# LEGISLATIVE AND JUDICIAL RESPONSES TO TAX EVASION AND TAX AVOIDANCE IN INDIA

**Samriddhi Gupta[*] Alysa Khandelwal[*]**

## ABSTRACT

*Taxation forms the fiscal foundation of the Indian state, yet persistent tax evasion and avoidance have undermined its revenue imperatives and distributional objectives. This paper examines the legislative and judicial responses to these twin challenges within India's evolving taxation framework, tracing their historical roots, structural causes, and contemporary regulatory architectures. The paper adopts a doctrinal research methodology, analysing primary legal sources, including statutory provisions, judicial decisions, and parliamentary amendments, alongside secondary academic literature, policy reports, and investigative disclosures, to evaluate the adequacy of India's anti-evasion framework. The paper begins by distinguishing tax evasion, an illegal concealment of income and assets, from tax avoidance, a legally ambiguous exploitation of legislative loopholes. Drawing on academic literature, OECD definitions, and foundational judicial pronouncements, it establishes the conceptual boundaries that have shaped Indian tax jurisprudence. It then charts the evolution of India's taxation system from ancient revenue practices through colonial income tax legislation to the enactment of the Income Tax Act, 1961 and the transformative pressures of post-liberalisation globalisation. A central concern of the paper is the structural deficiencies of the Income Tax Act, 1961, its inadequacy in regulating offshore corporate structures, indirect asset transfers, and benami transactions, illustrated through landmark controversies including the Vodafone case, the Panama Papers disclosures, and widespread GST fake invoice frauds. These cases reveal recurring vulnerabilities: treaty shopping through bilateral tax agreements, the pre-2012 legislative gap on indirect offshore transfers, and the exploitation of shell entities for fraudulent input tax credit claims. The judicial evolution across three distinct phases, strict Westminster formalism, the McDowell activist intervention of 1985 demanding substance over*

[*]BBA LLB (HONS.), FIRST YEAR, SYMBIOSIS LAW SCHOOL, PUNE.
[*]BBA LLB (HONS.), FIRST YEAR, SYMBIOSIS LAW SCHOOL, PUNE.

*form, and the calibrated post-Vodafone balance restored in Azadi Bachao Andolan, demonstrates the courts' ongoing effort to reconcile taxpayer rights with fiscal justice. This jurisprudential arc ultimately culminated in the statutory codification of the General Anti-Avoidance Rules under Chapter X-A of the Income Tax Act, effective from Assessment Year 2018-19. The paper also examines the broader legislative response, including the Prohibition of Benami Property Transactions Act, the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act 2015, the Prevention of Money Laundering Act, and GST enforcement mechanisms. Finally, it assesses the Income Tax Act, 2025, as a modernisation initiative emphasising digital governance, AI-driven scrutiny, and expanded powers over virtual digital spaces, while critically evaluating the constitutional concerns regarding privacy and algorithmic accountability that this transition raises. The paper concludes that while India's anti-evasion framework has matured considerably, its effectiveness requires continuous institutional adaptation, proportionate enforcement, and a principled balance between state revenue imperatives and the protection of fundamental taxpayer rights.*

**Keywords:** GST, Money laundering, Income Tax Act, Black Money.

## INTRODUCTION

Taxation is the process by which the government collects mandatory financial contributions from Individuals and Businesses. It is a payment without direct quid pro quo, which involves some type of compulsion because the taxpayers derive no direct benefit in paying taxes except the negative advantage that they would not be punished for violating the taxation laws of the state.[1] Article 265[2] Article 265 of the Indian Constitution provides that no tax shall be levied or collected except by authority of law. The main goal of taxation is revenue generation for government expenditure and other economic functions such as redistribution of wealth, deterring consumption and controlling inflation.

'Tax Evasion' and 'Tax Avoidance' are two very frequently referred to terms in economic and business relationships. People use these terms without even knowing their exact meaning and differences. It is often said that the debate between tax evasion and tax avoidance is as old as

[1] Bhargava RN, *The Theory and Working of Union Finance in India* (Chaitanya Publishing House 1971)
[2] Constitution of India 1950, art 265

taxation itself.[3] Different scholars have different views regarding the definition of tax avoidance and tax evasion.

Tax avoidance has no explicit definition under any act. However, the following definitions have evolved from academic literature and judicial rulings:

a. Justice Reddy[4] calls it the "art of dodging tax without breaking the law"
b. The Organisation for Economic Co-operation & Development (OECD) terms "tax avoidance as an arrangement of a taxpayer's affairs that is intended to reduce his liability and that, although the arrangement could be strictly legal, is usually in contradiction with the intent of the law it purports to follow.[5]
c. The European Court of Justice (ECJ) views tax avoidance as "artificial arrangements aimed at circumventing law";
d. The Carter Commission Report (Canada, 1966) states that tax avoidance is "every attempt by legal means to reduce tax liability which would otherwise be incurred by taking advantage of some provision or lack of provision in the law."[6]
e. The landmark Helvering v. Gregory[7] judgment says "anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes."

The common definition that comes out of all the above literature and rulings is that tax avoidance refers to the "Grey Area" of exploiting the tax laws of a country, to the extent that it is legally valid, to gain the maximum benefit possible as a taxpayer. There is often a thin line between acceptable tax avoidance, which is also called tax planning, and unacceptable tax planning.

Tax Evasion refers to "unlawfully escaping tax liabilities". It is an illegal practice. Section 276C[8] of the Income Tax Act, 1961 states the penalties and imprisonment for a wilful attempt

---

[3] Walter J Blum, 'Knetsch v United States: A Pronouncement on Tax Avoidance' (1961) Supreme Court Review 135, 135–36.
[4] McDowell v. Commercial Tax Officer, (1985) 154 ITR 148 (Supreme Court of India)
[5] OECD, 'Glossary of Tax Terms' http://www.oecd.org/document/29/0,3343,en_2649_34897_33933853_1_1_1_1,00.html (accessed 20 May 2026)
[6] Royal Commission on Taxation (Carter Commission), *Report of the Royal Commission on Taxation* (Canada 1966)
[7] *Helvering v Gregory* 69 F 2d 809 (2d Cir 1934)

to evade tax. It has been referred to as a criminal offence. Common methods include concealing income, falsifying records, underreporting turnovers and fabricating deductions.

Although both aim at reducing tax liability, there is a very clear distinction between tax evasion and tax avoidance based on legality, intention and legal consequences. The former is a crime, and the latter is merely a breach of the social contract. Tax evasion directly violates statutory provisions, whereas tax avoidance operates within the boundaries while exploiting legislative ambiguities.

## EVOLUTION OF TAX ADMINISTRATION AND EMERGENCE OF TAX EVASION AND TAX AVOIDANCE IN INDIA

The concept of taxation in India has existed since ancient times and was regarded as a very important element for maintaining public order and administration. Indian texts such as Kautilya's Arthashastra discussed systematic methods of revenue collection and explained in detail the importance of taxation.[8] During the Medieval and Colonial periods, taxation primarily focused on land revenue (Zamindari) and trade-related levies.

Under the British, the formal introduction of income taxation in India took place. The Income Tax Act, 1860[9] was enacted primarily with the purpose of financing British administrative and military expenditure. However, the colonial taxation system lacked a comprehensive framework for modern economic regulation. Procedures were largely manual and dependent upon bureaucratic discretion. These structural weaknesses influenced post-independence taxation administration.

Following independence, India adopted a welfare-oriented economic model that required substantial public revenue for national development, industrialisation, addressing poverty and welfare schemes. All this made taxation one of the most important instruments for fiscal governance. To establish a unified taxation framework, the government enacted the Income Tax Act, 1961. The act replaced earlier fragmented taxation laws and became the foundation of India's direct taxation system. Initially, the act functioned effectively within a relatively close

[8] 'Financial Administration in Kautilya's Arthashastra: Foundations for Economic Stability' (BA Notes, 2023) https://banotes.org/administrative-thinkers/financial-administration-kautilya-arthashastra-economic-stability/ (accessed 20 May 2026)

[9] Income Tax Act 1860

domestic economy that had limited international financial transactions and not so complex commercial structures.[10]

The economic liberalisation policies significantly transformed India's economic structure, as a result of which taxation systems faced new challenges that were not anticipated under the original framework of the Income Tax Act, 1961. Modern corporations began utilising offshore holding companies, transfer pricing mechanisms and tax havens to minimise tax liabilities. Globalisation increased the complexity of tax administration and created opportunities for tax avoidance strategies. Simultaneously, the rapid growth of industrialisation and private wealth also contributed to the expansion of black money, undisclosed incomes and illegal financial transactions. The structural weaknesses within the framework contributed significantly to the emergence and expansion of tax evasion practices. Factors that encourage tax evasion include high tax rates, complex procedural requirements, weak enforcement mechanisms and corruption within the system.

