. But all these penal provisions have not brought about the desired effect in reducing the quantum of tax evasion.

No sooner is a method of concealment is detected, another method or the same method in another garb is devised. Thus, a regular game of hide and seek goes on between the tax evaders and the tax gatherers.
The data on the size of the unaccounted income give a measure of tax potential of the economy. For example, if the size of unaccounted income in a particular year is ₹10,000 crores and the average rate of tax liability is 30%, then ₹3,000 crores represent tax potential. The data on tax potential is of particular significance to developing economies. Such economies require resources for development purposes and data on tax potential provides opportunity to increase revenue, provided there is an improvement in the consciousness of people to pay taxes as provided under the law and effectiveness of tax authorities in the administration of tax provisions.

Data on unaccounted income are an indirect measure of effective administration of tax law. It also reflects on tax provisions which may be ideal for the economy but lack feasibility.

However, the extent of evasion cannot be proved with reference to statistics, but one of the results is that tax rates have been raised for higher income brackets to meet the growing expenditure. Since there was considerable criticism on the maximum rate of tax, the same has been reduced but the minimum rate of tax is increased, the number of income tax slabs in case of individuals are reduced. Thus, though the maximum rate is reduced, the rigour of tax burden continued and the worst sufferer remained the fixed income group.
6.3 Causes of evasion and avoidance:

Reasons for tax evasion are numerous and vary from person to person, trade to trade and profession to profession. However, there are certain common reasons for evasion of income tax. According to Prof. F.W. Taussing, the essence of tax, as distinguished from other charges by Government, is the absence of a direct 'quid pro quo' between the tax payer and public authority. People do not want to pay taxes because they do not get any direct benefit from such payment. These people who evade taxes maintain big temples, dharmashalas and spend a huge sum of money on Sadhus or pilgrimage but they do not want to pay taxes.

(1) One of the reasons given is that tax has to be paid under compulsion but charity is voluntary. Another possible reason is the distrust in the utilisation of public money collected as tax. People have no faith that the taxes levied on huge scale are properly utilised for the purpose for which they are meant. Tax payer earns money by certain means which are justifiable or not, legal or illegal but it is a fact that they become the owner of that money and once acquired they feel that the tax which they have to pay constitutes a major part of their income. The major part of such tax is enjoyed by Government officers and other engaged in executing public projects, part of it is a wasted and small part thereof is used for the purposes for which they are meant. In short, it is like one thief avoiding to pay to another thief.
People elect their representative for legislative council say a member of legislature assembly or a member of parliament or a municipal council. However, the tax payer observes that these peoples' representatives use their offices for themselves. They earn huge income abusing their power. Can this be stopped? They remain undetected and continue to enjoy their positions, election after election without being punished. If these ideals before the people are changed, there would be an air of sacrifice and tax evasion can be stopped to a large extent.

(ii) Tax payers are not conscious of their responsibilities towards the society and the country in which they are living. People blame the Government for difficulties and shortages but as regards the payment of taxes, they feel as if it is their right to evade the tax. This is because proper training is not imparted in this direction. In America, school-going children are taught to fill in an income tax return and they are taught that they should pay proper taxes. In India, nothing to talk of school-going children, many of the university students do not know how to fill in an income tax return.

(iii) On the other hand, the Indian Income Tax Act is highly complicated and constant amendments have been made to it from time to time. The Income Tax Act, 1961 was expected to simplify the 1922 Act. However, in the years that followed more than 400 amendments were introduced. As a result the whole Act has become so complicated that even the income tax
authorities and tax consultants cannot keep themselves well acquainted with the latest amendments along with the earlier provisions. This has, therefore, remained as one of the reasons of tax evasion.

(iv) However, this is not the entire story. There are people who have got expert tax consultants to suggest them the means and methods to evade taxes. There is also the dearth of experienced personnel in the Income Tax Department. The present strength of fully trained and experienced officers is inadequate for dealing with the current cases. In addition, there is a backlog of arrears which presents serious difficulties. Because of the time lag in completing assessments in quite a few cases, the assets are alienated or frittered away during the interval between the earning of income and its assessment, and even if ultimately a demand is raised, its collection is rendered very difficult.

(v) There is no doubt that the Direct Taxes Acts provide for prosecution and imprisonment in cases of concealments and false declaration of statements but in actual practice rarely any man is prosecuted on this ground or severe penalties are imposed. Even the moderately levied penalties by the assessing officers have been reduced by the appellate authorities. The Taxation Laws Amendment Act (Amendments and Misc. Provisions), 1986 w.e.f. 10.9.1986 and the amendments introduced by Finance Act, 1986 have made these penalties still stricter. Even then the loopholes are available. The prosecution proceedings
have to be kept pending when appeals are pending. When the prosecution proceedings are in progress, the offences can be compounded.

(vi) Previously, the Department was statutorily prohibited from disclosing any information relating to persons' returns or assessments, except to specified authorities like the courts of law, Reserve Bank of India for limited purposes and the Central and the State Governments. In such a case, even if a tax payer was caught and penalised for concealment, he could keep it a secret from everyone and escape the odium. It is a happy augury that of late these provisions have been relaxed to some extent. The Department now makes available the names of tax evaders and may also supply information if it is considered to be in the public interest. In fact, it may be in public interest to publish the income returned in all doubtful cases so that public will know who are the tax evaders and to what extent they are doing so.

