CRITICAL ANALYSIS OF CRIMINAL PROSECUTION UNDER THE INCOME TAX LAW IN INDIA

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ABSTRACT

Criminal prosecution under the Income-tax Act, 1961 (now Income-tax Act, 2025) represents the strongest enforcement remedy available to the Indian revenue administration. Unlike assessment, interest and penalty, prosecution engages the coercive machinery of criminal law and exposes taxpayers, directors and other responsible persons to imprisonment, fine and serious reputational threat. This paper critically examines the statutory design, judicial doctrine and administrative practice of criminal prosecution under the Indian income-tax law. It argues that while prosecution is normatively justified in cases of deliberate evasion of tax, false verification, tax-deduction and deposit defaults and structured fraud, the present regime suffers from uneven administrative implementation and delay in taking such action of launching prosecution against the offenders. Particular attention is devoted to the relationship between prosecution and assessment, the role of *mens-rea*, the presumption of culpable mental state under section 278E of the Act, 1961 (section 490 of the new Act), sanction under section 279 of the Act, 1961 (sections 491 & 532 of the new Act) and the compounding process. The article contends that the legitimacy of criminal tax enforcement depends on principled selectivity, transparent standards and stronger safeguards against mechanical invocation. It concludes by proposing a calibrated prosecution policy that distinguishes serious fiscal crime from technical or debatable non-compliance, thereby reconciling deterrence with fairness and rule-of-law values. The Income-tax Act, 1961 shall hereinafter be referred to as "the Act, 1961" and the Income-tax Act, 2025 shall hereinafter be referred to as "the new Act" for the sake of brevity.

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Aims of the Study

This paper aims to clarify the doctrinal boundaries and evidentiary requirements for criminal prosecution under the Income-tax Act, with special focus on wilfulness and *mens-rea;* assess as to how administrative practice (sanction, complaint drafting, compounding) affects the fairness and effectiveness of tax prosecution.

Objectives of the Study

To achieve the above aims, this paper pursues the following objectives:

1. To examine the statutory provisions and recent amendments (including graded punishment and substitution of simple imprisonment) relevant to tax prosecution.

2. To analyse leading judicial decisions to identify doctrinal constraints and safeguards.

3. To evaluate administrative practice across sanction, complaint filing and compounding to identify recurring deficiencies (mechanical invocation, delay and lack of thresholds).

4. To examine the role and limits of section 278E[3] (presumption as to culpable mental state) in light of *mens-rea* principles.

5. To offer practical drafting and institutional recommendations (reasoned sanction orders, mandatory review after appellate relief and transparent compounding criteria).

6. To propose policy and procedural reforms to make prosecution selective, effective, transparent and proportionate.

1. Introduction

A modern tax system requires not only sound legislation and efficient administration but also credible enforcement. In a self-assessment regime, non-compliance may attract interest, penalties or, in serious cases, criminal prosecution. Criminal prosecution under income-tax law is both necessary and controversial. While it is needed to address serious misconduct such as evasion, fabricated records, false statements and non-remittance of tax deducted at source, its

[3] Section 278E of the Act, 1961

overuse is risky because tax liability often involves interpretation and factual complexity. Broad deployment of prosecution may therefore convert uncertain tax disputes into coercive criminal proceedings and weaken confidence in fair administration. The Indian legal framework reflects both concerns under the direct tax law. Chapter XXII of the Act, 1961 (retained as same Chapter XXII in the New Act) creates a wide range of tax offences, including wilful attempt to evade tax, failure to furnish returns, false verification and defaults in relation to tax deducted at source and tax collected at source. At the same time, the law incorporates certain safeguards such as sanctions for prosecution and the possibility of compounding. Yet in practice, the line between legitimate deterrence and excessive criminalisation remains difficult to maintain.

This article examines criminal prosecution under the Income-tax Act through both doctrinal and administrative lenses. Its core argument is that the existing regime is justified in principle but inconsistently disciplined in operation. The most serious challenge is not the existence of criminal tax offences as such, but the absence of a sufficiently transparent, proportionate and evidence-sensitive policy governing their use. The article proceeds in six parts. It first outlines the conceptual basis for criminal tax enforcement. It then maps the statutory framework and key offences. Next, it analyses major judicial decisions on the relationship between assessment, penalty and prosecution, with particular emphasis on *mens rea* and burden-shifting. It then turns to the administrative architecture of sanction, complaint filing and compounding. Finally, it proposes reforms aimed at aligning prosecution practice with constitutional fairness, prosecutorial restraint and effective deterrence.