Traditional tax administration in India relied upon paper-based records, physical assessments and manual scrutiny procedures. With time, the absence of integrated digital databases made it difficult for authorities to verify taxpayer information, trace disclosed assets or monitor suspicious financial activities. The growth of the informal economy further facilitated tax evasion because large financial transactions remained outside formal monitoring systems. Hawala Networks and black money operations enabled individuals and corporations to transfer and conceal untaxed wealth through unofficial channels. These practices necessitated stronger legislative intervention, such as the prohibition of the Benami Property Transactions Act,1988[11] and Anti-Black Money legislation.

The increasing complexity of economic activities and financial systems created a need for modernisation. Traditional manual procedures gradually proved inadequate for addressing the challenges in a rapidly changing economy. The introduction of the GST under the Central Goods and Services Tax Act, 2017, further accelerated the transition towards digital governance in taxation administration. The Income Tax Act, 2025, represents a further stage

[10] S Kapoor and A Singh, 'Development of Indian Tax System: Pre and Post-Colonial Influences' (2025) 14(3) *FIIB Business Review* 261.

[11] *The Prohibition of Benami Property Transactions Act, 1988* https://www.indiacode.nic.in/handle/123456789/1840 (accessed 20 May 2026)

in this process of modernisation and restructuring. The act seeks to simplify taxation procedures, improve compliance and strengthen digital governance.

## LOOPHOLES AND SHORTCOMINGS IN THE INCOME TAX ACT, 1961

The Income Tax Act, 1961, was enacted with the purpose of establishing a comprehensive framework for direct taxation in India. However, as decades passed, the act continued to undergo amendments, insertions, exemptions and procedural modifications, which gradually transformed the act into a very complex statutory framework. Also, globalisation, liberalisation, and the emergence of digitalisation made the provisions of the act a little obsolete. The increasing complexity created interpretation difficulties for the taxpayers, administrators and the judicial authorities. The act indirectly contributed to the growth of tax evasion and aggressive tax avoidance because highly technical statutory provisions created opportunities for the exploitation of loopholes and interpretational ambiguities.

One of the shortcomings was the absence of clear legislative definitions. The distinction between lawful tax planning and impermissible became one of the most controversial issues within Indian tax jurisprudence. Courts were repeatedly required to determine whether a particular transaction was a genuine commercial activity or merely a device to avoid taxation. In McDowell & Co. Ltd. v. Commercial Tax Office,[12] the Supreme Court criticised artificial tax avoidance arrangements and condemned the abuse of legal form for reducing tax liability. Decided on April 17, 1985, by a Constitution Bench, McDowell is the cornerstone of anti-avoidance jurisprudence in India.[13] McDowell, a licensed liquor manufacturer in Andhra Pradesh, arranged for buyers to pay excise duty directly, keeping that amount outside its sales tax turnover.

Justice Ranganath Misra held for the majority that tax planning is legitimate only within the framework of law; colourable devices cannot form part of it, and citizens are obligated to pay taxes honestly.[14]

In his powerful concurrence, Justice Chinnappa Reddy repudiated the Westminster doctrine, which had permitted taxpayers to arrange affairs in any technically lawful manner, as outdated in a welfare state, invoking the English Ramsay principle to require courts to expose artificial

[12] *McDowell & Co Ltd v Commercial Tax Officer* (1985) 3 SCC 230, AIR 1986 SC 649
[13] *McDowell & Co Ltd v Commercial Tax Officer* (1985) 3 SCC 230, AIR 1986 SC 649
[14] *ibid* 824A (Ranganath Misra J)

devices for what they are.[15] McDowell laid the intellectual foundation for GAAR, though subsequent cases in Azadi Bachao Andolan (2003) and Vodafone (2012) clarified that it targets only sham transactions, not genuine commercial arrangements.[16]

Later on, in Union of India v. Azadi Bachao Andolan, the court adopted a liberal approach by recognising legitimate tax planning within the framework of law. The case clarified that a Mauritius Tax Residency Certificate sufficed to claim India-Mauritius DTAA benefits, exempting Mauritius-resident FIIs from Indian capital gains tax under Article 13(4). Azadi Bachao Andolan's PIL challenged the circular as enabling treaty shopping. On October 7, 2003, the Supreme Court upheld the circular, holding that a DTAA overrides conflicting Income Tax Act provisions; 'liable to tax' does not require actually paying tax; and treaty shopping is not illegal per se, availing expressly provided treaty benefits is legitimate tax planning, not a colourable device within McDowell's meaning. The judgment validated the Mauritius investment route and revived the Westminster principle for treaty contexts. However, it catalysed subsequent reform: the India-Mauritius and India-Singapore DTAAs were amended in 2016 to grant India source-based capital gains taxation rights on post-April 2017 acquisitions, and GAAR now requires commercial substance in treaty jurisdictions to sustain benefits.[17]

These conflicting approaches demonstrated the inability of the existing framework to clearly define boundaries between acceptable tax planning and abusive tax avoidance.

Another shortcoming was that the act was enacted during a period when international transactions and cross-border corporate structures were very limited. As globalisation expanded, the act was not adequate for regulating complex international taxation arrangements involving multinational companies and offshore investments. There was a clear absence of provisions relating to indirect offshore transfers and taxation of cross-border transactions involving Indian assets. This loophole became evident in *Vodafone International Holdings BV*

[15] *ibid* 809–10 (Chinnappa Reddy J, concurring), citing *WT Ramsay Ltd v Inland Revenue Commissioners* [1982] AC 300 (HL)
[16] *Union of India v Azadi Bachao Andolan* (2004) 10 SCC 1, 263 ITR 706 (SC); *Vodafone International Holdings BV v Union of India* (2012) 6 SCC 613
[17] Protocol Amending the Convention between the Government of the Republic of India and the Government of Mauritius for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (10 May 2016)

*v. Union of India,* which acquired a foreign company that indirectly controlled Indian telecom assets through offshore corporate structures.

In February 2007, Hutchison Telecommunications International Ltd. (HTIL), a Hong Kong entity, sold its 67% equity stake in CGP Investments (Holdings) Ltd. (CGP), a Cayman Islands company, to Vodafone International Holdings BV (a Dutch entity) for approximately US $11.08 billion. Through CGP's downstream subsidiaries, Vodafone thereby acquired control over Hutchison Essar Ltd. (HEL), India's leading telecom joint venture.[18]

Indian Revenue authorities demanded approximately Rs. 12,000 crore in capital gains tax under Section 9(1)(i) of the Income-tax Act, 1961, asserting that the offshore share transfer effectively transferred Indian assets.[19]

A bench of CJ S.H. Kapadia, Justice K.S. Radhakrishnan, and Justice Swatanter Kumar reversed the Bombay High Court on January 20, 2012. The Court held that the transaction was a single composite offshore share sale; the situs of CGP shares was outside India; Section 9(1)(i) did not then cover indirect transfers; and the Revenue could not invoke substance over form without first establishing that the structure was a sham, which it was not, given CGP's decade-long existence for genuine commercial purposes.[20] Vodafone was absolved of all liability.

