Chapter 4

TAX EVASION AND ROLE OF TAX ADMINISTRATION
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Tax evasion occurs when the efforts are made by individuals, Firm’s Trusts and various other entities to avoid paying taxes by illegal and unfair means. The evasion of tax usually takes place when taxpayers deliberately hide their incomes from the tax authorities in order to reduce their tax liability. Evasion of tax, takes place when the people report dishonest tax that includes declaring less gains, profits, or income than what has been actually earned and they even go for overstating deductions.

The evasion of tax level depends on certain factors such as fiscal equation which means that peoples tendency to pay less tax declines when the payment due from taxes becomes obvious. The level of tax evasion is also dependent on the tax administration’s efficiency and corruption levels. The level of tax evasion is also depends on the chartered accountants and tax lawyers who help companies, firms and individuals evade taxes.

The role of tax administration in maximising revenue generation and minimising tax evasion cannot be over emphasised, This remain challenging task at every stage of development of a tax administration. This is because it is not just a matter of maximisation or minimisation, but rather one of optimisation. Thus, there has to a genuine threat and actual carrying out of audit, scrutiny, investigation, penalty and punishment for an errant tax payer while, at the same time, his compliance costs must be minimal, and he should be guaranteed and avenue for redressal of
genuine grievances for payment of tax, with robust systems of at jurisdiction, appeal and final decision. Besides, to minimise lengthy adjudication processes, they should be practical avenues such as advanced rulings or tribunals that would cut back an undue delay and facilitate speedy administration decisions.

Computerisation has become a main stay in efficient administration that can successfully curb tax evasion. For example, for income tax, Electronic filing is possible, Tax Deduction at Source (TDS), the mechanisms-including filing at banks-and transfer of data and revenue to further points in the system can be computerised. For indirect taxes, for example value added tax (VAT), there has to be a computerised method for cross-checking invoices that is precise and incisive, and certainly not cumbersome, for both domestic and international transaction.

An increasingly recognised element in controlling tax evasion is to reduce, as much as possible, the likelihood of interface between tax payer and tax administrator. Computer-assisted processes have helped in this objective. Thus, selection of audit or scrutiny cases should be primarily random and computer assisted except in the case of criminal suspicion. The role of appropriate tax design in assisting efficient tax administration is equally important. A complex tax structure or tax law is difficult to administer and, therefore, easy to evade. For example, if VAT has three rates but no exemptions, then it should not create too many problems. A taxpayer would just need to subtract total taxes paid by him on his purchases-irrespective of tax rates-from all tax collected by him on his sales, and transfer the difference to the administration.
Tax evasion has been estimated in many ways and in many developing countries, half the income tax is evaded and one-third the VAT or consumptions tax is evaded. To combat tax evasion, tax administration should have adequate resources. In most countries, however, they form part of general government administration and must therefore, compete for scarce resources.

Thus tax administrations are requiring third-party information returns in which a third-party is asked to submit returns on transactions with others, Tax deductions at source is also a third-party device to facilitate tax collection and is increasingly used for many sources of income.

Large tax payers units are being used in many countries to reduce tax evasion by requiring all taxes to be paid through one window by large taxpayers. This facilitates cross-checking across all taxes while providing a single facility to the taxpayer. The small taxpayer is being assisted with the establishment of help centres external to the tax office to reduce his inherent fear of tax officers. The potential taxpayer is being required to file returns even with zero taxable income as long as he is captured under specified expenditure criteria.

Joint audits by central and local governments are being carried out to facilitate matching of information across a wide geographical area. Such audits focus on transfer pricing behaviour and use as a wide variety of indicators for selection and examination. Audits can be of various types: random audits, emerging sector activities, and of high-income individuals identified through information and intelligence. The latter remains limited in scope and is reserved usually for cases of repeat offenders. A review of Asian countries reveals an increase in administrative action and follow-up in the administration of International taxation.
In an increasingly complex world faced by the tax administration, computerisation is of the essence. Experience reveals that the computerised systems for tax collection may be successfully put in place, but it remains a challenge to make such systems user-friendly. There are likely to be quite a few initial glitches, but these can be resolved with time and a full understanding of the underlying needs of the tax administration to implement the tax structure.

Nevertheless, taxes should not be devised merely to accommodate tax administration. For, if they increase inefficiencies in resource allocation and inequity among taxpayers, they will affect economic growth adversely in the medium term and, consequently, be deleterious to revenue productivity.

**Tax evasion – its forms and effects**

Tax administration is closely linked with three concepts of tax avoidance, tax evasion and corruption, they are sometimes used interchangeably. However, there are essential differences among the three, mainly reflecting the degree of malpractice involved.

Tax avoidance is not illegal in the sense that it usually results from the creativity and planning of tax accountants and lawyers within the gambit of existing tax laws in aiding taxpayers to minimise their tax. Tax avoidance is obviously facilitated by complex tax statutes in which opportunities exist to interpret the tax in the taxpayer’s favour when it is not so intended by the drafters of the law. Therefore, tax avoidance as a matter is mostly addressed in the context of the tax policy reform.

Tax evasion, on the other hand, is illegal though, if detected, it normally leads to civil rather than criminal penalties. It generates an underground
economy in the form of income that is not reported or accounted for in tax returns. As a result, a subterranean economy begins to function in parallel to the organised economy with generally deleterious effects on equity among taxable persons, on the efficiency of resource allocation, and on the stability of revenue collection and the macro-economy.