2. The Normative Basis of Criminal Prosecution in Tax Law

The criminalisation of tax violations is justified by three principal considerations: deterrence, public condemnation and protection of the revenue system. Prosecution deters intentional evasion by imposing risks that civil penalties may not, expresses that deliberate tax fraud is a public wrong rather than a routine dispute and protects the integrity of a self-reporting system that depends on truthful disclosure and remittance. At the same time, these justifications do not support indiscriminate prosecution. Criminal law must remain confined to serious and blameworthy misconduct, not errors, negligence or arguable interpretive positions that fail on appeal. A principled tax prosecution regime should target intentional wrongdoing and leave ordinary disputes to civil mechanisms.

3. Statutory Framework under the Act, 1961 vis-à-vis the New Act

3.1 Criminal prosecution under the income-tax law in India is principally governed by Chapter XXII of the Act, 1961[4], read with section 279 of the Act, 1961 (sections 491 & 532 of the new Act) and related procedural provisions. The scheme covers a broad range of conduct, some directly linked to tax evasion and some connected to the administration of the statute. The most frequently invoked provisions include sections 276C, 276CC, 276B, 276BB, 277, 278, 278B, 278E and 279 of the Act, 1961 (corresponding sections 478, 479, 476, 477, 482, 484, 487, 490, 491 & 532 of the New Act).

3.2 Analysis of Amendments Relating to Prosecution Provisions enumerated in the Act, 1961 vis-à-vis the New Act - This study comparatively analyses the prosecution provisions contained in the Act, 1961, as amended by the Finance Act, 2026, and the corresponding provisions of the New Act, as amended by the same Finance Act.

3.2.1 Substitution of "Rigorous Imprisonment" with "Simple Imprisonment"

The prosecution-related provisions under Chapter XXII of the New Act[5], have undergone a significant legislative modification through the Finance Act, 2026[6]. One of the most notable changes is the replacement of the expression "rigorous imprisonment" with "simple imprisonment" throughout the prosecution chapter in both enactments. Under Section 4 of the *Bharatiya Nyaya Sanhita*, 2023[7], imprisonment is classified into two categories, namely rigorous imprisonment, which involves compulsory hard labour, and simple imprisonment, which does not require the convict to perform hard labour. By substituting rigorous imprisonment with simple imprisonment, the legislature has consciously diluted the severity associated with custodial punishment under tax laws. Although imprisonment continues to remain part of the penal framework, the amendment indicates a perceptible shift in legislative policy. Tax offences are now being treated more as economic and regulatory violations rather than offences involving violence or moral depravity. Consequently, while deterrence has been retained, the punitive harshness attached to such offences has been moderated. These amendments came into force from 1 April 2026 in relation to the New Act and from 1 March

[4] Retained the same as Chapter XXII in the Income-tax Act, 2025
[5] Corresponding to Chapter XXII of the Act, 1961
[6] Act No.4, 2026 [received the assent of the President of India on 30.03.2026]
[7] Corresponding section 53 of the Indian Penal Code

2026 in relation to the Act, 1961.

3.3 Introduction of a Graded Punishment Mechanism

Prior to the amendments introduced by the Finance Act, 2026, the prosecution provisions contained in Chapter XXII prescribed imprisonment ranging from three months to seven years for a variety of defaults and offences. These included, inter alia, wilful tax evasion, failure to remit TDS or TCS, furnishing false statements, falsification of books of account, non-filing of returns, abetment of false verification, and non-compliance with statutory directions issued by tax authorities.

3.3.1 Graded Structure of Punishment

The Finance Act, 2026 has introduced a graded sentencing framework whereby the extent of punishment is linked to the quantum involved in the offence. The revised provisions seek to establish proportionality between the seriousness of the offence and the punishment imposed.

Under the amended framework, prosecution consequences are broadly structured as follows:

- where the amount involved exceeds Rs.50 lakh, the offender may be punished with simple imprisonment extending up to two years, or with fine, or with both;
- where the amount involved is between Rs.10 lakh and Rs.50 lakh, the punishment may extend to simple imprisonment up to six months, or fine, or both;
- where the amount involved is below Rs.10 lakh, only monetary penalty in the nature of fine may be imposed;
- certain other procedural or technical defaults have been decriminalised to the extent that they now attract only fine without custodial punishment.

This amendment reflects a movement towards a more calibrated and proportionate prosecution regime. The earlier framework often prescribed severe imprisonment irrespective of the monetary magnitude of the default. The revised approach attempts to distinguish between substantial tax fraud and comparatively minor or technical non-compliances.