(vii) Many retail traders try to evade sales tax and considerably understate their sales. They avoid the issue of cash memos and the purchasers also do not insist because they save sales tax. In such cases, although the intention is not primarily one of evading the Income Tax but since the business has been done outside the books of accounts, businessmen also do not show it in their books of accounts. Thus, by suppressing sales, a trader not only defrauds the State Governments of the Sales Tax but also the Central and State Governments of their share of Income Tax.
On the contrary, there are number of professionals and small businessmen who inflate their purchases by obtaining bogus bills and cash memos. In their cases, such purchases inflate the expenditure side and reduce their real income. Manufacturers show these purchases as consumed in the manufacture process. Such purchases are mainly of packing material, raw material, travel expenses, office expenses, stationery, advertisements, labour charges etc.

(viii) The officers of the Income Tax Department also find it difficult to unearth cases of tax evasion because of several reasons. Firstly, they are allotted large quantum of work. Some of these officers are called upon to dispose of between 300 to 500 assessments per month. From the year 1944-45, in which the reorganisation of the Income Tax Department commenced to the year 1966-67, the number of assessees increased from about 4 lakhs to about 29 lakhs but the number of officers employed on assessment duty increased only from 744 to 1648. As on 31.3.1987 the total number of assessees in the books of the Department was 62,61,465. In such a situation, it is very difficult for these officers to detect cases of tax evasion. Secondly, the field machinery of Income Tax Department is hopelessly poor, resulting in a long gap between two surveys. Surveys are undertaken from time to time but the time lag between the two surveys is so wide that many businesses might

(1) Report of the Comptroller and Auditor-General of India, Union Government (Revenue Receipts - Direct Taxes for the year ended 31st March 1987 (Page 2.05)
have come and gone without paying any income tax. Moreover, in these surveys, the inspectors were generally called upon to survey about 100 cases a day. This results in reporting same cases in many survey reports.

Thirdly, the execution of the Income Tax Act requires the knowledge of several other acts such as Hindu Laws, Partnership Act, Companies' Act, Registration of Property Act, Negotiable Instruments Act, Evidence Act etc. Moreover, the Income Tax Officer has to handle cases of different types involving complexities of different trades, professions and vocations. Unless an officer is well-versed about the technical details of each trade, which is very difficult, he cannot detect concealments.

Fourthly, tax audit of accounts is compulsory in limited cases. The auditors are appointed or removed by the Directors of Companies. Under such circumstances one can hardly expect them to discharge the duties properly.

Finally, there is no coordination between different departments of the Government. It is a common knowledge that the higher class society get their lands and buildings sale or purchase transactions at much lower figure than the actual price. On account of this, the State Governments loose revenue as registration fees and Income Tax Department finds it difficult to enhance the value of such property. The Income Tax Department is also not benefited much from obtaining comparative figures from Registration office. A large number
of commodities are subject to excise duties. The manufacturers keep a record of the production. The production registers are signed by the officers of the excise department but businessmen manages to show in the registers less quantity than actually manufactured. When these registers are produced before the Income Tax Officers, they are accepted as correct record and thus tax on correct turnover is evaded.

The worst affected category of population is the middle class. Due to increase in population, there is an inflationary trend. Once the prices take increase trend, they never come down to original level. Even people living in hand to mouth conditions have to pay income tax. The amount of income has increased but the real value of the income has gone down. Even then, they have to pay taxes on their income. Hence the natural tendency, even from salary earners, is to adopt evil practices of evasion and they become the victim of bribery and corruption.

(ix) High tax rates are also responsible to some extent for tax evasion. These high rates are said to be tolerated only because of the considerable evasion that takes place. Tax evasion exists at all levels of income. The voluntary disclosure schemes also do not evoke good response from people because they fear that the income tax officers might probe into the earlier or subsequent assessments which might lead to further troubles. It appears that the Government is caught in a vicious circle. Government is fully aware of the
magnitude of avoidance and evasion which has kept the income tax receipts at lower levels, taken into consideration the inflationary situation. The low tax receipts do not permit the Government to reduce rates of income tax, as high income tax rates are necessary to fill up the resource gap created by tax evasion and inflation. The high rates of tax in turn, provoke tax payers to evade tax payment.

(x) The Income Tax Department is also responsible for the present state of affairs. It is seen that even when the assesses submit correct returns and produce sufficient evidence in their support, the assessing officers do not always accept them and make some additions. However, this problem is now reduced by the summary assessment schemes. But when a notice is issued and assessees is called upon to furnish information, he feels more upset - more than going to a police station. They prefer amicable settlement at lower levels than going to superior authorities for justice. In one case of a businessman, certain deductions were disallowed by the assessing officer and he went in appeal to the Appellate Assistant Commissioner against the order of the Income Tax Officer. The Appelate Assistant Commissioner told him that it was a question of fact and should have been settled at the time of assessment. Now it would cost him more to settle at appellate level.

Bribery and corruption are rampant at all levels and in all walks of life, therefore, the business cannot alone be blamed for this. Fact can be turned into false and false into
a fact. Substantial relief is now available by the method of summary assessments introduced.