Corruption goes one step further. It has been defined as the “abuse of power for private gain”. Its ramifications are grave since it burrows into the very foundations of the society and the institutional frame work of the government. Unlike tax avoidance and tax evasion, corruption involves collusion and, often, criminal connotations. The role of tax administration in curbing corruption is through its investigative wings but it has to be supported by the prime control wings—such as intelligence, enforcement and internal security of government.

Besides, tax evasion occurs when a taxpayer indulge in any of the following methods of tax avoidance.

1. Declaring less incomes, profits or gains

Tax payers declare less income than the actual income earned by them in any financial year under various heads of income (ie.,under reporting of incomes) is given below:

a. Income from salaries

Salaried tax payers evades tax by using any of the following methods, like claiming higher rent receipts than the actual rent paid to avail the HRA exemption, breaking the salary component in to cash and cheque’s, claiming exemption for school fee, donations and other abnormal indirect expenses like conveyance allowances, claiming for exemptions of certain
perquisites like LTC, claiming HRA exemption though residing in own house etc.

b. Income from House property
While computing total income from house property tax payer may evade taxes by claiming unrealised rent, vacancy allowance and also interest on borrowed capital by generating documents.

c. Corporate tax evasion and/professional income
Corporations and professional persons evade taxes generally by non recording/under reporting of receipts and claiming over stated deductions. Companies usually adopt over depreciation of assets, claiming exemption for amount spent on scientific research activities, advertising expenses, bad debts, issue of salaries and wages in the names of their family members, excess bonus fees and commission paid to employees.

Professionals like doctor’s, chartered accountants, lawyers, Engineers etc, evade taxes by not recording their receipts like consultation fees, gifts given by patients and clients and over stating their personal expenses as professional expenses, claiming for depreciation of office equipments which are hired or leased.

d. Capital gain
Capital gain shall be one of the most important area of tax evasion because of the taxpayers adopt under valuation of properties sold and purchased for registration and evading the stamp duty by real estates and others, claiming for brokerage, stamp paper and other selling expenses more than the actual expenditure, purchasing another property even though they are the owners of more than one property, declaring industries as sick units and also transfer of industries to rural areas
because of different rates of tax for long term capital gains and short term capital gains.

**e. Income from other sources**

Since, it is a residuary head of income and tax payers follow self assessment method of tax payment, don’t disclose information on winning from lotteries, puzzles, gambling, betting, card games, Interest on deposits, royalty’s, interest on securities through bond washing transactions, director fee and other additional revenues received by them in any financial year.

**f. Evasion under incentives as per the IT Act**

Indian income tax Act, 1961 provided various incentives to encourage general public for social savings under section 88 of the Act. The same provisions are misused by tax payers in the form of Rebate in respect of tuition fee’s of children, expenditure on medical treatment of self and handicapped dependents, donations to various institutions, interest on educational loans, deduction for rent paid etc.

**2. Over stated expenses**

Employees evade taxes by claiming expenses more than their actual amount spent like children school fee, hostel expenses, conveyance allowances, rent expenses, selling expenses in case of selling of properties, expenses on purchase of securities, collection charges of interest and dividends, medical expenses of physically handicapped dependents etc.

Companies also over state expenses relating to welfare expenses of employees, transportation expenses (petrol, diesel, maintenance charges), advertising expenses, salaries and wages, commission fees paid to the
employees and scientific research expenses and thereby evading the taxes by avoiding the actual amount of income earned by the tax payers.

3. Manipulation of accounts
Taxpayer either as an individual or business firm manipulates the books of accounts either by non-recording of certain incomes or overstating certain deductions and exemptions. There are four methods of tax evasion practiced by companies across the country. First it is common to show inflated expenditures, secondly companies routinely reduce collection figures thirdly companies often reduce stock valuation and fourthly the trend is to make capital expenditure especially in real estates and show it in accounts as repairs which are not taxed.

Many real estate companies have in the past been caught under-reporting their income and evading tax. Raids carried out by the department last year unearthed Rs. 800 crore of undisclosed income. Companies that admitted under-reporting of income included Mumbai-based HDIL group along with two Mumbai-based developers Bombay Rayon and Electro groups; Delhi-based Modi and Mehta groups; Jaipur based Agarwal group and Pune-based Panchshil group.

According to the income tax department, all these companies provided inflated expenses for purchase of materials, suppressed amount of professional income and indulged in cash transactions.

While Mumbai-based Electro group admitted undisclosed income of Rs. 114.50 crore, HDIL (Housing Development and Infrastructure Ltd) made a disclosure to the stock exchanges about defaulting to the tune of Rs. 350 crore. The other five companies admitted undisclosed income ranging from Rs. 22.80 crore to Rs. 85 crore.
In September 2010, the income tax department had raided premises of some other real estate companies and found gross irregularities on their part. Prominent among those found guilty is the Delhi-based Amrapali group, which according to sources in the department has admitted undisclosed income of Rs. 73 crore.

4. Accepted Corruption

Corruption is the abuse of the power for private gain. Tax officials indulge in corruption and help the taxpayers by using their discretionary powers and interpretation of tax provisions in favour of the tax payers by accepting the bribe by minimising the tax liability through avoiding the penalty, interest on outstanding liability. Taxpayers accept the evil of corruption for their personal benefit and believed that the work can be completed /done by bribing the officials faster than the legal method.