The amended provisions affecting various offences under the New Act and the corresponding provisions of the Act, 1961 may be summarised as follows:

Provision	**Nature of Offence**	**Position Prior to Amendment**	**Position After Amendment**
Section 473 / Section 275A	Violation of restraint order relating to property	“Rigorous imprisonment up to two years and fine”	“Simple imprisonment up to two years and fine”
Section 474 / Section 275B	Failure to provide access to books and documents during search	“Rigorous imprisonment up to two years and fine”	“Simple imprisonment up to six months, or fine, or both”
Section 475 / Section 276	Concealment or transfer of property to obstruct tax recovery	“Rigorous imprisonment up to two years and fine”	“Simple imprisonment up to two years and fine”
Section 476 / Section 276B	Failure to deposit TDS or tax relating to online gaming/VDA	“Imprisonment from three months to seven years and fine”	Graded punishment introduced
Section 477 / Section 276BB	Failure to deposit TCS	“Imprisonment from three months to seven years and fine”	Graded punishment introduced
Section 478 / Section 276C	“Wilful attempt to evade tax, penalty or interest”	Imprisonment up to seven years depending on amount involved	Graded punishment introduced
Section 479 / Section 276CC	“Failure to furnish return of income”	“Imprisonment up to seven years depending on tax sought to be evaded”	Graded punishment introduced
Section 480 / Section 276CCC	“Failure to furnish block return in search cases”	Imprisonment from three months to three years and fine	Graded punishment introduced
Section 481 / Section 276D	Failure to comply with special audit directions	“Imprisonment up to one year and fine”	“Simple imprisonment up to six months, or fine, or both”
Section 482 / Section 277	False verification or false statement	Imprisonment up to seven years depending on amount involved	Graded punishment introduced
Section 483 / Section 277A	Falsification of books or documents	“Imprisonment from three months to two years and fine”	“Simple imprisonment up to two years and fine”
Section 484 / Section 278	Abetment of false return or tax evasion	Imprisonment up to seven years depending on amount involved	Graded punishment introduced
Section 485 / Section 278A	Repeat offences	“Imprisonment from six months to seven years and fine”	“Simple imprisonment from six months to three years and fine”
Section 494 / Section 280	Unauthorised disclosure by public servant	“Simple imprisonment up to six months and fine”	One month imprisonment, or fine, or both

The amendments are operative from 1 April 2026 for the New Act and from 1 March 2026 for the Act, 1961. However, as a general principle of criminal jurisprudence, the penal consequences applicable to an offence are ordinarily determined according to the law prevailing on the date on which the offence was committed. This principle received judicial recognition in CIT v. Onkar Saran & Sons[8]. Accordingly, offences committed prior to the commencement of these amendments may continue to be governed by the earlier prosecution framework prescribing rigorous imprisonment and higher custodial exposure.

A. Section 276C of the Act, 1961 : Wilful Attempt to Evade Tax, Penalty or Interest (Section 478 of the New Act)

Section 276C (Section 478 of the new Act) is the central anti-evasion offence. It criminalises a **wilful attempt** to evade tax, penalty or interest. The language is significant. The term "attempt" expands the provision beyond completed evasion, while the word "wilful" narrows it to conscious and blameworthy conduct. This provision is generally invoked in cases involving concealment of income, sham transactions, fabricated expenses, bogus accommodation entries, suppression of receipts, falsified books or other deliberate devices aimed at defeating tax liability.

B. Section 276CC of the Act, 1961: Failure to Furnish Return of Income (Section 479 of the new Act)

Section 276CC (479 of the new Act) addresses the failure to furnish returns of income in due time in circumstances contemplated by the Act. Given that return filing is the basic entry point of the self-assessment system, this provision has considerable compliance significance. Judicial interpretation has clarified that subsequent filing does not necessarily erase an earlier prosecutable default where statutory conditions are met.

C. Section 276B of the Act, 1961: Failure to Pay TDS to the Credit of the Central Government (Section 476 of the new Act)

Section 276BB of the Act, 1961: Failure to Pay TCS to the Credit of the Central Government (Section 477 of the new Act)

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8 [1992] 195 ITR 1 (SC)

Section 276B (Section 476 of the new Act) deals with failure to deposit the TDS with the Central Government, while section 276BB (Section 477 of the new Act) addresses tax collected at source. These provisions are treated seriously because the deductor or collector is not merely dealing with its own funds; it is withholding or collecting amounts that the law regards as payable to the State. Persistent or deliberate retention of such sums can therefore attract criminal sanction even where the underlying business remains operational.