6.4 **Tax Avoidance by companies**

It is often argued that the marginal (and average) income tax rates are directly related with the degree of tax avoidance and evasion by the individual taxpayers. The basic idea underlying this proposition is that as the income tax rates rise, the taxpayers try to adjust their economic affairs so as to reduce their taxable incomes and hence their tax liability. They attempt to (1) substitute non-taxable income for taxable ones; (2) claim a sum as large as possible by way of tax free deductions and allowances and (3) even they conceal certain parts of their incomes from the Income Tax authorities. The former two are the tax avoidance devices and the later is tax evasion. While the scope of the tax avoidance devices would depend on the provisions of the income tax Act, the frequency with which latter will be resorted to, would depend upon element of risk involved.

The reason for this behaviour is simple. The higher the tax rate, the larger the incentives to reduce the tax base; every rupee not shown as taxable income implies a larger tax saving than even before. As Kaldor puts it, "The incentive to evade taxes depends on the marginal rates of taxation, since these govern the gains from evasion as a percentage of the sums evaded."

While investigating the causes of tax evasion in
the country, the Direct Taxes Administration Enquiry Committee found high income tax rates to be one of the major factors. The Committee Report said: "It was stated by many witnesses that the prevailing high rates of taxation were one of the main causes for tax evasion. The high rates of tax in the top income brackets are said to be tolerated only because of the considerable evasion that takes place. We cannot deny that higher the rate of tax, the greater will be the temptation for evasion and avoidance ... (for)as the stakes involved are larger ... the tendency to avoid or evade tax is also greater." (1)

The direct relationship between income tax rates and tax evasion and avoidance, given the Government needs, has serious implications in terms of Government revenues and future tax rates. In case, higher tax rates lead to larger tax evasion, this, in turn, would lead to still higher tax rates. To quote Kaldor again, "India, like most Western countries, has been in the grip of a vicious circle so far as progressive taxation is concerned - evasion and avoidance by cutting down potential revenue led to higher marginal rates of taxation and this, in turn, to further evasion and avoidance and still higher rates. It is a vicious circle of charging more and more on less and less." (1)

While the income tax rates are in some ways inversely related to the base on which income tax might be levied in the case of individual tax payers, does this relationship hold good in the case of companies as well? Or, in other words, do high company tax rates encourage tax evasion and avoidance and reduce the company tax base?

The feelings of the Government were expressed by the Finance Minister in 1963 that "in our system of corporate taxation, there is no co-relation between the rate of tax and the percentage of profits". (1)

The implications of this statement appears to be that profits in the Indian economy are monopoly profits which are not affected by the rates of the corporation tax. Or that the corporate sector is expected to take care in their cost analysis of their product and services, the element of tax which they have to pay to the Government.

On the other hand, the corporate sector have expressed the feelings that high rate of corporation tax "destroys all cost conscious ... a company has little incentives to economise when 70% of its expenses are met by the Government". (2)

By implication, as the corporation tax rates rise,

(1) Finance Minister's Budget Speech, Budget for 1963-64 (New Delhi, Ministry of Finance, 1964)

companies indulge in "wasteful" expenditures, leading to a relative contraction of the corporation tax base.

There is a logic in this contention of the corporate sector. Instead of paying tax, they would like to pay more salary to the employees, more travel expenses on foreign tour, more tax-free reimbursement of expenditure on furniture, furnishings to officers and what not. Those who think in a democratic set up, that more revenue can be raised by raising taxes are living in Fools' Paradise. They should leave this job to the economists, legal experts to study full implications and feasibility of any tax policy. Merely revising rates by every year's Finance Act cannot solve the problem and such ad hoc handling of tax policy leads to inflationary trends in the country.

6.5 **Tax evasion by companies:**

There is a general impression, not only among the public but also in the minds of policy makers that tax evasion and avoidance by the companies is difficult and not safe for two reasons. First, under the companies Act, all companies are required to publish financial statements, including the profit and loss account, audited by the qualified auditors and chartered accountants. Second, in modern times, particularly in the case of public limited companies the management and ownership are so much diversified from each other that the management can have little interest, if any, in the gains from tax evasion.
This, however is not to say that companies do not indulge in tax avoidance. The concept of taxable profits being different from that of book profits, this provides the companies with the tax avoidance devices.

Taxable profits equal to book profits plus disallowances minus non-book allowances or concessions. The higher the rate of tax, the greater might be the incentive to the companies to control the partially or fully disallowed expenses like employees perquisites, entertainment expenses, advertisement expenses, conveyance and travelling allowances, bonus and commission payments, payments and benefits to and expenditure on directors with 'substantial interest in the company' and initial capital expenditure.

Similarly, the higher the tax rate, the greater might be the temptation to the companies to widen for themselves the scope of tax concessions like the 'partial' tax holidays, development rebate, loss offsets, special allowances granted to 'priority industries' full deductibility of interest costs and tax allowances granted towards business expenses incurred on agricultural inputs or that on export market development.