Parliament responded with the Finance Act, 2012, inserting Explanation 5 to Section 9(1)(i) with retroactive effect from April 1, 1962, purporting to override the Supreme Court's ruling.[21] Vodafone initiated arbitration under the Netherlands-India Bilateral Investment Treaty; in 2020, the Permanent Court of Arbitration found the retrospective tax violated the fair and equitable treatment clause and barred India from collecting it.[22] The Taxation Laws (Amendment) Act, 2021, ultimately withdrew the retrospective amendment, restoring legal certainty for foreign investors.[23]

---

[18] *Vodafone International Holdings BV v Union of India* Civil Appeal No 733 of 2012, (2012) 6 SCC 613, 341 ITR 1 (SC)
[19] Income Tax Act 1961, s 9(1)(i)
[20] *Vodafone International Holdings BV v Union of India* (2012) 6 SCC 613, 73–79, 87
[21] Finance Act 2012, s 113 (inserting Explanation 5 to Income Tax Act 1961, s 9(1)(i) retrospectively from 1 April 1962)
[22] *Vodafone International Holdings BV v Republic of India* PCA Case No 2016-35, Award 220–35 (Permanent Court of Arbitration)
[23] Taxation Laws (Amendment) Act 2021

The growth of globalisation and international finance enables corporations and wealthy individuals to exploit offshore jurisdictions and tax havens for reducing tax liability and concealing financial assets. Offshore structuring involves the use of foreign holding companies, shell corporations, trusts, and layered financial arrangements located in low-tax jurisdictions. Tax havens provide low taxation, financial secrecy, weak disclosure requirements and protection of beneficial ownership information. These jurisdictions were frequently used for hiding undisclosed income, transferring profits, avoiding capital gain taxation and concealing ownership of assets. The Panama Papers expose the widespread global use of offshore shell companies and tax haven structures for concealing wealth and avoiding taxation obligations. In April 2016, the International Consortium of Investigative Journalists (ICIJ) and over 100 media partners published findings from 11.5 million documents leaked from Panamanian law firm Mossack Fonseca, exposing 214,000-plus offshore entities connected to people in over 200 countries, including 12 sitting or former world leaders.[24] In India, The Indian Express led the investigation (codenamed 'Project Prometheus'), revealing systematic use of offshore shell companies in British Virgin Islands, Cayman Islands, and Panama to shelter undisclosed wealth.

India's special task force probed the offshore affairs of 415 Indians, the country's largest-ever tax inquiry at that time.[25] A CBDT officer attended a 30-country response meeting in Paris just one week after publication, and India intensified enforcement under the Black Money Act, 2015, FEMA, and the Income Tax Act. Globally, governments have since recouped hundreds of millions in back taxes directly attributable to ICIJ investigations.[26]

The provisions of the Income Tax Act, 1961, lacked mechanisms for tracing beneficial ownership, monitoring offshore assets and ensuring effective disclosure of foreign financial holdings. Consequently, the government introduced stronger anti-black money legislation through the black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act,

[24] International Consortium of Investigative Journalists, 'The Panama Papers: Exposing the Rogue Offshore Finance Industry' (3 April 2016) https://www.icij.org/investigations/panama-papers/ (accessed 20 May 2026); 'Panama Papers' (Wikipedia) https://en.wikipedia.org/wiki/Panama_Papers (accessed 20 May 2026).
[25] International Consortium of Investigative Journalists, 'Panama Papers Have Had Historic Global Effects—and the Impacts Keep Coming' (1 October 2021) https://www.icij.org/investigations/panama-papers/20161201-global-impact/ accessed 20 May 2026
[26] International Consortium of Investigative Journalists, 'Tax Evasion & ICIJ Reporting: Governments Recoup Millions' (17 April 2025) https://www.icij.org/investigations/panama-papers/hundreds-of-millions-more-dollars-recouped-by-governments-after-icij-investigations/ accessed 20 May 2026.

2015. The act imposed stricter disclosure obligations, severe penalties and prosecution provisions for undisclosed foreign assets and income.

The Income Tax Act, 1961, in its traditional form, vested income tax authorities with extensive discretionary powers across a wide range of assessment and enforcement functions. Officers could select cases for scrutiny, determine the scope of inquiry, decide on the disallowance of expenses and deductions, impose penalties, and initiate prosecution, all within frameworks that permitted significant latitude in the exercise of official judgment. This structural grant of discretion, while intended to allow flexible and contextually appropriate administration, created the conditions for both legitimate administrative decision-making and its corrupt counterpart.

Empirical research into the phenomenon of corruption in India's income tax administration has consistently identified excessive discretionary power as the primary driver of corrupt behaviour. A study published in the Indian Journal of Finance surveyed taxpayers and found that the respondents identified "excessive discretionary powers available with income tax authorities" as the most significant reason for corruption. This was followed by "a lot of harassment to taxpayers" (62%), "lack of integrity on the part of tax officials" (61%), "lack of awareness regarding rights available to taxpayers" (55%), and "time-consuming and costly judicial process" (52%).

The study found that respondents across locations unanimously pointed to the role of excessive discretionary powers, suggesting that this is not a localised or idiosyncratic problem but a systemic feature of the administration. The monopoly power that tax officers exercise over their designated taxpayers, where, for a particular taxpayer, the tax officer is effectively the tax department, allows tax officers to extract corrupt benefits, while political interference at higher levels sustains and protects corruption at lower levels.[27]

A particularly significant example of institutional corruption emerged in early 2025, when the Central Bureau of Investigation charged a nexus of income tax officers and chartered accountants with rigging the Faceless Assessment Scheme, a system explicitly designed to eliminate human discretion. Raids were conducted across 18 locations in Delhi, Mumbai, Thane, West Champaran, Bengaluru, and Kottayam following the booking of a 2015 batch

---

[27] Mahesh C Purohit, 'Corruption in Tax Administration' in Anwar Shah (ed), *Budgeting and Budgetary Institutions* (World Bank 2007) 281 https://www.cabri-sbo.org/uploads/files/Documents/seminar_paper_2007_purohit.pdf accessed 20 May 2026.

Indian Revenue Service officer, Vijayendran R, who was posted as Deputy Commissioner at Central Circle-1 in New Delhi. According to the Income Tax Department's complaint, the officer leaked sensitive information to a network of chartered accountants who then exploited this information to sabotage the faceless assessment mechanism on behalf of wealthy clients.[28]

This case is particularly revealing because it demonstrates that even comprehensive systemic reforms designed to eliminate discretion can be circumvented by determined corrupt networks. The formal elimination of face-to-face contact did not sever the informal networks through which corrupt influence was exercised; it merely drove those networks underground and into digital channels.

The relationship between political power and income tax enforcement has been a persistent concern in India's governance landscape. Political organisations, corrupt politicians, and government officials who take bribes from foreign companies typically park or invest money abroad through hawala channels to evade tax authorities and legal implications.61 Conversely, the selective use of tax raid powers against political opponents has been widely alleged as an instrument of political intimidation, undermining public confidence in the neutrality of tax enforcement.

The most fundamental weakness in India's digital enforcement framework is the vast informal economy that operates largely beyond digital reach. India's shadow economy has been estimated to range from approximately 20-30% of GDP by the World Bank and other international institutions.46 A more recent study using the MIMIC model estimated that in 2022, the shadow economy accounted for approximately Rs. 1,076.82 lakh crore, equivalent to 41.1% of India's GDP. This informal sector largely remains outside the tax net due to non-registration under any law and a predominantly cash-based mode of operation that digital monitoring systems cannot easily track.

Only about 5% of India's population actually files tax returns (approximately 71.4 million returns were filed during the Financial Year 2021-22), with a large proportion of filers declaring income levels that are not subject to tax or that are only marginally so.[29] A study by

[28] 'Faceless Assessment "Scam": How Nexus of I-T Officers & CAs Rigged the System to Net Big Fish' *The Print* (7 February 2025) https://theprint.in/india/faceless-assessment-scam-how-nexus-of-i-t-officers-cas-rigged-the-system-to-net-big-fish/2483927/ accessed 20 May 2026

[29] PwC India, 'Addressing the "Tax Gap" in India' https://www.pwc.in/research-and-insights-hub/immersive-outlook/addressing-the-tax-gap-in-india.html accessed 20 May 2026.

the International Monetary Fund found that the informal sector, while shrinking, still represents up to one-third of India's economy. This means that a substantial portion of economic activity escapes digital monitoring entirely.

The Faceless Assessment Scheme, introduced through Section 144B of the Act as part of the Finance Act, 2020, was designed to eliminate personal contact between taxpayers and assessing officers, thereby reducing corruption and human discretion in assessment proceedings. While the scheme has achieved notable successes in reducing overt bribery and physical harassment, it has also generated serious new challenges. Critics have identified issues including technical glitches in the portal, inadequate acknowledgement of submissions, system-generated mismatches that do not reflect real-world facts, and a reliance on automated risk parameters that may not fully capture the complexities of individual taxpayer situations.