D. Section 277 of the Act, 1961: False Statement in Verification (Section 482 of the new Act)

Section 277 (Section 482 of the new Act) criminalises making a false statement in any verification under the Act or delivering an account or statement known to be false or not believed to be true. This offence goes to the heart of self-assessment because the tax system depends heavily on the authenticity of taxpayer declarations. It is particularly relevant where documents, declarations, confirmations or statements accompanying a return are knowingly false.

E. Section 278 of the Act, 1961: Abetment (Section 484 of the new Act)

Section 278 (Section 484 of the new Act) extends criminality beyond the principal offender to those who abet the making and delivery of false returns, accounts, statements or declarations. Its importance lies in addressing collaborative tax fraud involving accountants, intermediaries, entry operators, company officials or others who enable structured evasion.

F. Section 278B of the Act, 1961: Offences by Companies (Section 487 of the new Act)

Section 278B (Section 487 of the new Act) deals with offences committed by companies and attributes criminal liability to persons responsible for the conduct of the company's business, subject to statutory qualifications. This provision is central to corporate tax prosecution and raises important questions regarding vicarious liability and pleading standards.

G. Section 278E of the Act, 1961: Presumption as to Culpable Mental State (Section 490 of the New Act)

Section 278E (Section 490 of the new Act) creates a statutory presumption regarding culpable mental state in prosecutions requiring such a mental element. Although enacted to address evidentiary difficulties in economic offences, it represents a marked shift from ordinary criminal law, where the prosecution ordinarily bears the burden of proving mens rea. The provision has major implications for fairness and burden allocation, discussed later in this article.

H. Section 279 of the Act, 1961: Sanction and Compounding (Section 491 & 532 of the New Act)

Section 279 (Sections 491 & 532 of the new Act) serves as the procedural gateway to prosecution. It requires sanction by the competent authority before institution of criminal proceedings and also empowers compounding of offences in specified circumstances. This section is doctrinally and administratively crucial because it is intended to ensure that criminal law is not triggered casually or mechanically.

4. Major Offences and Their Legal Elements

4.1 Wilful Attempt to Evade Tax under Section 276C of the Act, 1961 (Section 478 of the New Act)

Among all tax offences, section 276C (Section 478 of the new Act) has the greatest symbolic and practical significance. It is the provision most closely associated with "tax evasion" in the strict sense. Yet the breadth of the phrase "wilful attempt" creates interpretive difficulties. The prosecution must establish not merely that tax was underpaid or avoided, but that the accused engaged in conduct intended to bring about such evasion. If section 276C of the Act, 1961 (section 478 of the new Act) is invoked every time, the Department succeeds in assessment; however, criminal law collapses into a punitive extension of adjudication.

A principled reading of section 276C (section 478 of the new Act), therefore, requires affirmative indicators of wilfulness, such as:

- fabricated or backdated documentation;
- suppression of material receipts;
- multiple books of account;
- bogus entries through accommodation networks;

- deliberate routing of income through opaque entities;
- systematic misreporting inconsistent with business reality; or
- post-detection conduct revealing consciousness of guilt.

The stronger the element of deception, the more justified the recourse to prosecution. Conversely, where the dispute turns substantially on inference, valuation, interpretation or estimation, the criminal route should be approached with caution.

4.2 Failure to Furnish Return under Section 276CC of the Act, 1961 Section 479 of the New Act)

Section 276CC, now section 479 of the 2025 Act, treats non-filing of returns as more than a minor procedural default. In a self-assessment regime, failure to file may frustrate assessment and conceal taxable income, particularly where it is deliberate or repeated. The real issue is when such non-filing becomes criminally culpable. Although defaults may arise from misunderstanding, illness, disorganisation or genuine uncertainty, the provision permits prosecution where statutory conditions are satisfied and the return is not filed within the legally prescribed time. Judicial interpretation has given the section significant operative effect. The policy concern, however, is proportionality. Criminal prosecution for non-filing is more defensible where:

- the taxpayer had substantial taxable income;
- notices were ignored;
- the default was repeated;
- the conduct appears deliberate rather than accidental; or
- the delay was used to defeat detection or frustrate the Department.

Where tax liability is marginal, taxes are substantially prepaid or the default is quickly cured without indications of concealment, civil enforcement may often be the more proportionate response.

4.3 Failure to Deposit TDS under Section 276B of the Act, 1961 (Section 476 of the New Act)

Section 276B, now section 476 of the 2025 Act, is distinctive because it concerns fiduciary non-compliance: tax deducted at source is held by the deductor as a statutory intermediary and does not belong to it. Using such deducted amounts for business purposes is therefore more serious than disputing one's own tax liability, and courts and tax authorities have often treated these defaults accordingly. However, not every delay is equally blameworthy. A brief operational delay differs from systematic retention of deducted tax as working capital, and relevant factors include the length and amount of default, recurrence, prior warnings, overall financial conduct and whether payments were made without remitting the related tax.