5. Procurement of Materials without bill

Materials as a factor of production can be procured either from registered or unregistered dealers according to their convenient. When the materials are procured from unregistered dealers through cash transaction without bill /invoice to avoid the VAT and other charges payable towards the procurement of materials there by the buyer also benefited and sell the finished products at a lower rate as well as records the same sales value in the books of accounts which results in evasion of corporate tax.

6. Loopholes in Indian tax system

The Indian tax system so complicated that a common person will never be able to understand it. One common and ordinary man works so hard after a month of sweating out when he gets his salary in hand, he comes to know that already a part of his hard earned income has been taken
away by the government in the form of TDS and he is not able to claim the refund back due to the complicated structure of the tax system and many tax provisions can be interpreted by tax officials and chartered accountants according to their interest to gain personal benefits.

7. **Progressivity of tax rates**

Tax liability of an individual is calculated based on slab system at the rates proposed by the annual budgets of the central government. Income of the taxpayer is exempted from tax if the net income is up to certain limit (Rs.1,60,000 for men) and tax shall be levied if the income is between certain limits (Rs.1,60,000 to Rs. 3,00,000 at 10 percent and Rs.3,00,000 to Rs. 5,00,00 at 20 percent and Above Rs. 500,000 at 30 percent) and more tax if the income exceeds the maximum limit. Therefore the taxpayers always make efforts to reduce their income at a slab which carries lower tax rate.

8. **Dishonesty and Individual behaviour**

Tax evasion starts where the national interest ends. Tax payers evade taxes because of the behavior of the tax payer towards the corrupt system and with an apprehension that the tax money will be misused. Level of tax evasion depends on the honesty of the tax payers in declaring their actual income earned by them from all sources and also Chartered Accountant and lawyers who help the company, firms and individuals to evade taxes.

9. **Lack of knowledge**

Many tax payers have the opinion that the filing the tax returns is a tedious process and many provisions of the Act can not be understand by the common person which requires the assistance from the Chartered
accountant either for the calculation of taxable income and various provisions applicable for each of the assessment year make the tax payers to evade the taxes.

10. Compliance Cost
Cost incurred by the taxpayer to submit the tax returns influences the behavior of the tax payer for the payment of taxes to the government. Since the Indian tax system adopted the self assessment scheme many tax payers take the assistance of the experts which cost the tax payers may affect the interest of the tax payers towards the payment of taxes.

11. Lack of responsibility and integrity of tax officials
The tax officials do not have the responsibility of minimum amount of collection of taxes by adopting various methods of assessments of tax collection by organising the adalat’s, workshops and public meetings to guide the general public relating to tax matters and their role is limited only to exercise powers vested by the Income tax Act.

12. Discretionary Powers of tax officials
The income tax Act gives the discretionary powers to tax officials to determine whether a certain expenses are reasonable or unreasonable, whether business is separately assessable for tax holiday method of depreciation, amount of penalty and interest by interpreting the provisions according to the situation to get personal benefit.

13. Smuggling
Smuggling is a method tax evasion, which people export or import foreign goods through routes that are unauthorized. People resort to smuggling because they want to avoid paying total customs duties that
are chargeable and also when they want to import items that are contraband.

14. **Evasion of duties**

Customs duty evasion is another method of tax evasion under which the importers evade paying customs duty by false declarations of the description of product and quantity. The importers in order to evade paying customs duty also resort to under invoicing.

**Sources and causes of tax evasion**

The evil of tax evasion starts where the national interest ends. Mainly there are three reasons for tax evasion (1) Exorbitant rates of taxes (2) Lack of simplicity/transparency in tax laws (3) Inefficient and corrupt government administration. In India corporate evade taxes in order to maintain some black money to be used for transactions with government bodies and government servants. Professionals evade taxes in order to save for future/rainy days since tax rates are very high that too multiple in number. Politicians and public servants generally evade taxes since their income is out of bribes and illegal. Tax evasion is the outcome of individual taxpayer behaviour and social norms on the supply side, and shortcomings in tax administration on the demand side. To begin with, the tax structure has to perceive as equitable across various groups of taxpayers. Also, if marginal rates are too high, tax payers are likely to find ways to evade tax. Across the world, these aspects are well recognised today, and the outcome of international tax harmonisation has been a lowering in the rate structure (to improve incentives) and attempts at broadening the tax base (to reduce inequities).
The various methods of tax evasion are:

1. Smuggling
2. Customs duty evasion
3. Value added tax evasion
4. Illegal income tax evasion

Smuggling is a method of tax evasion, which people export or import foreign goods through the routes that are unauthorized. People resort to smuggling for they want to avoid paying total customs duties that are chargeable and also when they want to import items that are contraband.

Customs duty evasion is another method of tax evasion under which the importers evade paying customs duty by false declarations of the description of product and quantity. The importers in order to evade paying customs duty also resort to under invoicing.