In a nut shell, as corporation tax rate rises, the companies might try to plan their present and future activities in such a way as to minimise the tax disallowance and maximise the tax allowances. One might conclude from this theoretical reasoning that given their book profits, the companies try,
more than ever before, to reduce their taxable profits whenever the corporation tax rates rise. " High corporation tax rates in India in the past did have a tendency to be associated with lower assessed profits. But this tendency has been weak statistically. Hence, one cannot make a sure enough statement that higher corporation tax rates have led to large tax avoidance by the companies. Thus, while the inverse relationship between the income tax rate and income tax base may be valid for the individual tax payers, it does not appear to be true for the companies on the basis of limited data available. " (1)

The degree of difference between 'avoidance' and 'evasion' for a joint stock company is very small. For instance, claiming excessive relief for new industrial undertaking by diversing capital of old unit to a new unit, setting off business loss against agricultural income, claiming depreciation and investment allowance on inflated 'actual cost', reimbursing expenditure on furnishings, medical, travel expenses by the Directors or employees, payment of foreign travel expenses of Directors classifying them as business tour, classifying expenses on servants, vehicles, phones etc. as office expenses. Payments are so made and accounted for that they appear within the ambit of the provisions of the income tax law. Verification of such

(1) SOME ASPECTS OF INDIA'S TAX STRUCTURE : AN ECONOMIC ANALYSIS by Ved P. Gandhi, Prof. Indian Institute of Management, Ahmedabad, Page 188.
transactions is difficult even for auditors. Strictly speaking, they amount to evasion of tax liability. Whether it is a question of fact or law, they can be challenged in courts of law, if disputed by assessing officers.

6.6 **Tax litigation by public sector undertakings**

The Chokshi Committee have observed that there are certain problems which are special to certain public undertakings and considering this aspect, it made a very strong recommendation on tax litigation by public sector undertakings in its interim report. It said: "Frequently, public sector undertakings and Government companies also get involved in litigation with the tax authorities. Instances are quite common where public corporations like Air India's Indian Airlines, Life Insurance Corporation of India and similar corporations have entered into litigation with the department on certain questions. This is hardly a desirable trend. It is difficult to understand why such litigation should at all arise and why it cannot be avoided. Ultimately, it is the Government of India on either side and there is no question of any benefit to the Govt. of India in any form whatsoever by the outcome of the litigation. Similarly, State Corporations have also got involved in litigation with the tax authorities. In all these cases, public funds are frittered away in futile litigation.

There should be no need for appeal by any Government undertaking or company against any adverse decision in tax matters. If, subsequently, at any time the same issue is decided differently by a High Court or the Supreme Court in the case of any other tax payer, then it would be open to the undertaking/company to claim the benefit of such decision in respect of its past assessments. We recommend that dispute between public sector undertakings or Government companies and the Income Tax Department should be resolved by the Central Board of Direct Taxes by discussion with the administrative Ministry of the Central Government or the local government concerned with the undertaking or company and where necessary, in consultation with the Ministry of law."

Justice S. Ranganathan, judge Delhi High Court in his book 'Corporate Taxation in India' has commented on the above views as follows:

"I would, however, suggest that instead of having these disputes decided by the Central Board of Taxes, it may be appropriate to have them resolved by reference to a high powered arbitration Board which could straight away give its award on a case stated, which can be treated as final. A Board presided over by a Chairman from the judiciary and

(1) This is in the light of another recommendation made by the Committee in Para 11.16 of the same report.

(2) 'Corporate Taxation in India' Mr. Justice S. Ranganathan Forwarded by N.A. Palkhiwala, published by Documentation Centre for Corporate and Business Policy Research, New Delhi.
having for its members the chairman or a senior member of
the Central Board of Direct Taxes, the President or a
senior vice-president of the Income Tax Appellate Tribunal,
a representative of the profession of Chartered Accountants
may be thought of. Such a body will, it seems to me, command
respect and bring to bear on the issue raised before it a
deep consideration from all aspects and points of view. The
decisions of this Board, on such of those issues as may be
common and of general application to all corporate sector,
can be adopted for, and applied uniformly to, all such
assessees by the issue of necessary circulars. In case, some
of these circulars are adverse to assessees and not acceptable
to them, they may be made challengeable in the Supreme Court
at the instance of the assessee. The course suggested will
have the advantage that, if on experiment it is found to be
practical, it can be extended to evolve a general procedure
by way of alternative to the cumbersome procedure of appeals
and references for solving fundamental, far-reaching and of
recurring problems on which there is controversy of judicial
opinion and which, in the normal course, it may take decide
or more to settle. This type of solution will also perhaps
be found quicker and relatively more expedient in direct tax
matters where large batches of cases involve a common point
lying in a narrow compass."

It is felt that the above suggestion is very practical
and should be implemented and applied to only public
undertakings but to the whole of the corporate sector.
6.7 **Modes of tax avoidance and tax evasion**

(I) Modes of income tax avoidance and evasion adopted by the tax dodgers, are varied and varying. Different methods are adopted by different 'persons' as defined for Income Tax in the Income Tax Act:

In so far as HUF is concerned, tax avoidance is practised (i) by throwing self-acquired property into common hotchpotch of the Hindu Undivided Family; (ii) by effecting partial partition in the joint family; (iii) by creating smaller HUFs within the main family; (iv) by retaining the ancestral property as the property of the joint family.