4.4 False Verification under Section 277 of the Act, 1961 (section 482 of the New Act)

Section 277 (Section 482 of the new Act) is central to the integrity of taxpayer declarations. It penalises false statements in verification and false accounts or statements known to be false or not believed to be true. Because self-assessment depends heavily on truthful filings, section 277 can be seen as protecting the evidentiary foundation of the tax system. This provision should be invoked especially where falsity is direct and demonstrable: forged certificates, knowingly false schedules, fabricated confirmations, false claims of exempt income, misdescribed ownership or deliberate inflation of deductions with fabricated support. The provision is normatively strongest where the prosecution can show not only inaccuracy but conscious falsity.

4.5 Abetment and Corporate Liability

Sections 278 (section 484 of the new Act) and 278B (section 487 of the new Act) enlarge the prosecutorial field. Tax fraud in contemporary practice is often collaborative and institutional. Shell entities, fake invoices, layered banking channels, falsified payroll systems and circular transactions may involve several actors. Abetment and corporate liability provisions are therefore necessary to avoid leaving the masterminds outside the reach of criminal law. At the same time, these provisions are susceptible to overreach. In corporate prosecutions, it is common for complaints to array multiple directors or officers without sufficient specification of their actual role. Merely holding office in a company should not automatically trigger criminal liability. Courts have repeatedly insisted, in analogous contexts and in tax prosecutions, that liability must be grounded in statutory language and supported by specific allegations of responsibility, consent, connivance or neglect.

5. The Relationship between Assessment, Penalty and Prosecution

One of the most difficult questions in tax criminal law is how prosecution relates to assessment and penalty. The three processes are formally distinct but factually intertwined. Assessment determines tax liability; penalty examines civil culpability under the statute; prosecution addresses criminal wrongdoing. Yet, all three may arise from the same set of facts. As a matter of legal structure, prosecution is not automatically dependent on the final outcome of assessment proceedings. Despite formal separation, prosecution often relies on factual findings developed in tax proceedings. This is especially true in concealment-based prosecutions under sections 276C (section 478 of the new Act) and 277 of the Act, 1961 (section 482 of the new Act).

6. Judicial Development of the Law

Indian courts, especially the Supreme Court, have significantly shaped the contours of tax prosecution. A few key decisions illustrate the doctrinal trajectory.

6.1 *P. Jayappan v. S.K. Perumal*[9]

In *P. Jayappan v. S.K. Perumal, First ITO*, the Supreme Court held in substance that prosecution need not invariably await the completion of reassessment or other tax proceedings. The decision affirmed the formal independence of prosecution and recognised that the criminal process need not be paralysed by the pendency of assessment. The significance of *Jayappan* lies in preventing abuse of procedural delay. However, the case should not be read as authorising prosecution irrespective of later tax findings. It only establishes that pendency alone is not an automatic bar.

6.2 *K.C. Builders v. Assistant Commissioner of Income Tax*[10]

In *K.C. Builders v. Assistant Commissioner of Income Tax*, the Supreme Court emphasized that where the basis of concealment is removed, prosecution founded on that concealment cannot

[9] (1984] 19 Taxman 1 (SC)/(1984] 149 ITR 696 (SC)/(1984] 42 CTR 180 (SC)(17-08-1934]

[10] (2004] 135 Taxman 461 (SC)/(2004] 265 ITR 562 (SC)/(2004] 186 CTR 721 (SC)(28-01-2004]

ordinarily survive. The case has become central to the proposition that criminal proceedings cannot continue when appellate findings erase the foundational allegation. Its importance extends beyond concealment penalties. It expresses a broader rule-of-law principle: criminal prosecution must remain tethered to actual, legally sustainable facts.

6.3 *Prakash Nath Khanna v. Commissioner of Income Tax*[11]

In *Prakash Nath Khanna v. Commissioner of Income Tax*, the Supreme Court interpreted section 276CC of the Act, 1961 in a manner that gave meaningful force to statutory filing deadlines. The decision rejected the argument that belated compliance automatically cures earlier prosecutable default. It signalled that return filing obligations are central to the revenue system and that wilful failure to comply may attract criminal consequences. This decision strengthened the Department's hand, but it also heightened the importance of administrative restraint. A broad reading of section 276CC of the Act, 1961 should not lead to indiscriminate prosecution for every delayed filing.