Table 4.1
Value of goods seized and customs, Excise duty and Service tax evasion

<table>
<thead>
<tr>
<th>Years</th>
<th>Customs Seizure value in Crore</th>
<th>No of evasion cases</th>
<th>Excise and service tax No of cases of evasion</th>
<th>Duty evasion Rs in Crore</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004-05</td>
<td>859.30</td>
<td>1080.40</td>
<td>4813</td>
<td>2696.48</td>
</tr>
<tr>
<td>2005-06</td>
<td>675.17</td>
<td>760.32</td>
<td>7621</td>
<td>4663.33</td>
</tr>
<tr>
<td>2006-07</td>
<td>689.16</td>
<td>900.01</td>
<td>7199</td>
<td>4123.93</td>
</tr>
<tr>
<td>2007-08</td>
<td>890.78</td>
<td>1300.09</td>
<td>1015</td>
<td>6102.10</td>
</tr>
<tr>
<td>2008-09</td>
<td>1202.90</td>
<td>1600.01</td>
<td>1509</td>
<td>7150.92</td>
</tr>
</tbody>
</table>

Source: Lok sabha un starred question No 2367 dated on 14.03.2008

Another method of tax evasion is value added tax evasion under which the producers who collect from the consumers the vale added tax evade paying taxes by showing less sales amount.
Many people earn money by means that are illegal such as theft, gambling and drug trafficking and so they do not pay tax on this amount and thus this is another method tax evasion that is called illegal income tax evasion.

Nevertheless, tax evasion tends to arise also from other factors. Individual behaviour in certain sectors is known to be highly tax-evasive. This includes professional services including the usually highly paid medical profession, and the construction industry, to name a few. They tend to receive fees and make payments in cash, fuelling the underground economy. Even in developed countries such as United States, medical practitioners, in particular, comprise a difficult sector to tax. Indeed, a number of western authors have dubbed the individual income tax a voluntary tax. Difficult- to tax taxable persons may even include large corporations that typically contract out- through work contracts- to smaller units.

With globalisation, this phenomenon has assumed challenging dimensions. As capital becomes increasingly fungible, sources of income and expenditure are spread across the globe and difficult to track or even identify since they often leave little trace in any one national tax jurisdiction. Increasingly, therefore, the globalised economies of East Asia are demonstrating their conservatism in International taxation rules and practices.

Social norms have been changing in many economies. Since the 1990s, as large public corporations have been privatised in Latin American and South Asian countries , the small service sector one that is traditionally difficult to tax has grown. With the emergence of Eastern Europe and the former Soviet Union (FSU), and their entrance into the international
market economy, the taxpayer role has multiplied but revenue intake is not reflected commensurately. In traditional economies, if eminent persons do not pay their fair share to the exchequer, that becomes an example to be emulated by all and sundry.

Ineffective administration exacerbates tax evasion. For example, extremely punitive penalties encourage tax payers to appeal tax demands easily since it gives them time until final determination of the tax. By that time, the real-as opposed to nominal- value of the revenue in the hands of the government is likely to diminish. Bureaucratic lethargy in applying the law- perhaps in reflection of social norms-increases evasion and hurts revenue. Slow development of information technology (IT) due to its complexity, or its ineffective use by the administration, signals to taxpayers that tax evasion carries low risk. Indeed, technological advances have, in particular instances, translated into tax evader’s computer capabilities running well ahead of the administrators exacerbating the problem.

**Estimating tax evasion**

The difference between actual revenue collection and an estimation of potential collection is the tax gap. It is an estimate of total leakage, comprising the effects of tax avoidance, tax evasion and corruption. Typically, however, the tax gap is referred to as estimated tax evasion.

Estimating tax evasion can be direct or indirect. The indirect method links tax evasion to the underground economy since the latter could be thought of as the size of economic activity that would be taxed if reported in tax returns. A more direct method of estimating the tax gap, in particular for VAT, is to obtain potential VAT revenue from the country’s input-output matrix and to compare it with VAT revenue collection. These methods
have revealed that as much as one-third of potential VAT collection and half of income tax collection may remain uncollected.

**Growth in tax evasion**

There is a prevalent view that tax evasion has grown in recent years and is growing. Many factors account for it. The role of tax administration in the control of tax evasion is, therefore, not a static one but one that is dynamic and remains ever challenging. Among the significant reasons is that, first, in the last two decades the volume of internationally mobile global capital has increased by leaps and bounds and its flows keep increasing. Its dimensions—both direct investment and financial capital in the latter’s many diverse forms—also transmute and grow. Opportunities for tax evasion abound and increase before even well developed and tax administrations can understand or confront them.

The services sector has been growing phenomenally in many countries, in particular in the Asian region, as agriculture looses its comparative advantage, manufacturing faces stiff international competition under new World Trade Organisation rules and swift economic growth shifts the comparative balance towards the specialised services sector. The services sector is often represented by the micro-units whether they are business processing offices (BPOs) covering a host of service-oriented activities, highly skilled medical practices cater to a primarily foreign clientele, or high class restaurants. These new types of economic agents are notoriously difficult to tax and if they have emerged as colossal of guaranteed revenue for government—and have then disappeared, then the loss to revenue collection could be significant. The challenge for the tax administration here is to develop precision instruments that are able to aim directly at newly emerging revenue sources. Such instruments
comprise third-party information sources, compulsory return filing, and other methods.