Furthermore, the virtual nature of faceless assessment does not alter the fundamental principles

of territorial jurisdiction established under the Act, and courts have repeatedly noted the tension between the centralised, location-agnostic approach of faceless assessments and the territorial organisation of judicial precedents in India's legal system. There have been numerous instances of assessments being quashed or set aside by courts, including the awarding of costs to taxpayers and judicial strictures, suggesting that the quality of assessment has not uniformly improved under the faceless scheme.[30]

Modern enterprises no longer maintain traditional physical books of account. Transaction histories reside on remote servers maintained by third-party vendors, often located outside India. Concepts such as "books of account" under the Act were originally framed in a physical-record era, and while they have been revisited to bring cloud-hosted data within enforcement access provisions, practical challenges remain, particularly where servers are located outside India.54 Expanding state access to private digital financial data raises concerns about proportionality and procedural fairness, and digital anomalies detected by automated systems do not automatically establish intent; software glitches, operational adjustments, or bona fide corrections require careful contextual evaluation.

[30] 'Faceless Assessment Under the Indian Income-Tax Regime: A Taxpayer-Centric Perspective' *Journal of Informatics Education and Research* (2 March 2026) https://jier.org/index.php/journal/article/view/4468 accessed 20 May 2026

A persistent structural constraint on digital enforcement is the technology access gap between different segments of India's population. Not all taxpayers have access to digital infrastructure, particularly in rural areas, which can hinder compliance and create inequitable enforcement outcomes. Small businesses and self-employed individuals in the informal economy lack the digital literacy and infrastructure to engage with mandatory digital compliance systems, creating a bifurcated enforcement environment in which formally employed taxpayers face increasingly sophisticated digital scrutiny while the informal sector remains substantially beyond reach.

## JUDICIAL AND LEGISLATIVE RESPONSE TO TAX EVASION AND TAX AVOIDANCE

Tax evasion, the illegal non-payment of taxes through concealment and fraud and tax avoidance, the legal but ethically contested exploitation of loopholes to reduce liability, are among India's most pressing financial challenges.

Justice Chinnappa Reddy, in *McDowell & Co. Ltd. v. Commercial Tax Officer (1985),* articulated their social costs: distortion of the economy through black money, a perpetual war between sophisticated avoiders and under-resourced tax authorities, and a pervasive sense of injustice among honest taxpayers.[31]

**GST Fake Invoice Scams and Shell Entities: Mechanics:** GST's self-policing design, where one taxpayer's output tax becomes another's Input Tax Credit (ITC), was weaponised by fraudsters creating shell entities that issue invoices for non-existent goods or services. Recipient companies claim fraudulent ITC, and credits are passed through networks of bogus firms registered using stolen Aadhaar and PAN credentials.[32]

**Scale:** Between FY 2020-21 and FY 2024-25, GST authorities detected evasion of approximately Rs. 7.08 lakh crore, including Rs. 1.79 lakh crore in fake ITC claims, across 91,370cases.[33] Fake ITC cases alone rose from 7,231 (Rs. 24,140 crore) in FY23 to 15,283 (Rs.

[31] *McDowell & Co Ltd v Commercial Tax Officer* (1985) 3 SCC 230, AIR 1986 SC 649 (Chinnappa Reddy J, concurring)
[32] 'Shell Firms, Circular Trading: Fake GST Invoice Frauds Continue Despite Safeguards' *Business Today* (8 February 2026) https://www.businesstoday.in/india/story/shell-firms-circular-trading-fake-gst-invoice-frauds-continue-despite-safeguards-515130-2026-02-08 accessed 20 May 2026.
[33] *ibid* (citing Written Reply by Minister of State for Finance Pankaj Chaudhary to Lok Sabha, August 2025).

58,772 crore) in FY25.[34] In November 2025, a Chennai-based racket of 95+ bogus entities across Tamil Nadu and Karnataka was busted, with evasion suspected to exceed Rs. 350 crore; in May 2026, Delhi Police's EOW arrested six persons in a Rs. 128 crore fake invoicing network.[35]

**Response:** Countermeasures include mandatory e-invoicing, biometric and Aadhaar-based registration verification, geo-tagging, an Invoice Management System for real-time reconciliation, and amendment of the CGST Act to make fake ITC claims cognisable and non-bailable with PMLA prosecution for large frauds.[36]

**Hawala Transactions and Black Money Operations:** Hawala is an informal value transfer system enabling cross-border fund movement without physical currency flows or banking channels, operating through a trust-based network of brokers

(hawaladars) who settle accounts through trade or cash. Banned in India under FEMA, 1999 and PMLA, 2002, and linked to terrorism financing under UAPA, 1967, hawala is systematically used to move black money, untaxed, unaccounted income offshore.[37] India's most notorious hawala scandal, the Jain Hawala Case of the 1990s, revealed a network operated by S.K. and N.K. Jain channelled kickbacks from arms dealers to senior politicians across party lines, prompting unprecedented Supreme Court oversight.[38] The World Bank estimates India's shadow economy at approximately 20% of GDP (~$490 billion); the Global Financial Integrity report (2022) calculated average annual illicit financial outflows of $64 billion.[39] Between 2005

[34] Arpit Kulshrestha, 'GST Fraud Alert: India Uncovers 24,109 Fake Invoice Cases in FY 2025-26' (SAG Infotech, 10 December 2025) https://blog.saginfotech.com/gst-fraud-alert-india-uncovers-24109-fake-invoice-cases-fy-2025-26 accessed 20 May 2026.
[35] 'Delhi EOW Busts ₹128 Crore Fake GST Invoicing Racket, Six Arrested' *Outlook India* (16 May 2026) https://www.outlookindia.com/national/delhi-eow-busts-128-crore-fake-gst-invoicing-racket-six-arrested accessed 20 May 2026
[36] TTaxTMI, 'GST Fake Invoicing Scams: Legal Loopholes, Crackdowns, and the Way Forward' (25 March 2025) https://www.taxtmi.com/article/detailed?id=13906 accessed 20 May 2026.
[37] Foreign Exchange Management Act 1999; Prevention of Money Laundering Act 2002; ClearTax, 'Hawala Money: Meaning, Transaction and How Do They Work' (25 June 2025) https://cleartax.in/s/hawala-money accessed 20 May 2026
[38] 'Hawala Scandal' (Wikipedia) https://en.wikipedia.org/wiki/Hawala_scandal accessed 20 May 2026
[39] Leveraged Growth, 'The Black Money Maze: Unravelling India's Shadow Economy' (7 October 2025) https://blog.leveragedgrowth.in/the-black-money-maze-unravelling-indias-shadow-economy/ accessed 20 May 2026.

and 2014, India ranked among the top five countries globally in illicit outflows, with cumulative losses estimated at USD 770 billion.[40]

## LOOPHOLES EXPLOITED: ECONOMIC AND LEGAL IMPACT

**Key Loopholes:** The cases above reveal recurring structural vulnerabilities:

a. treaty shopping through DTAAs lacking limitation-on-benefits clauses, exploited via Mauritius and Cayman structures.
b. the pre-2012 gap in Section 9(1)(i) permitting offshore holding structures for indirect transfers.
c. ease of shell company registration under GST, enabling fake invoice networks;
d. identity theft for fraudulent registrations
e. , cash-intensive sectors, and facilitating systematic income underreporting.[41]

**Economic Impact:** Tax evasion erodes the revenue base, forces deficit financing, distorts GDP statistics, and fuels inflation through black money accumulation. It widens inequality; the ratio of income between the top 3% and bottom 40% of India's population, when black economy income is included, jumps from 12:1 to 57:1.[42]

**Legal Impact:** Scandals have driven major reforms: GAAR (effective AY 2018-19), renegotiation of the India-Mauritius and India-Singapore DTAAs (2016), India's CRS participation for automatic information exchange, and GST Network analytics upgrades. The retrospective Vodafone amendment damaged investor confidence, and India lost international arbitrations before the Permanent Court of Arbitration in both Vodafone (2020) and Cairn Energy (2020), prompting the 2021 rollback.[43]

---

[40] 'Tax Evasion and Black Money in India: Causes and Solutions' (ResearchGate, December 2023) https://www.researchgate.net/publication/393634178_TAX_EVASION_AND_BLACK_MONEY_IN_INDIA_CAUSES_AND_SOLUTIONS accessed 20 May 2026.
[41] IP and Legal Filings, 'Cross-Border M&A in India: Legal Hurdles and Taxation Challenges Post-Vodafone Ruling' (6 October 2025) https://www.ipandlegalfilings.com/cross-border-ma-in-india-legal-hurdles-and-taxation-challenges-post-vodafone-ruling/ accessed 20 May 2026.
[42] 'Black Money – A Big Menace in Indian Economy' (JETIR 2018) https://www.jetir.org/papers/JETIR1810009.pdf accessed 20 May 2026.
[43] *Vodafone International Holdings BV v Republic of India* PCA Case No 2016-35, Award (Permanent Court of Arbitration); *Cairn Energy PLC v Republic of India* PCA Case No 2016-7, Award (21 December 2020); Taxation Laws (Amendment) Act 2021

## JUDICIAL INTERPRETATION OF TAX AVOIDANCE AND THE DOCTRINE OF SUBSTANCE OVER FORM

Indian tax jurisprudence has evolved through three distinct phases. In the pre-McDowell era, courts applied strict formalism derived from the Westminster doctrine: if a taxpayer fell outside the literal words of the taxing provision, no tax could be imposed. CIT v. A. Raman & Co. (1967) exemplified this approach, holding that the avoidance of tax liability by arranging commercial affairs so the charge is distributed is not prohibited, and a taxpayer may resort to any device to divert income before it accrues to him.[44] The McDowell phase (1985–2003) disrupted this consensus by demanding judicial scrutiny of substance over legal form, authorising courts to expose colourable devices and refuse them judicial benediction.