6.4 *Sasi Enterprises v. Assistant Commissioner of Income Tax*[12]

In *Sasi Enterprises v. Assistant Commissioner of Income Tax*, the Supreme Court again underscored the seriousness of failure to furnish returns and clarified aspects of section 276CC of the Act, 1961. The decision confirmed that prosecution may be maintainable even where the taxpayer seeks to regularise compliance later. Like *Prakash Nath Khanna*, it reinforces the view that tax filing duties form part of the substantive architecture of self-assessment rather than mere procedural formalities.

6.5 *Mens Rea* and Section 278E of the Act, 1961 (section 490 of the New Act)

Perhaps the most analytically difficult part of the judicial landscape concerns section 278E, which creates a presumption as to culpable mental state. Courts have generally accepted the validity of such presumptions in economic offences but the provision remains sensitive because it shifts practical burdens in criminal adjudication. A careful judicial approach requires two stages. First, the prosecution must prove the primary facts constituting the alleged offence. Second, once such facts are established, the presumption may operate regarding the mental

[11] (2004] 135 Taxman 327 (SC)/(2004] 266 ITR 1 (SC)/(2004] 187 CTR 97 (SC)(16-02-2004]

[12] (2014] 41 taxmann.com 500 (SC)/(2014] 222 Taxman 78 (SC)/(2014] 361 ITR 163 (SC)/(2014] 265 CTR 225 (SC)(30-01-2014]

element, subject to rebuttal by the accused according to the statutory standard. If the first stage is diluted, the presumption risks functioning as a shortcut around proof and undermining the moral logic of criminal law.

7. *Mens Rea*, Presumptions and Fairness

7.1 Why *Mens Rea* Matters in Tax Crimes

Mens rea remains central to distinguishing civil non-compliance from criminal wrongdoing. Tax law already contains extensive civil consequences. The reason prosecution exists in addition to these consequences is precisely because some conduct is not merely unlawful but blameworthy. Without a meaningful mental element, the line between civil and criminal sanction becomes unstable.

7.2 The Function of Section 278E of the Act, 1961 (section 490 of the New Act)

Section 278E (section 490 of the new Act) was enacted to overcome the difficulty of proving subjective intent in economic offences, where direct evidence of mental state is rare and wrongdoing is often concealed behind documents and corporate structures. The legislative concern is understandable. Sophisticated evaders rarely confess their intention and insistence on direct proof could render prosecution ineffective.

7.3 Risks of Over-extension

Yet the presumption under section 278E creates significant risks. If relied upon too early or too broadly, it may transform weak documentary suspicion into presumptive criminal guilt. This is particularly troubling where the underlying tax dispute is itself interpretive or where the alleged falsity depends on estimation rather than objectively false fact. A constitutionally sensitive application of section 278E should, therefore, require:

- proof of foundational facts independent of the presumption;
- strict scrutiny where the dispute is interpretive rather than deceptive;
- narrow construction of “wilful” in mixed-law-and-fact controversies; and

- careful judicial differentiation between inference of intent and automatic assumption of guilt.

7.4 Economic Offence Logic versus Criminal Law Morality

The broader jurisprudential issue is whether tax prosecution should increasingly resemble regulatory enforcement rather than classic criminal adjudication. The answer should be nuanced. Economic offences do justify evidentiary adaptations, but the moral seriousness of criminal conviction still demands that such adaptations not extinguish the requirement of genuine culpability. Otherwise, the law risks punishing mere unsuccessful compliance or negligent administration with the symbolic weight of criminal guilt.

8. Administrative Architecture of Prosecution

The law on the books is only part of the story. Tax prosecution is filtered through an administrative system that determines which cases become criminal complaints and which are resolved through civil consequences or compounding. This institutional layer is critical to understanding how the regime actually functions.

8.1 Initiation

Cases may emerge from regular assessment, reassessment, search and seizure operations, survey proceedings, TDS verification, information statements, data analytics or complaints from other agencies. The jurisdictional authority or relevant unit identifies potential prosecutable conduct and prepares a recommendation based on the material available.

8.2 Sanction under Section 279 of the Act, 1961 (sections 491 & 532 of the New Act)

Section 279 (sections 491 of the new Act) requires prior sanction by the competent authority. In theory, sanctions perform a vital screening function. It is intended to ensure that prosecution is launched only after a deliberate evaluation of legal ingredients, evidentiary sufficiency, gravity of conduct and administrative appropriateness. However, the effectiveness of this safeguard depends entirely on how the sanction is exercised. If sanction becomes a routine endorsement of departmental recommendations, it fails to protect against weak, premature or disproportionate prosecutions. A legally meaningful sanction order should demonstrate at least minimal application of mind to the facts, the offence charged, the available evidence and the reasons why criminal action is warranted.