Effects of tax evasion

Tax evasions have numerous ill effects on the tax payer, total revenue and the society. The important effects are;

1. Despite erring on the side of brevity, there needs to be some mention of the negative effects of tax evasion on the economic environment. It’s most important adverse affect is perhaps on equity. A wage-earning factory worker pays tax. A restaurant worker whose income is the same but who receives part of his income in tips does not reveal it for tax purposes. Thus, one blue-collar worker gains at the expense of the other. This is horizontal inequity. A barrister charges his fees, in part, in non-pecuniary terms, for example, a foreign trip for his family, all expenses paid. This is not reported on his income tax return. A salaried employee in the organised corporate sector earns the same reported as the barrister. Their incomes appear to be the same for tax purposes.

2. The tax evasion distorts economic efficiency. In sector, that are less subject to the administrator’s scrutiny, there will be more investment. That may one reason why certain service sector activities- for example, the construction industry- have grown, so phenomenally as companies move across national barriers in a globalised world economy. Similarly, the unorganised sector may evade taxes much more easily than the organised sector. It is no wonder that, in the VAT where there usually a threshold level below which taxpayers are not expected to keep detailed accounts, allowing them to pay a small percentage of their turn over as tax
(termed compounding), there is a clustering of registrants just below this threshold. Small taxpayers have remained very difficult to tax and maintain a constant presence in the list of administrative corners. Based on a theoretical model, conclude that only incomes below some threshold level should be audited with a probability that is positive and less than unity.

3. As inequity and inefficiency lead to lower revenue intake for government, its functional capacity, efficiency and effectiveness suffer because of tax evasion. Capacity suffers due to lower availability of resources. Efficiency declines since important functions may have to be given less priority than others and effectiveness declines as compliant taxpayers realise that government is unable or unwilling to take corrective action and, therefore, feel increasingly comfortable in joining the rest in the act of tax evasion. The result could very well be an increase in tax rates, or the imposition of distortive taxes, thereby initiating a vicious cycle of inequity and inefficiency. Clearly, the escalation in property tax rates or the imposition of entry taxes by many municipalities, turnover taxes in addition to the sales tax at the level of states or provinces, or inventive surcharges and cesses at the level of the central government are cases in point.

4. Tax evasion being under-reporting of income implies under-estimation of GDP and all its commensurate macroeconomic ramifications. Since the denominator is under-estimated, the ratios of tax to GDP, the fiscal deficit to GDP, and public debt to GDP are all over estimated. The perceived higher tax/GDP ratio leads to false comfort, but exaggerated deflationary action may be taken to
rein back an exaggerated fiscal deficit or public debt ratio. Policy
could thus turn pro-cyclical, leading to suppression of the
organised economy and exacerbating a vicious cycle of less
revenue generation and higher tax rates. If the underground
economy absorbs labour, then the adverse impact of
unemployment-by focusing primarily on the organised sector-will
also be over-emphasised. Inflation estimates would be similarly
distorted unless care is taken to include all segments of the market
economy, both organised and underground.

Measures to fight tax evasion

1. Reduction in tax rates
Prevalence of high tax rates is the first and for most reason for tax evasion,
because this is what makes the evasion so profitable and attractive in spite
of the attendant risks. If public conscience is to be aroused against tax
evasion and if tax evaders are to be ostracised by the society at large, the
public needs to be convinced that tax evasion is antisocial. This objective is
difficult to achieve so long as the marginal rates of taxation are
confiscatory. The high rates of taxation create a psychological barrier to
greater effort and undermine the capacity and the will to save and invest.
The present high level of taxation leaves the Government with little scope
for maneuverability for raising additional resources in times of emergency.
The maximum marginal rate of income tax, including surcharge, should
be brought down in order to create an impact, the reduction in the rates of
taxation should be at one stroke
2. Minimisation of controls and licenses
A committee of experts should be appointed to enquire into the utility of all existing controls, licensing and permit systems, and suggest elimination of such of these as are no longer considered necessary. This committee may also suggest changes in law and procedures so as to ensure that the controls which are absolutely essential for the health of the economy are administered more effectively and with the least harassment to the public.

3. Regulation of donations to political parties
There is a need to keep political institutions free of corruption. Removal of the ban on donations by companies to political parties is, therefore, not favoured. Nevertheless, it is an accepted fact of life that in a democratic set-up, political parties have to spend considerable sums of money and that large sums are required for elections. As in West Germany and Japan, in our country also, the Government should finance political parties. Reasonable grants-in-aid should be given by the Government to national political parties and suitable criteria should be evolved for recognising such parties and determining the extent of grant-in-aid to each of them. For according recognition to a political party for this purpose, it should be necessary, inter alia that it is registered under the Societies Registration Act, 1860 and its yearly accounts are audited and published within a prescribed time. Irrespective of the decision of government on the question of financing political parties, the parties may be required to get their accounts audited and published annually.

Donation by taxpayers, other than companies, to recognised political parties should be allowed as a deduction from the gross total income subject to certain restrictions. The maximum amount eligible for deduction on account of donations to political parties should be 10 per cent of the gross
total income, subject to ceiling of rupees ten thousand. The deduction to be allowed should be 30 per cent of the qualifying amount of the donation.

4. Creating Confidence among Small taxpayers
The practice of being to meticulous in small cases, where no worthwhile revenue is involved, has done much to damage of the department in the public eye. The initiative for undoing the danger lies with the department. The instructions issued by the Central Board of Direct Taxes on the new procedure for making assessments in small income cases make a bold departure from the past and are likely to achieve more significant results than the earlier small income scheme.