In all these methods, the intention is to avoid increase in the tax liability applicable to the higher income slabs. In the case of an individual, whose total income is taxable at the rate applicable to higher income slab, his efforts are to put the property to common hotchpotch of the HUF so that the income from such property is assessed in the hand of that HUF whose income including income of such property may attract lower rate of tax.

In the second method, if the income of the HUF is substantial, falling in the higher income slab and attracting higher rate of tax, a partial partition of HUF is carried out by allowing its one or more coparceners to claim partition. Thus, the HUF property is divided into two or more HUFs so that the total income of the HUF is liable to lower rate of tax. Partial partition may even result in reducing total
income of HUF and increasing income of an individual coparcener if it is so beneficial for purposes of reducing tax liability.

In the third method, instead of claiming partition of HUF property, the ancestral property is continued as HUF property thereby the income of an individual coparcener is not increased while continuing to gain the benefits of HUF property.

The HUF is a creation of law and within the provisions of the law and taking the benefits of judicial pronouncements, tax liability is avoided though the joint Hindu family exists for name sake.

These are only a few modes discussed above but in practice even individual property or business is converted into HUF property or business by creating new HUFs.

(II) As individual basis of assessment is followed in India, tax is avoided (i) by employing spouse as a highly paid employee of the firm, (ii) by admitting minors to the benefit of partnership. Apart from these accepted methods of tax evasion of registered firms, many more ingenious manipulations of income are done by multiplying the number of partnership firms and dissolving the existing firms. The partnership Act does not put any limitation on the creation of new partnerships and the procedure for the purpose are very simple. Similarly, the procedure of dissolution of a firm
is very simple and as it suits to the partners, these methods are employed making the assessing officers only as silent spectators.

Sometimes, HUFs are admitted in partnership as a partner so that the individual partner continues to earn income as a partner and as a coparcener of HUF.

(III) Some business houses who have control over groups of companies, manipulate the results by dealing in the shares of companies controlled by them. The outdated rules of valuation of perquisites which still exist also help in avoidance of tax.

(IV) People try to evade taxes by showing less income in the form of sale proceeds, interest or commission, etc. showing the closing stock as damaged in a year of profit or reducing the value of the closing stock, omitting a part of cash sales or sales on consignment and, in the case of professionals, not showing the names of customers in their books, using the goods for self consumption without recording them in the books of account; suppressing the production of goods or claiming more wastage than the actual wastage, crediting sales to proprietors or partners accounts or the binamidar's accounts without entering them in the sales account; not recording the purchases and sales of certain goods at all; suppressing income from speculation, rebate, discount, commission etc.
(V) Tax is also evaded through starting a new business or branch of an existing business and not disclosing income therefrom. In some cases, the assesses close the businesses and start new businesses or change the names of the business. They file a fresh return for the new business thereby reducing the income and avoiding track of the old business. The existing business is also split up within the members of the family or new business is started in the names of wife or children.

(VI) The shares of a company are also held under blank transfers, or in benami names and not disclosing either the investment made out of concealed profits or divided incomes. Many times the investments are not disclosed as they are made in the names of wife, children, grand-children etc.

Bank accounts and post office accounts are opened in fictitious names. House property or income yielding assets are also held in 'Benami' names.

(VII) The manufacturing concerns sell their scrap but do not record their sales in the books of accounts. They sell their goods at a premium but record these sales at controlled prices in their books of accounts. The purchases are inflated by obtaining bogus bills or by classifying domestic and household expenses as business expenses. Expenses in the form of salaries, insurance, advertisement, interest, commission, travelling are also inflated. Traders also purchase speculative losses from other parties. They
show bogus payments of salaries and bonus to employees or compensation for breach of contracts to retiring employees or paying lesser salary than for which a receipt is taken from the employees or agents and including in the muster roll salary of non-existing employees.

(VIII) Yet other methods employed for evading taxes consist of appointing bogus commission agents and paying them huge sums of commission. Employees are introduced as partners and paying them nominal salaries only and pocketing the difference. They show full fire insurance premium as expenditure while keeping back the rebate secretly realised from the insurance agents. They charge capital expenditure as revenue expenditure. They show a part of income as arising from racing by acting in collusion with printers and bookmakers. Underhand profit transactions take place with the help of 'loan racket' which operate on the basis of post dated cheques and bogus bundles. They obtain multiple expense vouchers by effecting chained sales by some bogus importers of raw material for industry.

The working group of the Administrative Reforms Commission, in order to facilitate the tracing out of untaxed money has given a more or less comprehensive list of avenues into which the evaded or unaccounted money is generally utilised. These are as follow:

______________________________
(1) Deposits with indigenous bankers i.e. those who discount hundies, with companies and firms with fictitious names or in the names of close relatives.

(2) Purchase of gold and jewellery and keeping them in safe deposit vaults or in secret valuts in homes.

(3) Purchasing without bills, raw materials and stocks, for purchases of business or manufacturing and selling the stocks so manufactured without bills in due course.

(4) Purchasing and hoarding of grains stock with a view to selling them in rising market.

(5) Purchasing quotas and licences illegally.

(6) Purchasing smuggled goods to be resold without bills.

(7) Payment of money towards purchase of land or house properties.

(8) Payment of premium towards purchasing running concerns or controlling interest in flourishing companies.