Post-Azadi Bachao Andolan and Vodafone (2003–present), the Supreme Court struck a calibrated balance: only artificial or sham transactions lacking a genuine commercial purpose attract intervention; the Revenue bears the burden of proof.[45]

The doctrine of substance over form empowers courts to look through a transaction's legal label and assess its economic reality. Originating in the UK's Ramsay principle and absorbed into Indian law through McDowell, the doctrine was codified by GAAR under Sections 95–102 of the Income Tax Act, 1961 (effective AY 2018-19). Under GAAR, an 'Impermissible Avoidance Arrangement' (IAA) is one whose main purpose is obtaining a tax benefit and which lacks commercial substance, including arrangements involving round-trip financing, accommodation entries, or disguised ownership structures.[46]

**Colourable Devices and Sham Transactions:** A 'colourable device' is an arrangement that mimics the legal form of a legitimate transaction but whose sole or dominant purpose is tax avoidance without genuine commercial substance. Justice Ranganath Misra in McDowell established that colourable devices stand outside permissible tax planning; citizens bear a constitutional and moral obligation to pay taxes honestly.

The identification of a sham requires courts to assess:

[44] *Commissioner of Income Tax, Gujarat v A Raman & Co* (1968) 1 SCR 10, 67 ITR 11 (SC) (Shah J) decided 18 July 1967.
[45] *Union of India v Azadi Bachao Andolan* (2004) 10 SCC 1; *Vodafone International Holdings BV v Union of India* (2012) 6 SCC 613
[46] Income Tax Act 1961, ss 95–102 (Chapter X-A) inserted by Finance Act 2012

A) whether any genuine non-tax commercial purpose exists
B) whether legal form reflects economic reality
C) whether steps were pre-ordained solely for a fiscal result.

In CIT v. Walfort Share & Stock Brokers (2010), the Supreme Court upheld arrangements with genuine commercial purposes, distinguishing them from shams.[47] Vodafone (2012) reinforced that the mere presence of a tax benefit does not make a transaction a colourable device; the Revenue must positively establish sham character before invoking substance over form or piercing the corporate veil.[48]

**CIT v. A. Raman & Co. and Evolution of Judicial Approach:** CIT v. A. Raman & Co. (1967) remains the foundational pre-McDowell statement of legitimate tax planning in India. The Court held that income which the taxpayer could have earned but chose to divert before it accrued is not taxable in the taxpayer's hands; the effectiveness of the diversion depends not on morality but on the operation of the Income Tax Act.[49]

Justice Chinnappa Reddy in McDowell criticised this formalism as insufficient for a welfare state, while Vodafone's 2012 judgment restored its core insight: legitimate tax planning within the law is protected; only sham transactions are not. The evolutionary arc, from Raman's strict formalism to McDowell's activism to the Azadi Bachao/Vodafone balance and finally GAAR's statutory codification, reflects the Indian judiciary's ongoing effort to reconcile rule-of-law certainty with fiscal justice.[50]

## ETHICAL AND CONSTITUTIONAL CONCERNS IN JUDICIAL INTERPRETATIONS

Justice Chinnappa Reddy in McDowell declared that there is as much moral sanction behind taxation laws as behind any other welfare legislation, and it is a pretence to say that avoidance is not unethical.[51]

---

[47] *CIT v Walfort Share & Stock Brokers (P) Ltd* (2010) 326 ITR 1 (SC)
[48] *Vodafone International Holdings BV v Union of India* (2012) 6 SCC 613, [79].
[49] *Commissioner of Income Tax, Gujarat v A Raman & Co* (1968) 1 SCR 10 (SC).
[50] Huzaifa Salim, 'Tax Evasion, Avoidance and Planning: Evolution of Jurisprudence' (Metalegal Advocates, 24 May 2025) https://www.metalegal.in/post/tax-evasion-avoidance-and-planning-evolution-of-jurisprudence accessed 20 May 2026.;'Tax Avoidance Jurisprudence in India' (2025) 13 NLSBLR https://repository.nls.ac.in/cgi/viewcontent.cgi?article=1067&context=nlsblr accessed 20 May 2026.
[51] *McDowell & Co Ltd v CTO* (1985) 3 SCC 230, 809 (SC) (Chinnappa Reddy J, concurring).

However, Vodafone recognised that the tax motive alone cannot render an otherwise lawful transaction impermissible. The test is objective commercial genuineness, not subjective intent. Constitutionally, Article 265 mandates that no tax shall be levied or collected except by authority of law, protecting citizens from executive or retrospective taxation unsupported by valid statutory backing.[52] Article 14's equality guarantee and Article 19(1)(g)'s right to trade have been invoked against discriminatory or economically prohibitive tax provisions. The Vodafone and Cairn Energy BIT arbitrations confirmed that retrospective taxation overriding completed transactions and final court judgments violates international fair and equitable treatment standards.[53]

These constitutional and international dimensions underscore that judicial interpretation of tax law must balance the state's revenue imperatives with the taxpayer's legitimate expectations and fundamental rights, a balance that remains dynamic and contested.

In more recent years, the Indian government has sought to balance assertive anti-evasion policy with investor confidence. The passage of the Taxation Laws (Amendment) Act, 2021, the operationalisation of GAAR from April 1, 2017, PMLA, Benami Transactions Act, Central Goods and Service Tax Act and the enactment of the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, collectively represent the mature legislative architecture of India's anti-evasion framework.

**General Anti-Avoidance Rules (GAAR):** The introduction of General Anti-Avoidance Rules in India represents the legislature's most systematic attempt to address aggressive tax planning that, while technically legal, undermines the spirit of the fiscal law. GAAR was first proposed in the Direct Tax Code Bill, 2009, and subsequently appeared in the Direct Tax Code Bills of 2010 and 2013, none of which were ultimately enacted.[54] GAAR was eventually introduced through Chapter X-A of the Income Tax Act, 1961, inserted by the Finance Act, 2012, replacing an earlier version substituted by the Finance Act, 2013.[55]

---

[52] India Const art 265 ('No tax shall be levied or collected except by authority of law').
'Article 265 & Constitutional Limits on Taxation Power in India: Shield Against Arbitrary Taxation' (Tax Guru, 26 February 2026); https://taxguru.in/finance/article-265-constitutional-limits-taxation-power-india-shield-arbitrary-taxation.html accessed 20 May 2026.
[53] *Vodafone PCA Award* (n 6); *Cairn Energy plc and Cairn UK Holdings Ltd v Republic of India* (Permanent Court of Arbitration Award, 21 December 2020) ('Cairn Energy PCA Award').
[54] 'General Anti-Avoidance Rule (India)' https://en.wikipedia.org/wiki/General_anti-avoidance_rule_(India) accessed 20 May 2026.
[55] 'General Anti-Avoidance Rules in India' (India Law Offices) https://www.indialawoffices.com/legal-articles/general-anti-avoidance-rules-in-india accessed 20 May 2026.

Section 95 of the Act, which forms the cornerstone of GAAR, provides that any arrangement entered into by an assessee may be declared an "Impermissible Avoidance Arrangement" (IAA), and the consequential tax treatment may be determined in accordance with Chapter X-A.[56] The non-obstante clause in this section ensures GAAR overrides all other provisions of the Act. Under Section 96, an arrangement qualifies as an IAA where its main purpose, or one of its main purposes, is to obtain a tax benefit, and where the arrangement: (a) creates rights or obligations not ordinarily found between arm's-length parties; (b) results in misuse or abuse of the provisions of the Act; (c) lacks commercial substance; or (d) is carried out in a manner not ordinarily employed for bona fide purposes.