5. Allowance of Certain Business Expenses
Entertainment expenditure which is incurred primarily for the furtherance of the tax payers business and is directly related to its active conduct should be allowed to be deducted up to the ceilings prescribed under section 37 (2A) of the Income-tax Act, 1961.

Penalty serves its purpose only so long as it is with in the reasonable limit. Once it crosses that limit, it is more likely to increase the rigidity of the taxpayer's recalcitrance than to reform him. A penalty based on income instead of tax hits the smaller taxpayer more harshly. The quantum of penalty imposable for concealment of income should be with reference to the tax sought to be evaded, instead of the income concealed.

7. Vigorous Prosecution Policy
The department should completely reorient itself to a more vigorous prosecution policy in order to instill fear and whole some respect for the tax
laws in the minds of the taxpayers. Further, where there is reasonable chance of securing a conviction, the tax dodger should invariably be prosecuted.

8. Intelligence and Investigation
To cope with the increasing refinement and sophistication of the techniques of tax evasion, there is a need for complete re-orientation in the department's approach to its methods of intelligence as investigation. The machinery for intelligence and investigation at the command of the department should also be thoroughly overhauled and streamlined to tackle adequately the menace of tax evasion.

9. Taxation of agricultural income
Agricultural income, which is at present outside the central tax net, offers plenty of scope for camouflaging black money. There is urgent need for agricultural income being subjected to a uniform tax more or less on par with the tax on other incomes so as to eliminate the scope for evasion of direct taxes imposed by the Union Government.

10. Compulsory maintenance and audit of accounts
A statutory provision may be made requiring maintenance of accounts by all persons in profession, and by businessmen where the income from business is in excess of exempted limit or turnover or gross receipts are in excess of Rs. 50 lakh in any one of immediately three preceding years. A provision may be introduced in the law making presentation of audited accounts mandatory in all cases of business or profession where the sales /turnover /receipts exceeds the exemption limit.
11. Permanent Account Number
The absence of a uniform system of indexing all taxpayers in the country on a permanent basis has to some extent been responsible for the difficulties experienced by the department in tackling tax evasion. It will be necessary to have an additional code, a 'Records Locator Code', to help locate the records of a taxpayer when the case is transferred from one circle to another after the permanent account number has been allotted. To avoid confusion with the permanent numeric code, this records locator code may be short alphabetic code. It will not be a part of the permanent code and will not in any way vitiate its permanent character.

12. Power of Survey
A new provision may be introduced as an adjunct to section 133A of the Income-tax Act, 1961 to enable the Income-tax Officer to visit any premises of an assessee for the purposes of counting cash, verifying stocks, and inspecting such accounts or documents, as he may require and which may be available there. He may also obtain any additional information and record statement of any person who is found at the premises, in respect of matters which would be relevant for making a proper assessment.

Information made available by Central board of Direct taxes reveals that there had been a steady and continuous efforts to unearth the income tax evasion through searches. The assets seized during 2008-2009 were to the tune of Rs. 3059.89 crore. Tabulated information giving the details of number of searches, assets seized and unaccountable income disclosed for the years 1999-2000 to 2008-2009 is presented below. The statistics of prosecutions that are initiated against the tax evasions reveal that conviction awarded was low for such prosecutions. During the year 2000-
of the 678 cases in which prosecutions were decided under Direct
taxes enactments, 254 cases were compounded, 22 cases were acquitted
and only 17 cases resulted in convictions.

### Table 4.2
Seizures by income tax Department
Disclosed for Direct taxes in India (1999-2009)

<table>
<thead>
<tr>
<th>Year</th>
<th>No of searches conducted</th>
<th>Assets seized (Rs in Crore)</th>
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</thead>
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<tr>
<td>1999-00</td>
<td>4299</td>
<td>4384.18</td>
</tr>
<tr>
<td>2000-01</td>
<td>5321</td>
<td>512.36</td>
</tr>
<tr>
<td>2001-02</td>
<td>8054</td>
<td>163.60</td>
</tr>
<tr>
<td>2002-03</td>
<td>9385</td>
<td>193.65</td>
</tr>
<tr>
<td>2003-04</td>
<td>7248</td>
<td>209.49</td>
</tr>
<tr>
<td>2004-05</td>
<td>6028</td>
<td>1133.90</td>
</tr>
<tr>
<td>2005-06</td>
<td>7639</td>
<td>2324.57</td>
</tr>
<tr>
<td>2006-07</td>
<td>6207</td>
<td>2612.77</td>
</tr>
<tr>
<td>2007-08</td>
<td>6071</td>
<td>3581.42</td>
</tr>
<tr>
<td>2008-09</td>
<td>5777</td>
<td>3059.89</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance, Govt of India

### 13. Increasing Survey Operations

Adequate number of survey circles should be set up to ensure
comprehensive and continuing survey on rotational basis. Further, an
officer of the rank of Assistant Commissioner should be placed in over all
control of survey operation in each Commissioner's charge and he should
also hold charge of the Special Investigation Branch. Besides, in the bigger
cities like Delhi, Bombay, Calcutta, Bangalore and Madras, a survey
Range should be created in other cities too.
14. Collection, Collation and Dissemination of Information
The Central Board of Direct Taxes should lay down each year a programme and specify targets for collection, collation and dissemination of information. It should also ensure that the programme is strictly adhered to and efforts are made to reach the targets fixed. The sources to be tapped every year should be decided at the national level by the Board at the beginning of each year, to be followed and implemented strictly at all levels. Different types of information may be collected in different years so as to keep an element of surprise.