(9) Payment of pugree to secure residential properties.

(10) Utilisation of secret amounts held in foreign countries for imports, under invoicing such imports to the extent of such secret funds.

(11) Purchases of unauthorised foreign exchange to meet expenditure on visits abroad.
(12) Lavish household and personal expenditure.

(13) Meeting expenses on marriages, religious functions and social parties;

(14) Payment of bribes.

6.3 Detection of evasion cases -

In addition to the normal process of assessment, reassessments, reopening of assessments by the Income Tax Officers, there are provisions of 'search and seizure' which are specifically meant for detecting concealed income. Sections 132, 132A and 132B of the Income Tax Act, 1961 provide for search and seizure operations. A search has to be authorised by a Director of Inspection, Commissioner of Income Tax or a specified Deputy Director of Inspection, or Inspecting Assistant Commissioner. Where any money, bullion, jewellery or other valuable article or thing is seized, the income tax officer has, after necessary investigations, to make an order with the approval of the IAC within 90 days of the seizure, estimating the undisclosed income in summary manner on the basis of material available with him and calculating the amount of tax on the income so estimated, specifying the amount that will be required to satisfy any existing liability and retain in his custody such assets as are in the opinion sufficient to satisfy the aggregate of the tax demands and forthwith release the remaining portion, if any, of the assets to the person from whose custody they are seized. The books of accounts and other documents cannot be
retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approves of the retention for a longer period.

The results of the search and seizure provisions, however, are not very encouraging as seen from the details given below:

Sections 132, 132-A and 132-B of the Income Tax Act 1961 provide for search seizure operations. A search has to be authorised by a Director of Inspection, Commissioner of Income Tax, or a specified Dy. Director of Inspection or Inspecting Assistant Commissioner.

(a) The number of cases in which searches and seizures were conducted for the three years ending 1984-85 to 1986-87 was as under:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of cases where cash, jewellery etc. assets seized</th>
<th>No. of cases where no assets were seized</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>Value (₹ in thousands)</td>
</tr>
<tr>
<td>1984-85</td>
<td>1840</td>
<td>2,91,643</td>
</tr>
<tr>
<td>1985-86</td>
<td>2814</td>
<td>9,62,592</td>
</tr>
<tr>
<td>1986-87</td>
<td>4376</td>
<td>7,69,700</td>
</tr>
</tbody>
</table>
(b)(i) Particulars of orders under Section 132(5) passed during the three years ending 1986-87 were as under:

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening Balance of cases</th>
<th>Search cases during the year</th>
<th>Total</th>
<th>No. of cases where orders were passed during the year</th>
<th>No. of cases pending at the end of the year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-85</td>
<td>882</td>
<td>1821</td>
<td>2703</td>
<td>756</td>
<td>1947</td>
</tr>
<tr>
<td>1985-86</td>
<td>1947</td>
<td>1853</td>
<td>3800</td>
<td>1252</td>
<td>2548</td>
</tr>
<tr>
<td>1986-87</td>
<td>2548</td>
<td>3325</td>
<td>5873</td>
<td>3678</td>
<td>2195</td>
</tr>
</tbody>
</table>

(b)(ii) Particulars of income determined in the orders under Section 132(5), tax involved therein, assets retained and assets returned of the three years ending 1986-87 were as under:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of cases where orders were passed</th>
<th>Income determined in the orders</th>
<th>Tax involved therein</th>
<th>Value of assets retained</th>
<th>Value of assets returned (£. in thousands)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-85</td>
<td>712</td>
<td>3,62,668</td>
<td>5,77,303</td>
<td>1,30,135</td>
<td>36,346</td>
</tr>
<tr>
<td>1985-86</td>
<td>1192</td>
<td>13,12,160</td>
<td>16,81,260</td>
<td>2,59,691</td>
<td>1,32,886</td>
</tr>
<tr>
<td>1986-87</td>
<td>1693</td>
<td>14,14,474</td>
<td>10,05,150</td>
<td>5,13,231</td>
<td>65,912</td>
</tr>
</tbody>
</table>
(c)(1) The number of search cases out of (b)(ii) where final assessments were completed and pending for the three years ending 1986-87 was as under:

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening Balance of Section 132(5)</th>
<th>Opening Orders of Section 132(5)</th>
<th>Total Orders under Section 132(5) passed during the year</th>
<th>No. of cases where final assessments were completed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-85</td>
<td>663</td>
<td>550</td>
<td>1213</td>
<td>330</td>
</tr>
<tr>
<td>1985-86</td>
<td>758</td>
<td>1361</td>
<td>2119</td>
<td>723</td>
</tr>
<tr>
<td>1986-87</td>
<td>1136</td>
<td>1443</td>
<td>2579</td>
<td>684</td>
</tr>
</tbody>
</table>

No, of cases where final assessments were completed where concealed income found:

<table>
<thead>
<tr>
<th>Year</th>
<th>1984-85</th>
<th>1985-86</th>
<th>1986-87</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-85</td>
<td>380</td>
<td>723</td>
<td>684</td>
</tr>
<tr>
<td>1985-86</td>
<td>75</td>
<td>260</td>
<td>285</td>
</tr>
<tr>
<td>1986-87</td>
<td>455</td>
<td>983</td>
<td>969</td>
</tr>
</tbody>
</table>