The implementation of GAAR faced considerable delay owing to concerns about investor uncertainty and potential administrative overreach. Following widespread criticism, a review committee chaired by Parthasarathi Shome was constituted in July 2012 to recommend modifications. The Shome Committee recommended deferral of GAAR by three years and proposed several investor-friendly safeguards. The Government initially deferred implementation to 2016–17, and GAAR ultimately came into effect on April 1, 2017, applicable from Assessment Year 2018–19.[57]

Several important safeguards accompany GAAR's operation. The threshold for invocation requires that the tax benefit in the relevant assessment year exceed Rs. 3 crore (INR 30 million).[58] Grandfathering protection is extended to investments made before April 1, 2017, including bonus and split shares arising from such holdings. GAAR cannot be invoked where an arrangement has been approved by a court or tribunal and the tax consequences were explicitly examined. A multi-tiered procedural safeguard requires the Assessing Officer to refer potential GAAR cases to the Commissioner of Income Tax, who notifies the taxpayer, and may further refer the matter to an independent Approving Panel whose directions are binding on both tax authorities and the assessee.[59]

[56] Income Tax Act 1961, s 95, ch X-A, inserted by Finance Act 2012.
[57] General Anti-Avoidance Rules (GAAR): Provisions, Applicability in India' (ClearTax) https://cleartax.in/s/gaar-general-anti-avoidance-rules accessed 20 May 2026.
[58] India's GAAR Explained: Anti-Tax Avoidance Rules, Risks and Compliance Strategies' (India Briefing, 15 August 2025) https://www.india-briefing.com/news/indias-gaar-explained-anti-tax-avoidance-rules-risks-and-compliance-strategies-39244.html accessed 20 May 2026.
[59] General Anti-Avoidance Rule (GAAR)' (BYJU'S Exam Prep) https://byjus.com/free-ias-prep/general-anti-avoidance-rule-gaar/ accessed 20 May 2026.

Crucially, under Section 90(2A) of the Act, GAAR can override Double Taxation Avoidance Agreements (DTAAs), meaning that treaty benefits may be denied to an arrangement that qualifies as an IAA.[60] This override power distinguishes India's GAAR from the regimes of several comparable jurisdictions and has significant implications for multinational structuring.

**Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015:** The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (Act 22 of 2015) was enacted in response to longstanding concerns about offshore tax evasion by Indian residents. The National Council of Applied Economic Research estimated that illicit wealth accumulated outside India between 1980 and 2010 amounted to between USD 384 billion and USD 490 billion.[61] The Act received presidential assent on May 26, 2015, and came into effect on July 1, 2015, with operative tax provisions applying from April 1, 2016.[62]

The Act operates as a self-contained regime, supplementary to but separate from the Income Tax Act, 1961. Unlike the general income tax framework, the Black Money Act applies exclusively to persons who are residents of India in the relevant year, targeting undisclosed income from foreign sources and assets located outside India.[63] A 2019 amendment extended its applicability retrospectively to cover persons who, while currently non-resident, were resident at the time the asset was acquired or the income was earned.[64]

The Act's principal punitive architecture is threefold. First, undisclosed foreign income and assets are subjected to a flat tax rate of 30% on the fair market value of the asset or income, without the benefit of any deductions, exemptions, or set-off of losses available under the Income Tax Act.[65] Second, a penalty equal to three times the tax payable (i.e., 90% of the asset's fair market value) is imposed for non-disclosure, bringing total liability to

[60] *India Briefing* (n 59).
[61] The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015: An Introduction' (Lexology, 4 August 2021) https://www.lexology.com/library/detail.aspx?g=3f0230a3-9a41-4369-9d0c-8d299c7b116e accessed 20 May 2026.
[62] Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015' https://en.wikipedia.org/wiki/Black_Money_(Undisclosed_Foreign_Income_and_Assets)_and_Imposition_of_Tax_Act,_2015 accessed 20 May 2026.
[63] *The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015: An Introduction* (n 61).
[64] *General Anti-Avoidance Rule (India)* (n 54).
[65] The Undisclosed Foreign Income and Assets (Imposition of Tax) Bill, 2015' (PRS Legislative Research) https://prsindia.org/billtrack/the-undisclosed-foreign-income-and-assets-imposition-of-tax-bill-2015 accessed 20 May 2026.

approximately 120% of the value of the undisclosed foreign asset.[66] Third, willful evasion attracts criminal prosecution with imprisonment ranging from three to ten years.[67]

For non-compliance with return filing obligations relating to foreign assets, Section 42 of the Act imposes a penalty of Rs. 10 lakh for each year the asset was held without disclosure; Section 43 similarly penalises inaccurate disclosure of foreign assets in income tax returns.[68] In a notable departure from the Income Tax Act, the Black Money Act reverses the burden of proof, placing it on the taxpayer to demonstrate the legitimacy of foreign assets.

Upon its initial notification, the Act offered a one-time compliance window from July 1 to September 30, 2015, allowing assessees to declare undisclosed foreign assets and income. The penalty within this window was reduced to 100% of tax payable, as opposed to the standard 300%[69] and no criminal consequences ensued for voluntary declarations made within this period. Persons with pending assessments, ongoing prosecutions, or information received by the government before June 30, 2015, were excluded from this compliance window.[70]

The Finance (No. 2) Act, 2024, subsequently revised the penalty threshold, raising the exemption from the Rs. 10 lakh penalty from Rs. 5 lakhs to Rs. 20 lakhs for all asset classes other than immovable property, responding to concerns that penalties disproportionately burdened minor inadvertent non-disclosures.[71] The Act also empowers tax authorities to utilise advanced data analysis and information received through international agreements, including the Common Reporting Standard (CRS), to identify and tax undisclosed foreign assets.[72]

Taken together, the reforms addressed in this chapter, from the contentious retrospective amendments post-Vodafone, to the sophisticated anti-avoidance architecture of GAAR, to the

[66] Relief from Penalty for Small Value Assets Under the Black Money Law: Is It Adequate?' (Business Today, 3 September 2024) https://www.businesstoday.in/personal-finance/news/story/relief-from-penalty-for-small-value-assets-under-the-black-money-law-is-it-adequate-444164-2024-09-03 accessed 20 May 2026.
[67] Black Money Act: What is It & Its Importance' (Bajaj Finserv) https://www.bajajfinserv.in/investments/black-money-act accessed 20 May 2026.
[68] Non-Disclosure of Foreign Assets in the ITR: Ownership, Valuation & Threshold for Penalty Under the Black Money Act' (Lakshmikumaran & Sridharan Attorneys, 20 November 2025) https://www.lakshmisri.com/insights/articles/non-disclosure-of-foreign-assets-in-the-itr-ownership-valuation-threshold-for-penalty-under-the-black-money-act/ accessed 20 May 2026.
[69] *The Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015: An Introduction* (n 61).
[70] *Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015* (n 62).
[71] *Business Today* (n 66).
[72] eatures and Details of the Black Money Act, 2015' (KS & DK Advocates and Legal Consultants, 27 July 2024) https://ksandk.com/tax/black-money-foreign-income-assets-tax-act-2015/ accessed 20 May 2026.

stringent offshore compliance regime under the Black Money Act, illustrate India's increasingly assertive and multi-pronged legislative response to tax evasion and avoidance.