9. Compounding of Offences

Compounding under section 279(2) of the Act, 1961 (section 491(4) of the new Act) is a distinctive feature of the Indian regime. It allows certain offences to be settled administratively on payment of compounding charges and fulfilment of prescribed conditions. Compounding serves practical purposes: it reduces criminal litigation, secures revenue, facilitates closure and allows flexibility in cases where a full criminal trial may be unnecessary or disproportionate.

9.1 Merits of Compounding

Compounding can be defended on several grounds:

- it recognises gradations of seriousness within tax offences;
- it avoids burdening criminal courts with cases better resolved administratively;
- it provides an exit route in cases where prosecution would be punitive but not especially productive; and
- it incentivises remediation and cooperation.

10. Corporate Prosecution and Vicarious Liability

Corporate taxation makes section 278B of the Act, 1961 (section 487 of the new Act) especially significant. Modern tax non-compliance may involve complex group structures, delegated finance teams, outsourced payroll systems and cross-border arrangements. In such contexts, identifying the relevant human actors is both necessary and difficult.

10.1 Justification for Vicarious Liability

Since a company acts through natural persons, prosecution would often be ineffective if only the juristic entity were arrayed as an accused. Section 278B of the Act, 1961 (section 487 of the new Act) ensures that those who were in charge of and responsible for the conduct of business are not shielded by the corporate form. It also extends to officers whose consent, connivance or neglect contributed to the offence.

11. Conclusion

Criminal prosecution under the Income-tax Act is both indispensable and risky. It is indispensable because serious misconduct such as evasion, false verification and retention of deducted taxes threatens the integrity of the tax system; it is risky because tax law is complex, tax liability is often contested and criminal proceedings are coercive and prone to overreach. The law attempts to manage this tension through requirements of wilfulness, sanction for prosecution and compounding, while judicial decisions such as *P. Jayappan*, *K.C. Builders*, *Prakash Nath Khanna* and *Sasi Enterprises* have refined the balance between assessment and prosecution. Yet concerns remain regarding the harshness of section 278E, mechanical sanction, overbroad corporate liability and insufficiently transparent compounding. A sound prosecution policy should therefore focus on serious dishonesty rather than routine tax disputes, with legitimacy measured by fairness, selectivity and consistency rather than volume.

12. Suggestions

12.1 Drafting and Filing of Complaint

After sanction, the complaint is filed before the competent criminal court. The quality of complaint drafting is especially important in corporate cases, where the role of each accused must be pleaded with specificity. Vague and formulaic complaints not only weaken the prosecution but also generate avoidable litigation on summons, discharge, and quashing; hence, they should be avoided.

12.2 Trial Delay

One of the persistent weaknesses of tax prosecution is delay. Delays may arise from sanction processes, drafting deficiencies, adjournments, pendency in criminal courts, changes in tax findings during appeal and the practical complexity of documentary evidence. Delayed prosecution undermines deterrence, burdens the accused and often reduces the legal and moral clarity of the case. A prosecution initiated years after the alleged conduct may have little preventive value and may survive primarily as institutional inertia.

12.3 Uneven Enforcement

A further administrative concern is inconsistency across regions or officers. Similar fact patterns may receive different responses depending on local practice, institutional culture or prosecutorial appetite. Such variation is difficult to justify in a national tax system and can invite concerns under equality and fairness principles.

12.4 Concerns with Compounding

Compounding can create structural concerns if prosecution is used aggressively and compounding becomes the practical route to resolution. In such cases, the criminal process may resemble negotiated pressure rather than principled adjudication, especially where charges are high or standards are opaque and inconsistently applied. It should not replace careful screening at the outset. The real question is not only whether a case is compoundable, but whether prosecution was justified at all.

12.5 Need for Transparent Standards of Compounding

A fair compounding policy should take into account:

- gravity of conduct;
- quantum of revenue involved;
- presence of falsification or sham structures;
- recurrence of default;
- stage at which the taxpayer came forward;
- degree of cooperation; and
- whether the default was technical, negligent or fraudulent.

Speaking orders for grant or rejection of compounding would improve accountability and reduce perceptions of arbitrariness.

12.6 Risks of Over-Inclusion of persons as accused

The problem is that complaints sometimes proceed against all directors or senior personnel without adequate attention to actual function. Non-executive directors, independent directors or officers with no role in tax compliance may be drawn into criminal proceedings merely by virtue of designation. This is unfair and doctrinally weak. The law requires more than status; it requires responsibility or culpable involvement as contemplated by the statute.