(c)(ii) Particulars of income determined, tax levied, balance tax outstanding after adjustment of value of assets retained on final assessment for the three years ending 1986-87 were as under:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of cases where final assessments were completed</th>
<th>Income Tax determined</th>
<th>Demand Raised</th>
<th>Total Demand adjusted</th>
<th>Balance out standing recovery</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-85</td>
<td>663</td>
<td>458646</td>
<td>205990</td>
<td>6922</td>
<td>212912</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>34781 174301 3830</td>
</tr>
<tr>
<td>1985-86</td>
<td>1596</td>
<td>1258208</td>
<td>758114</td>
<td>41322</td>
<td>799436</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>659999 696461 36976</td>
</tr>
<tr>
<td>1986-87</td>
<td>1475</td>
<td>866422</td>
<td>502553</td>
<td>4859</td>
<td>507412</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>78216 425176 4020</td>
</tr>
</tbody>
</table>

Demand adjusted out of retained assets:

<table>
<thead>
<tr>
<th>Year</th>
<th>1984-85</th>
<th>1985-86</th>
<th>1986-87</th>
</tr>
</thead>
<tbody>
<tr>
<td>1984-85</td>
<td>34781</td>
<td>174301</td>
<td>3830</td>
</tr>
<tr>
<td>1985-86</td>
<td>659999</td>
<td>696461</td>
<td>36976</td>
</tr>
<tr>
<td>1986-87</td>
<td>78216</td>
<td>425176</td>
<td>4020</td>
</tr>
</tbody>
</table>
(c)(iii) The number of cases of prosecutions launched, compounded and convictions obtained for the three years ending 1986-87 was as under:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of prosecutions launched</th>
<th>No. of cases</th>
<th>No. of cases in which convictions obtained</th>
<th>No. of cases pending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening</td>
<td>During</td>
<td>Total</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Balance</td>
<td>the year</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1984-85</td>
<td>1060</td>
<td>795</td>
<td>1855</td>
<td>86</td>
</tr>
<tr>
<td>1985-86</td>
<td>1769</td>
<td>1315</td>
<td>3084</td>
<td>361</td>
</tr>
<tr>
<td>1986-87</td>
<td>2723</td>
<td>931</td>
<td>3654</td>
<td>128</td>
</tr>
</tbody>
</table>

The details underlined above exhibit the results of the provisions of search and seizures. However, all such cases are disputed in appeal and the results of appeals are not available.

After introducing provisions for levy of penalty and prosecution for concealment of income, the provisions for 'search and seizure' came into force, and now the Direct Taxes laws (Amendments) Act, 1987 has introduced a new Section 158-B which came into force from 1.4.1989. Section 158-B provides levy of additional income tax at a flat rate of 30 per

cent on the excess of assessed income over returned income. According to this new Section 158-B, where in the case of any person, the assessed income exceeds the returned income by any amount, the assessing officer shall make an order that such person shall pay additional income tax on such excess amount at the rate of 30%. There is no requirement here that before making such an order the assessee shall be heard. There is no provision for appeal against such an order when made. This provision has been criticised as discriminating between tax payers in whose case additions are made by the assessing officers to the returned incomes and those in whose case no such additions are made. It is also a question whether these provisions would contravene article 14 of the Constitution which guarantees equality before the law.

6.9 **Business income never suffers income tax - effect of evasion**

Tax evasion or avoidance therefore, exists (i) in the computation of income from business or profession; (ii) in the application of rate structure or (iii) in concealing income from business or profession.

The effect of tax evasion is however, uniform or common. The tax revenue is reduced, more energy and money or time is wasted in gaining revenue which is not commensurate with this loss. However, the important effect is that income from business or profession never suffers income tax which it should have suffered. They recover tax from a consumer or
a customer and pay to the Government. Alternatively, they evade tax liability. Though tax is recovered, it is not paid to the Government or it is not recovered and not paid, depending upon market forces. This aspect needs detailed investigations by Government.

Five years plans of the Government require revenue on a very large scale for developmental schemes. There is competition in various States to obtain maximum allocation of revenue for Plan expenditure or developmental projects in their States. If spending on these projects is not done in time, there is a possibility of shifting these projects to other States or shelving them or dropping them altogether. This naturally results in unjudicious expenditure. In other words, the proper implementation of projects is not given the importance which it deserves. There is, therefore, ever-growing need for increase in revenue. This in turn, leaves no alternative but to increase the rates of tax or to introduce new taxes. There is always an expectation that higher income bracket assesses should contribute more to income tax revenue. This income bracket consists mainly of business or professionals.