**Prohibition of Benami Property Act, 1988:** A benami transaction, as defined under Section 2(9) of the Prohibition of Benami Property Transactions Act, 1988 (as amended in 2016), is any arrangement where property is held in the name of one person while the consideration is paid by another, who reaps the true economic benefit. Such transactions have been a pervasive feature of India's economic landscape, historically prevalent in real estate, securities, and gold, enabling tax evasion, money laundering and the concealment of illicit wealth.[73]

The legal architecture governing benami transactions primarily comprises the Prohibition of Benami Property Transactions Act, 1988 (originally enacted with a mere 9 sections), which was fundamentally overhauled by the Benami Transactions (Prohibition) Amendment Act, 2016. The 2016 amendment, part of the Modi government's broader anti-corruption initiative, which expanded the legislation to 72 sections, introduced criminalisation, established specialised adjudicating authorities with search and seizure powers, and integrated the framework with the Prevention of Money Laundering Act (PMLA) and the Income Tax Act. Violations carry rigorous imprisonment of up to seven years and a fine extending to 25% of the fair market value of the benami property.[74]

Shell companies, entities with no active business operations or significant assets, constitute the corporate equivalent of benami structures. In the domestic context, shell companies are used to route income through fictitious entities, inflate expenses, claim false depreciation, and layer transactions to obscure ultimate beneficial ownership. The Income Tax Department's Benami Prohibition Units (BPUs) have used data-driven approaches to investigate such structures. In a documented case, using registry data on properties and companies and coordinating search operations across four cities, investigators secured evidence leading to the attachment of assets worth over Rs. 2.4 billion in a single case involving a retired civil servant.[75]

[73] Understanding India's Benami Transactions Act 1988 (Amended 2016)' (LawSection.in, 1 November 2025) https://lawsection.in/understanding-indias-benami-transactions-act-1988-amended-2016/ accessed 20 May 2026.
[74] *The Prohibition of Benami Property Transactions Act 1988* <https://www.indiacode.nic.in/bitstream/123456789/15415/1/the_prohibition_of_benami_property_transactions_act,_1988.pdf
[75] The Hunt for Benami Property: A Data-Driven Approach to Financial Investigation' (Asian Development Bank)https://www.adb.org/publications/the-hunt-for-benami-property-a-data-driven-approach-to-financial-investigation accessed 20 May 2026.

By 2023, enforcement actions under the Benami Act had enabled attachments exceeding Rs. 10,000 crores, targeting shell companies and structures used following demonetisation in 2016.[76] The post-demonetisation enforcement context revealed the extent to which benami transactions were used to absorb cash: a trader depositing Rs. 2 crores in black money into a relative's account following demonetisation, promising repayment, was treated as a benami transaction where no legitimate source was traceable. These enforcement actions, while significant, represented only a fraction of estimated benami holdings across India.

The connection between benami transactions and income tax evasion is direct and well-documented. By acquiring assets under fictitious or proxy names, individuals can avoid declaring these assets in their income tax returns, thereby evading capital gains tax, property tax, and other tax liabilities. This practice not only distorts economic transparency but also undermines the integrity of the tax system.[77] In the business context, individuals may show properties as belonging to third parties to inflate expenses or claim false depreciation, thus reducing taxable income. The corporate benami structure, involving shell companies holding assets for undisclosed principals, is especially prevalent in real estate and securities.[78]

Despite a strengthened legislative framework, benami transactions remain difficult to detect and prosecute. The investigation of benami structures is operationally complex because, as the Asian Development Bank noted, such properties are often concealed and typically revealed only during intrusive enforcement actions like searches.45 Enforcement resources are limited, the legal proceedings are prolonged, and the social and cultural normalisation of benami practices in certain contexts, particularly family property arrangements, creates enforcement ambiguities. The Supreme Court's ruling in *Ganpati Dealcom Pvt. Ltd. v. Union of India*[79] further complicated the retrospective application of the 2016 amendments, raising questions about the constitutionality of the retroactive provisions.

**Prevention of Money Laundering Act, 2002:** The Income Tax Act,1961, primarily focused on taxation and assessment procedures but lacked mechanisms for tracing and regulating the laundering of illegally acquired wealth. Unaccounted money generated through tax evasion

---

[76] Understanding India's Benami Transactions Act 1988 (Amended 2016)' (LawSection.in, 1 November 2025) https://lawsection.in/understanding-indias-benami-transactions-act-1988-amended-2016/ accessed 20 May 2026.
[77] Benami Transactions and Tax Evasion in India' (Bharat Law) https://bharat.law/opinions/benami-transactions-and-tax-evasion-in-india/ accessed 20 May 2026.
[78] Benami Transactions in Anti-Money Laundering' (AML Network, 7 January 2026) https://amlnetwork.org/aml-glossary/benami-transactions/ accessed 20 May 2026.
[79] *Ganpati Dealcom Pvt Ltd v Union of India* (2022) 7 SCC 736.

was often transferred through complex financial channels and layered transactions in order to disguise its origin. In response to growing concerns regarding illegal financial activities and global anti-money laundering obligations, the government enacted the Prevention of Money Laundering Act, 2002.[80] The enactment demonstrated that ordinary taxation statutes were inefficient for addressing increasingly sophisticated financial concealment.

GST enforcement and anti-fraud mechanisms.[81] The introduction of the Central Goods and Services Tax Act, 2017, represented one of the most significant tax reforms in India's taxation system.[82] It aimed at simplifying indirect taxation through a unified technology-driven framework. However, despite the modernisation efforts, the GST regime witnessed the emergence of large-scale tax frauds. One of the most significant challenges involved fake invoice scams and illegitimate input tax credit (ITC) claims. Fraudulent entity created Shell companies and generated fake invoices without the actual supply of goods or services in order to claim illegitimate tax credits and evade tax liability. The increase in scale of GST fraud forced authorities to introduce stronger anti-fraud mechanisms such as E-invoicing systems, Aadhar authentication and real-time transaction monitoring. The development of GST enforcement mechanisms reflected the glowing importance of digital governance within India's modern taxation framework.

**Strengthening Disclosure and Compliance Systems:** Traditional administrative systems relied heavily upon voluntary declarations and manual scrutiny procedures, which proved inadequate for monitoring in increasingly complex financial transactions. As a result, the government gradually introduced several reforms aimed at improving compliance and strengthening financial disclosure systems. These reforms included PAN integration, mandatory financial reporting, linking of bank accounts to Aadhaar cards, electronic filing systems, faceless assessments and integrated tax per databases.[83] The government also tried to strengthen the disclosure obligations relating to foreign assets, offshore accounts, high-value transactions and digital financial activities. The enactment of Black Money

[80] MM Sury, 'Black Money and Tax Evasion in India' (2014) 1(1) *VISION: Journal of Indian Taxation* 1 https://doi.org/10.17492/vision.v1i1.2412 accessed 20 May 2026

[81] *Prevention of Money Laundering Act 2002*; 'Prevention of Money Laundering Act, 2002' (Wikipedia) https://en.wikipedia.org/wiki/Prevention_of_Money_Laundering_Act%2C_2002 accessed 20 May 2026

[82] S Agarwal and S Shukla, 'GST 2.0: A Paradigm Shift Towards Simplified and Technology-Driven Taxation in India' (2025) 6(1) *Journal of International Commercial Law and Technology* 1871 https://doi.org/10.5281/zenodo 18081479 accessed 20 May 2026.

[83] Income Tax Department, 'Faceless Scheme' (2021) https://www.incometaxindia.gov.in/faceless-scheme accessed 20 May 2026.

(Undisclosed for Income and Assets) and the Imposition of Tax Act, 2015, further strengthened reporting obligations relating to undisclosed foreign assets and offshore wealth concealment. These developments reflect abroad shift towards digital governance and technology-driven compliance within India's taxation framework.

**Limitations of Existing Legislative Reforms:** Although the government introduced multiple anti-evasion laws and enforcement mechanisms, several limitations continue to exist. One major concern relates to procedural complexity, overlapping statutory framework and excessive compliance burdens imposed upon taxpayers. The coexistence of multiple anti-evasion statutes has increased regulatory complexity and occasionally resulted in overlapping jurisdictional powers among enforcement agencies. Another limitation involves administrative overreach, discretionary enforcement, and risk of misuse of investigative powers.

Digital governance mechanisms and enhanced surveillance powers have also generated concerns regarding privacy, data protection, algorithmic opacity, cybersecurity, and proportionality in enforcement. The expansion of technology-driven enforcement systems raises important constitutional concerns, particularly after Justice K.S. Puttaswamy v. Union of India recognised privacy as a fundamental right under the Constitution of India. Despite stronger anti-evasion frameworks, enforcement challenges continued due to international financial secrecy, the emergence of cryptocurrency transactions, digital concealment mechanisms, and rapidly evolving offshore financial structures. Therefore, while legislative reforms have strengthened India’s anti-evasion framework, the continuing evolution of financial technology and globalised commerce requires continuous adaptation, institutional accountability and balance between enforcement efficiency and protection of taxpayer rights.

**Income Tax Act, 2025, and Digital Governance:** One of the major criticisms of the Income Tax Act,1961, was its excessive complexity. Over several decades, the act underwent numerous amendments, insertions, explanations, and exceptions, making the legislation highly technical and difficult to interpret. The existence of complicated procedural provisions increased ambiguity and created opportunities for both tax evasion and aggressive tax avoidance. The earlier act was enacted during a period when international financial transactions were limited, digital economies did not exist, and commercial transactions were not at all complex.[84] This led to the proposal and enactment of the Income Tax Act, 2025, which was an attempt to address previous problems and another step towards digital governance.