15. Co-ordination between Banks, other offices and the Income tax department
The legal provisions under which the system of permanent account numbers is introduced should also include that tax payers should quote their permanent account number in applications for bank draft, mail transfers, telegraphic transfers, etc., if the amount involved in such transactions exceeds twenty thousand rupees.

16. Changes in the form of income-tax return
The form of return of income should be made more elaborate than what it is at present by incorporating a schedule of exempted income, net worth, personal expenditure and other outgoings. To start with, the requirement to furnish this additional information should be applicable only when the total income exceeds Rs. 5 lakh.
Table 4.3
Volume of income tax evaded by tax payers in India 2000-01 to 2007-08

<table>
<thead>
<tr>
<th>Years</th>
<th>Tax evaded</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001-02</td>
<td>1717.17</td>
</tr>
<tr>
<td>2002-03</td>
<td>1546.41</td>
</tr>
<tr>
<td>2003-04</td>
<td>5041.71</td>
</tr>
<tr>
<td>2004-05</td>
<td>6789.95</td>
</tr>
<tr>
<td>2005-06</td>
<td>8907.16</td>
</tr>
<tr>
<td>2006-07</td>
<td>11879.78</td>
</tr>
<tr>
<td>2007-08</td>
<td>12234.12</td>
</tr>
<tr>
<td>2008-09</td>
<td>15684.17</td>
</tr>
</tbody>
</table>

(Source: Lok sabha unstared question No 582, dated 09.07.2008)

17. **Reintroduction of expenditure tax**

Introduction of an expenditure statement as a part of the form of return of income should be quite effective in checking evasion through consumption expenditure, without disturbing the existing tax structure.

18. **Checking under-valuation of immovable Properties**

It would be expedient for the government to assume powers to acquire immovable properties in cases of understatement of cost of construction as well. However, the government should consider such extension only after it has had some experience of acquisition of immovable properties in cases of understatement of sale consideration.

19. **Tax treaties for exchange of information relating to tax evasion**

Section 90 of the Income-tax Act, 1961 may be suitably amended to enable the government to enter into agreements with foreign countries not only for the abidance of double taxation of income but also for prevention of fiscal
evasion, further, our existing agreements should be revised so as to provide for exchange of routine information and market intelligence as also specific information in individual cases to facilitate investigation of tax evasion and recovery of taxes.

20. Arousing social conscience against tax evasion

Tax evasion cannot be checked by stringent legal measures alone. It can be dealt with effectively only if such measures are backed by strong public opinion against black money and tax evasion. In helping to build up such public opinion, the government can play a vital role. The foremost measure in this regard is denial of the privileges which are still available to tax evaders.

Role of Administration

The most challenging task before a government is to design an appropriate administration and assessment system so that every person pays the tax due from him and pays the tax at the appropriate time and reports the correct income to the tax authorities. The law provides for the due date of filling tax returns, the mode of payment, the collection of tax, the information required to be given by the taxpayer to the tax authorities, examination of the information submitted by the taxpayer, and investigation of the affairs of the taxpayer. While formulating these policies, the government must ensure that the tax system is equity-based, i.e. it does not place undue burden on the taxpayer and at the same time helps the revenue authorities in collecting proper tax and is easy to administer. These provisions are amended from time to time, based on past experiences, administrative difficulties and convenience of taxpayers as well. In India, the levy of income tax is governed by the Income Tax Act, 1961. The administration of income tax in India is with Central
Board of Direct Taxes (CBDT), which has the powers to issue circulars and clarifications.

India follows the system of self-assessment. As such, every person, who is liable to pay tax, is required to compute tax liability at the time of filing of return and pay the balance tax, if any, before filing the return. This tax is called self-assessment tax. Any interest payable for late filing of return or for non-payment or short payment of advance tax is to be paid at the time of filing of the return of income. The return of income is to be accompanied by proof of payment of both tax and interest. If the total amount paid falls short of the total tax and interest, the amount paid is attributed first towards interest and the balance towards the tax liability.

**Simplification of tax procedure’s**

Over the last two decades, India’s tax administration has undergone extensive and much needed modification and modernisation. After the recommendations of Kelkar committee came in to force, tax collection has become easier. The image of the tax department had changed from repressive institute to a modern and professional organisation and there have been many attempts at simplification but many of them are ad-hoc basis, there still remain several areas where further attention is needed.

Computersiation of tax system, E-filing, the creation of the position of ombudsman with the aim of assisting tax payers with their minor grievances, improved tax payers service, introduction of a one page tax return form for individual tax payers having salary income, creation of national data base, allotment of PAN by private/ other institutes, refunds through electronic clearing system, simplification TDS from 42 to 22 pages, on line tracking of status of accounts, introduction of a risk management system and electronic data exchange (EDI) etc., has further
improved the process of tax administration. Where as several changes are underway to increase working efficiency. Most notably the continued roll out of automated systems in tax offices, assignment of responsibility to certain key positions. The most critical area for reform is the need to instill experienced people in areas of the administration that call for an exercise of sound judgment and the ability to adopt a standards on key issues. A move towards outsourcing would also serve to improve the efficiency of the tax administration, as in this case the work can be assigned to bodies that regulate and monitor their members more closely.