12.7 Pleading Standards

To maintain doctrinal discipline, complaints should specify:

- the role of each accused;
- how that person was in charge of and responsible for business conduct at the relevant time;
- whether the prosecution relies on direct responsibility, consent, connivance or neglect; and
- the factual basis for such attribution.

Without such specificity, corporate prosecution risks degenerating into indiscriminate arraignment rather than individualised criminal accountability.

12.8 Constitutional and Rule-of-Law Concerns

Criminal prosecution under tax law must conform not only to statutory requirements but also to constitutional values. Three dimensions deserve emphasis.

(a) Article 14[13] and Non-Arbitrariness

The decision to prosecute cannot be wholly opaque. Where similarly situated taxpayers are treated differently without intelligible criteria, concerns of arbitrariness arise. Discretion in prosecution is inevitable but unstructured discretion is constitutionally suspect. Transparent policy and reasoned sanction can help mitigate this problem.

(b) Fair Procedure

Though tax offences are economic offences, they remain criminal proceedings with

[13] Art. 14 of the Constitution of India, "*The State shall not deny to any person equality before the law or the equal protection of the laws within the territory of India*".

implications for liberty, reputation and livelihood. Fair notice, specific allegations, meaningful opportunity to defend and reasonable expedition are core procedural values. Mechanical complaints and prolonged trials compromise the fairness of the system, hence the same may be avoided.

(c) Proportionality

Criminal sanctions should be proportionate to the nature of the wrong. Technical defaults, curable omissions and genuinely arguable legal positions should ordinarily be addressed through civil mechanisms unless accompanied by clear evidence of fraud or deliberate defiance. Over-criminalisation weakens rather than strengthens the moral authority of enforcement.

12.9 Administrative and Policy Deficiencies

A critical legal analysis must be complemented by an examination of how the regime operates administratively. Several recurring deficiencies can be identified.

(a) Mechanical Invocation

The most serious problem is the tendency, in some cases, to treat prosecution as a near-automatic consequence of addition, penalty initiation or TDS default. This is inconsistent with the purpose of sanction and with the idea that criminal law should be reserved for aggravated non-compliance.

(b) Insufficient Distinction between Fraud and Dispute

Tax administration often fails to sufficiently distinguish among:

- intentional fraud;
- reckless disregard;
- negligent compliance;
- technical default; and
- genuine interpretive dispute.

A failure to draw these distinctions results in doctrinal confusion and unjust enforcement choices.

(c) Delayed Review after Appellate Relief

Even after major appellate developments, prosecution files may remain pending without serious re-evaluation. This produces the anomaly of criminal complaints continuing on weakened factual foundations. An institutional review mechanism is essential.

12.10 Towards a Principled Prosecution Policy

A more credible and just prosecution regime would incorporate the following reforms.

(a) Publish a Clear Prosecution Matrix

The tax administration should publicly articulate aggravating and mitigating factors relevant to prosecution. Aggravating factors may include fabrication, layering, accommodation entries, repeated TDS misuse, obstruction, recidivism and high-value evasion. Mitigating factors may include voluntary correction before detection, isolated default, minimal revenue impact, bona fide legal uncertainty and prompt cooperation.

(b) Require Reasoned Sanction Orders

Sanction orders should briefly but clearly indicate:

- the offence proposed;
- the material relied upon;
- the basis for inferring wilfulness or falsity; and
- why civil action alone is considered insufficient.

This would strengthen internal discipline and improve judicial review.

(c) Introduce Mandatory Review after Key Appellate Developments

Where additions are deleted, concealment findings reversed or the factual foundation materially altered, the prosecution should be mandatorily reconsidered by a designated authority.

(d) Prioritise Serious Cases

Given finite institutional capacity, prosecution should focus on:

- organised evasion schemes;
- false verification supported by forged or fabricated material;
- repeated TDS and TCS defaults;
- large-scale concealment with documentary evidence;
- use of shell entities and accommodation channels; and
- cases involving obstruction or repeated defiance.

(e) Improve Specialisation

Tax prosecution requires expertise in accounting, digital evidence, business records, beneficial ownership and statutory interpretation. Specialised training for officers and prosecutors would improve charge selection, complaint drafting and courtroom performance.

(f) Rationalise Compounding

Compounding should remain available, but decisions should be transparent, reasoned and linked to a coherent seriousness framework. It should not be treated as an informal market for purchasing exit from weak or excessive prosecution.

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