The Income Tax Act, 2025, attempts to address these problems by restructuring and simplifying the statutory framework. The act seeks to reduce redundancy, reorganise provisions, and improve the readability of tax laws. One important reform involves the replacement of the complicated distinction between “assessment year" and "previous year” with a simpler concept of “tax year”.[85] This change aims to reduce confusion and improve taxpayers' understanding of assessment procedures.

The act reflects a major transition from paper-based administration towards digitally integrated tax governance systems. The earlier framework relied heavily upon manual records, physical documentation and direct interaction between taxpayers and tax authorities.[86] These methods became inadequate in regulating modern financial systems involving digital transactions, online banking, electronic commerce, cryptocurrencies and virtual financial assets. Consequently, the new act strengthens digital governance mechanisms through electronic filing systems, online compliance platforms, centralised digital administration, automated verification mechanisms, and integrated financial databases. These reforms aim to improve transparency, reduce procedural delays and improve the overall efficiency of tax administration.

Modern tax evasion and tax avoidance practices also exposed the inability of traditional manual written systems to effectively monitor complex financial activity. Tax evasion methods involve shell companies, fake invoicing, offshore structures and electronically manipulated financial arrangements that are difficult to detect through conventional administrative methods. In order to address these challenges, the Income Tax Act, 2025 promotes greater reliance upon artificial intelligence, predictive analytics, automated risk assessment systems and integrated data analysis mechanisms. AI-based scrutiny enables taxation authorities to identify suspicious transaction patterns, discrepancies in financial disclosures, unusual financial behaviour, and possible concealment of taxable income or potentially underreported income. Integrated

[84] ‘Taxation of the Digital Economy in India: Challenges under the Income-tax Act and GST’ (Legal Service India, 13 May 2026) https://www.legalserviceindia.com/Legal-Articles/taxation-of-the-digital-economy-in-india-challenges-under-the-income-tax-act-and-gst/ accessed 20 May 2026
[85] PwC, ‘India – Corporate – Significant Developments’ (26 November 2025) https://taxsummaries.pwc.com/india/corporate/significant-developments accessed 20 May 2026
[86] Income Tax Department, ‘Form 3CB-3CD User Manual’ (2022) https://www.incometax.gov.in/iec/foportal/newformpage/forms/form3cb-3cd-UM accessed 20 May 2026

databases and income and automated verification systems further strengthen coordination between taxation authorities, financial institutions and compliance monitoring systems.

One of the most significant developments introduced in proposed legislation is the recognition of “virtual digital space” within taxation enforcement mechanisms. The traditional framework of the Income Tax Act, 1961, lacked clear provisions relating to cloud storage digital records, digital communication systems, online trading platforms and virtual financial environments.[87] As financial activities increasingly shifted towards digital platforms, authorities felt a difficulty in accessing concealed electronic information during investigation and enforcement proceedings. The Income Tax Act, 2025, therefore expands investigative powers relating to digital information, digital communication systems, and electronically stored financial data during tax investigations. These reforms seek to address modern forms of digital tax evasion involving cryptocurrencies, concealed digital assets, online shell companies, and electronically disguised financial arrangements.

The proposed legislation significantly strengthens India's transition toward technology-driven tax governance and digital compliance systems. The reforms introduced under the new framework are expected to improve transparency, speed of assessments, reduction of corruption, compliance efficiency, and monitoring of sophisticated financial transactions. Technology-driven governance mechanisms enable authorities to monitor high-value financial activities, suspicious transaction patterns, undisclosed assets, and digitally concealed financial arrangements more effectively than under traditional taxation systems. The legislation, therefore, reflects a broader transformation from conventional administrative frameworks toward integrated digital governance structures emphasising automation, data analytics, and centralised compliance monitoring.

However, despite its modernisation objectives, the Income Tax Act, 2025, also raises significant constitutional and ethical concerns. The expansion of state access to digital financial environments and electronically stored information has generated debate regarding privacy, surveillance, proportionality, and protection of taxpayer rights. These concerns became particularly important after Justice K.S. Puttaswamy v. Union of India[88] recognised privacy as a fundamental right under the Constitution of India. Critics argue that broader access to emails,

[87] Income Tax Department, ‘Section 115BBH – Tax on Income from Virtual Digital Assets’ (2024) https://www.incometaxindia.gov.in/w/section-115bbh-2 accessed 20 May 2026
[88] *Justice KS Puttaswamy (Retd) v Union of India* (2017) 10 SCC 1

online accounts, cloud storage systems, digital communication platforms and electronic records may potentially conflict with constitutional protections relating to informational privacy and individual liberty.[89] Concerns have also been raised regarding excessive state surveillance, lack of procedural safeguards, data protection risks, cybersecurity vulnerabilities, and absence of transparency in AI-driven administrative decision-making systems.

Another important challenge associated with technology-driven tax governance relates to algorithmic opacity and digital exclusion. Increasing dependence upon automated systems and AI-based scrutiny mechanisms may create risks of erroneous assessments, a lack of accountability, and insufficient human oversight within taxation administration. Furthermore, many taxpayers, particularly those from economically weaker or rural backgrounds, may face difficulties in adapting to highly digitalised compliance systems due to a lack of technological literacy and access to digital infrastructure.[90] Rapidly evolving financial technologies such as cryptocurrencies, decentralised finance systems, and anonymous digital transactions also continue to create enforcement challenges despite modernisation efforts.[91]

Therefore, while the Income Tax Act, 2025, represents a major step toward modernisation of India's taxation framework and addresses several structural weaknesses of the earlier taxation regime, its effectiveness will ultimately depend upon the ability of the legal and administrative system to balance efficient tax enforcement with constitutional safeguards, transparency, accountability, and protection of taxpayer rights within increasingly digital governance structures.

## CONCLUSION

The evolution of India’s taxation framework reflects the changing nature of economic systems, financial structures and governance mechanisms within the country. The study demonstrates that while the Income Tax Act, 1961, served as the foundation of India’s direct taxation system for several decades, its increasing complexity, interpretational ambiguities, weak international

[89] Rödl & Partner, ‘Privacy vs Transparency: The Constitutional Dilemma of India’s DPDP Act’ (2026) https://www.roedl.it/en-gb/it/insights/Pages/Tech-Data-Bites/3-26/privacy-vs-transparency-constitutional-dilemma-india-dpdp-act.aspx accessed 20 May 2026

[90] Abhishek Tripathy, ‘Challenges of Digitalization for Tax Administrations’ (IMF Conference Presentation, 2024) https://www.imf.org/-/media/files/conferences/2024/13-imf-japan-conf/presentations/abhishek-tripathy-india-challenges-of-digitilization-for-tax-administrations.pdf accessed 20 May 2026

[91] ‘Regulating the Unregulated: India’s Legal Conundrum with Cryptocurrencies’ (SCC Online, 23 January 2026) https://www.scconline.com/blog/post/2026/01/23/regulating-unregulated-india-legal-conundrum-cryptocurrencies/amp/ accessed 20 May 2026

taxation provisions, inadequate digital enforcement mechanisms and absence of strong anti-avoidance frameworks gradually created opportunities for tax evasion and aggressive tax avoidance practices. The emergence of offshore structuring, shell companies, Benami transactions, fake invoicing and digitally concealed financial arrangements exposed serious structural limitations within the traditional taxation administration systems to effectively regulate modern financial realities. Judicial intervention and enactment of specialised anti-evasion legislations such as General Anti-Avoidance Rules, Prohibition of Benami Property Transactions Act, 1988 and Prevention of Money Laundering Act, 2002, reflected the growing necessity of strengthening India's fiscal and regulatory framework.

The study further establishes that the proposed Income Tax, 2025, represents a significant attempt to modernise tax administration through simplification of tax laws, digital governance, faceless assessments, AI-based scrutiny and technology-driven compliance systems. These reforms seek to improve transparency, reduce corruption, strengthen enforcement efficiency and address many of the loopholes and administrative shortcomings that existed within the earlier framework. However, the transition toward digital tax governance also raises important constitutional and ethical concerns relating to privacy, surveillance, data protection and accountability within automated administrative systems. Therefore, while the Income Tax Act, 2025, marks an important step toward modernisation of India's taxation framework, its long-term effectiveness will depend upon maintaining an appropriate balance between efficient tax enforcement, technological advancement and protection of taxpayer rights within an increasingly digital and globalised economy.