**Penal provisions and tax collections**

If an assessee fails to furnish return of income/wealth or files a false return or fails to produce accounts and documents, penalty is leviable. The assessee is also liable to be prosecuted for the offence. Penalty is also leviable for failure to deduct or pay tax.

Under the income tax Act penalty for delay in filing of the return of income is calculated as a percentage of shortfall of tax. Where tax is deducted at source or advance tax is duly paid no penalty is leviable. The way the deductions and rebates are allowed in the income tax, several penalties adhere to the tax offences which may be committed. Penal interest is levied apart from penalties for various defaults in making the tax payments. A person may be prosecuted Under the income tax Act for various offences under section 275A, 276, 276A, 276AB, 276B, 276BB, 276C, 276CC, 276CCC, 276D, 277, 278, 278A,278B, and 278C.The punishment is by the order of court on the prosecution launched by chief commissioner or CIT only when there is willful offence.
## Penal provisions of income tax Act 1961

<table>
<thead>
<tr>
<th>Section applied</th>
<th>Offences</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>171(1)(b)</td>
<td>Failure to comply with a notice U/S142(1) or 143(2)</td>
<td>Rs.10,000</td>
</tr>
<tr>
<td>271(1)(C)</td>
<td>Concealment of income</td>
<td>Min 100%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Max 300% of tax evaded</td>
</tr>
<tr>
<td>271A</td>
<td>Failure to maintain/ retain books of accounts</td>
<td>Rs. 25,000</td>
</tr>
<tr>
<td>271AA</td>
<td>Failure to keep and maintain information &amp; documents in respect of international transaction</td>
<td>2% of the value of each international transaction</td>
</tr>
<tr>
<td>271B</td>
<td>Failure to get accounts audited U/S 44AB</td>
<td>Rs.1,00,000</td>
</tr>
<tr>
<td>271C</td>
<td>Failure to deduct TDS or pay</td>
<td>Amount equal to tax payable</td>
</tr>
<tr>
<td>271F</td>
<td>Failure to submit return of income before due date</td>
<td>Rs. 5,000</td>
</tr>
<tr>
<td>271G</td>
<td>Failure to furnish information or document u/s 92D</td>
<td>2% of the value of the international transaction for each such failure</td>
</tr>
<tr>
<td>272AA</td>
<td>Failure to comply with provisions of Sec.133B</td>
<td>Rs. 1,000</td>
</tr>
<tr>
<td>272(1)(a)&amp; (1)(b)</td>
<td>Failure to answer questions, sign statements</td>
<td>Rs. 10,000</td>
</tr>
<tr>
<td>272(1)(c)</td>
<td>Failure to comply with notice u/s 131(1)</td>
<td>Rs. 10,000</td>
</tr>
<tr>
<td>272A(1)(d)</td>
<td>Failure to comply with provisions for applying PAN</td>
<td>Maximum Rs. 10,000</td>
</tr>
<tr>
<td>272A(2)</td>
<td>Failure to comply with notice u/s 94(6), Notice of discontinued business, to file certain returns u/s 139(4A), etc</td>
<td>Maximum Rs. 100 per day and maximum Rs.200 per day</td>
</tr>
<tr>
<td>272BB</td>
<td>Failure to comply with provisions of Sec.203A (TAN)</td>
<td>Rs. 10,000</td>
</tr>
</tbody>
</table>

Source: Income tax Act,1961

The analysis indicates that out of 10.35 lakh cases where penalty proceedings were initiated, 0.70 lakh cases (6.74 per cent) were finalised during the year 2007-08 as compared to 0.59 lakh cases (6.90 per cent) in 2006-07. Total pendency has increased from 7.91 lakh cases at the end of 2006-07 to 9.65 lakh cases at the end of 2007-08. Out of 69,795 penalty cases disposed off during the year, penalty was imposed in 38,975 cases.
(56 per cent). Fifty three per cent of the penalty cases disposed off related to concealment of income. The number of cases where penalties were imposed increased from 22,392 in 2006-07 to 38,975 in 2007-08 but amount of penalty imposed decreased from Rs. 2,947.84 crore to Rs. 2,069.77 crore during the same period. Details are given in Table below:

<table>
<thead>
<tr>
<th>Nature of offence</th>
<th>Cases disposed off</th>
<th>Penalties imposed</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>No of cases</td>
</tr>
<tr>
<td>Concealment</td>
<td>43,380</td>
<td>20,568</td>
</tr>
<tr>
<td>Other than concealment</td>
<td>26,415</td>
<td>18,407</td>
</tr>
<tr>
<td>Total</td>
<td>69,795</td>
<td>38,975</td>
</tr>
</tbody>
</table>

Source: Report of comptroller and auditor General  2009-10

The income tax department had launched prosecutions in 11,894 cases of evasion up to 2008-09. Only 173 cases (1.5 per cent of the total cases) were disposed off, of which 146 cases resulted in acquittal. The high rate of acquittal needs to be analysed to ensure greater effectiveness of prosecution as a deterrent.

**Conclusion**

In sum, in order to keep tax evasion in check, the tax administration must: (i) incorporate genuine threat of penalty but ensure due process; in order to do this, of course, the tax administration should be adequately financed and structured: (ii) computerised as many administrative processes as possible to minimise the interface between tax payer and tax official; and (iii) not remain loof from tax policy but assist in every way possible to help design, in reflection of its field experience, a simple tax structure and its commensurate tax law.