Here a question arises as to how a business or profession pays tax? The answer may be that tax is paid by them from their income from business or profession. According to the plain meaning of the income tax law provisions, the answer is correct. Now say, there is an increase in the rate of tax and the quantum of income remains the same, whether
the same business or profession would pay the increased tax liability and accept the lower profits after tax, other things such as cost of the product or services of a business or profession remaining constant or the cost of living remaining constant. The business or profession cannot accept the lower profit after tax for long. This would discourage his business/profession and it would be unable to face competition in such business/profession. One day, the business or profession would be closed if it continues to pay tax honestly. Similar other business or profession around the honest business/profession would force the honest business to manipulate the dealings in such a way that percentage of the profit after tax would not decline. This may be called 'tax planning' practiced today or 'tax evasion' in legal terms. The effect is that the business or profession has not suffered due to increase in tax liability. In other words, in ordinary terms of meaning, the business income has not suffered the increase in tax, since profit after tax remains constant and there may be no increase in contribution to real revenue by such business/profession as a result of increase in rate of tax. The increase in tax revenue that appears in the Government account may be due to increase in quantum of business activity or due to inflationary trends. Thus, there would not be expected real increase in tax revenue and then Government would introduce new provisions or cancel existing concessions to raise the revenue required and the cycle of business dealings would repeat. This amounts to concealment
of the true income which is possible for a business or profession. In this process, only the class of fixed income group people suffer due to increase in tax liability as the rate of tax for the business/profession and the assessees having fixed income is the same i.e. it does not increase in proportion to rise in prices. The burden of increase in tax liability is passed on the tax payers who have less opportunity to manipulate their income. However, it has to be clarified here that this fixed income group cannot be called in general as free from tax evasion. They also indulge in earning side by side other income, each according to his capacity, from legal and illegal means. But the fact remains that the business/profession pass on their liability to increase tax to other class of the society which is more vulnerable. This is a subject which requires detail study at the Government level.

This reminds the period of the pre-budget days of January or February each year when the budget day or the day on which finance bill is presented to the State Legislature Assembly or Parliament. There is a pre-determined effort on the part of business community to speculate increase in taxes and prices are increased in anticipation. But once the price of a product or service is increased, it hardly comes to original level. In any case such an anticipatory price increase takes care for payment of increased tax on income from business/profession if any. Thus, the liability to additional tax, if any, is passed on the customer or consumer in anticipation. It is, however, argued that increase in price level due to
budget is temporary phase and should not be construed as on account of increase in taxes.

In a case of a building contract, an heavy income tax liability arising as a result of detection of a large concealed income is passed on to the flat owners. In addition to legal and illegal methods available to him to obtain reduction in tax liability through bribery, corruption or from appeals at various levels such as appellate asstt. commissioner, commissioner of income tax, settlement commissioner, tribunal, high courts, Supreme Court, the building contractor will simultaneously practise other ways and means which are open to him. He may use slightly inferior wood for wood work or useless cement, iron and steel or inferior quality of other raw material for construction works in progress and make good the 'loss' arising due to unexpected increase in tax liability.

Such a business may also increase the price per sq. ft. of construction or may charge in excess for the extra amenities that may be provided or economise the space or change the plans of construction. These activities are all aimed at recovering the amount of additional tax liability from the customers. In other words, such business would not meet the increase in tax liability from his predetermined income but will pass it on to the customers by hook or crook. This principle can be adopted by any business or profession with modification wherever necessary. Any business - manufacturing, trading or agency or profession would not allow its marginal returns to be affected by increase in tax liability. It may adopt either
any one or more methods mentioned below:

i) increase the price of goods or services;
ii) change the formula and use cheaper raw material in production or processing of goods;
iii) reduce the quantity for the same price charged previously;
iv) change the quality;
v) change the packing;
vi) drop the middleman;
vii) reduce the cost by any available method;
viii) inflate, manipulate, overstate the overhead expenses;
ix) change organisation of business/profession - say individual to partnership;
x) shift or discontinue one business and start the same in the garb of new.

All this and many more actions are affecting the customers and consumers. Whether incentives provided in the Income Tax law are available or not, they would continue to keep up the margin or profit or increase it according to increase in cost of living or according to available opportunities. They would raise hue and cry against tax liability but they are fully conscious that the business/profession would not be affected by increase in tax liability as the payment of tax is considered by them as primary cost of their business/profession and has to be passed on to consumers or customers without affecting their profits after tax.
This proposition is not easily acceptable as it is argued that income tax is a direct tax and it cannot be passed on to consumers or customers. If petrol prices are increased, everybody feels that prices of other commodities would shoot up but if income tax is increased or income tax liability is increased, it is expected that a business or profession should absorb it in its profits or gains. To what extent, this is possible is a matter of investigation.

The term 'tax avoidance' used in this Chapter has the same meaning as that of 'tax evasion'. However, tax avoidance is practised with the misuse of the loopholes in existing provisions of the law. In effect, tax avoidance with colourable devices amount to tax evasion.
CHAPTER - 7

'TAX PLANNING' - A TOOL TO PASS ON THE BURDEN OF TAX

7.1 The role of Tax Planning

7.2 Tax Planning and the provisions of Income Tax Act

7.3 Abusive use of plain meaning of the provisions of the Income Tax Act

7.4 Evasion of tax through Tax Planning

7.5 Tax avoidance by colourable and dubious devices

7.6 Tax Planning, an artful tax dodging

7.7 Instances of artful tax dodging

7.8 March of the judiciary against tax dodging
"For years a battle of manœuvrre has been waged between the legislature and those who are minded to throw the burden of taxation off their own shoulders on to those of their fellow subject. In that battle, the legislature has often been worsted by the skill, determination and resourcefulness of its opponents ....."

- Lord Greene, M.R.