## Chapter one: - Introduction and Research Methodology

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1 Introduction and Research Methodology

1-1-Introduction:-

There are two types of wants i.e. Individual Wants and Social Wants. Individual wants are satisfied with individual level of income. But Social Wants are common to everybody and an individual cannot satisfy within his given level of income, So these Social Wants are satisfied by Government or central planning authority, therefore Governments need to perform various functions in the field of political, basic infrastructure like roads, railways, water, hospitals, education post and telegraph, banking, insurance, safety, security, social & economic activities to maximise social and economic welfare. Governments require some income to satisfy these common wants. Whatever Government spends for it is known as public expenditures. In order to perform these duties and functions, and to meet out these expenses, governments require huge amount of resources. Income earned by Governments is known as Public Revenue. Government revenue is an important part of fiscal policy and Public revenue consists of taxes and non-tax revenue like revenue from administrative activities like fines, fees, gifts & grants, Surplus from public enterprises, special assessment of betterment levy and Deficit Financing. The Chart down represents common sources for public revenues.

Figure 1-1 Sources of public Revenue

Tax has existed since the birth of early civilization. Tax was either material or money; it has passed through stages in the course of time. The objectives of tax also have changed from
the ancient communities to medieval societies and to modern societies as well, so the tax has developed with the development of the role of the governments.

In the modern age, the tax is deemed as the main and most important revenue source for supporting the governments. It is the major and important source of domestic revenue to the Governments in the developing as well as developed countries in the world. Therefore tax is a compulsory charge imposed by a public authority.

India is among those countries that depend on tax revenue to carry out its public functions and to maximise social and economic welfare of the Indian society.

Ratio of tax revenue to GDP in the developing countries is very weak and it is approximately 15%. In India the ratio of tax revenue to GDP in the years 2005/2006, 2006/2007, 2007/2008, 2008/2009, 2009/2010 was 10.18%, 11.3%, 12.45%, 11.5% and 10.94 respectively.

The weakness of ratio of tax revenue to GDP that it is return back to many of reasons, among these reasons is tax evasion; the tax evasion problem continues to plague governments in all countries without exception. Tax evasion is a universal phenomenon; it takes place in all societies, all social classes, all professions, all industries, and all economic systems.

Tax evasion has bad effects and is harmful for both, the Governments and the society. In order to increase public revenues all the governments seek to reduce tax evasion by every possible ways. Tax Evasion entails the efforts that are made by trusts, individuals, firms, and various other entities to avoid paying taxes by illegal and unfair means. Ways of tax evasion are either overstatement of expenditures or understatement revenues. It has many tools like recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives. Adjusting assumptions inappropriately and changing judgments used to estimate account balances, omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period, concealing or not disclosing facts that could affect the amounts recorded in the financial statements.

Tax audit was introduced by section 11 of the finance Act, 1984, which inserted a new section 44AB with effect from 1st April, 1985 (Assessment Year 1985-86), The finance Minister, while presenting the union Budget for 1984-85 observed in his speech that: “In order to discourage tax avoidance and tax evasion I am also introducing some further
measures. In all cases where the annual turnover exceeds Rs.20 lakh (currently enhanced to Rs.60 lakh) or where the gross receipts from a profession exceeds Rs.10 lakh (currently enhanced to Rs.15 lakh), I am providing for a compulsory audit accounts (T.H.Gupta, and H.C.Gupta, 2007, p5)

So Section for compulsory ‘Tax Audit’ was introduced in order to curb ‘tax evasion’ as stated by the FM in his budget speech. It was also aimed at computing the taxable income according to the law and to ensure transparency in financial statements filed by the assesses. Tax audit has specific objective to assist both the tax payer and the tax gatherer to arrive at correct tax dues. Tax audit is in addition to the statutory audit under the Companies Act 1956, and mainly involves verification and confirmation of certain facts, figures and information that are generally required by the Tax authorities in the course of assessment proceedings in the audit of taxes, which are controlled more by laws than by financial rules and procedures.

There are many of kinds and ways of tax evasion as mentioned before. In fact the researcher study is trying to prove that. Does tax audit curb tax evasion and it is able to detect all those ways of tax evasion or some methods of tax evasion? Therefore, detecting of tax evasion by means of tax audit is a core of the researcher study

1-2-Problem of study:-

The tax evasion problem continues to plague governments in the all countries in the world without exception. India is among those countries which are suffering from this problem (tax evasion). Tax evasion is an illegal practice where a person, an organization or corporation intentionally avoids paying his, her or its true tax liability. The purpose of Tax evasion in business and profession is either an increase of expenditures items or decrease of revenues items, in the financial statements for decreasing taxable income. Tax evasion in business and profession may be accomplished by the following techniques such as.

a- Intentional mis-statements including omissions of amounts or disclosures in financial statements to deceive tax authorities

b- Manipulation, falsification, alteration of accounting records or supporting documentation from which the financial statements are prepared.

c- Misrepresentation or intentional omission from the financial statements of events, transactions or other significant information
d- Intentional misapplication of accounting principles relating to amounts, recording fictitious journal entries, omitting, concealing or not disclosing facts that could affect the amounts recorded in the financial statements.

e- Overstatement in the provisions and reserves to meet possible events likely to occur in the future.

f- Showing contingent liability as actual liability.

**1-3- Significance of the study:-**

The main significance for this study is unprecedented; suggestions are given to overcome the tax evasion problem on a personal level and also at the national level. This study would hopefully add to the knowledge and would be useful for making certain concrete changes like positive behavior of the taxpayer towards tax evasion. This research is meant to help tax authorities to increase tax revenue through reducing tax evasion by way of changing the mindset of the taxpayer for obeying the rules of the act and which would ultimately help the nation. The social significance of this research lies in the increase in the social welfare of the Indian society.

There are some questions that need to be answered like:

1- How can the government curb tax evasion in the field of business and professions?
2- How can the Government spread tax awareness amongst the taxpayers in India?

This study is trying to find an answer to these questions

**1-4-Objectives of the study:-**

In the light of the nature of the problem and significance of the study, it is clear that, the main objective of this research is to study the impact of tax auditing to detect tax evasion in business and professions in India, there are some other objectives like:-

1- To study Indian tax system.
2- To study reasons and devices of tax evasion
3- To study kinds of tax evasion.
4- To study forms and ways of tax evasion in business and professions.
5- To study why business and professions are subjected for tax auditing.
6- To study the similarities and differences between statutory audit and tax audit.
7- To study impact of accounting standards issued by ICAI on tax audit u/s 44AB in Income Tax Act 1961
8. To study the role of tax auditor for detection of fraud and tax evasion
9. To study the convergences and divergences between accounting standards issued by ICAI and Income Tax Act 1961 provisions

1-5. Hypotheses of the study:

Keeping in view the results of the various research related studies on tax evasion and those corresponding to the objectives of the present study, the following hypotheses have been formulated and tested,

1. Tax audit helps to prohibit tax evasion by the Assesses. This hypothesis has been tested through the following four mini-hypotheses:
   a. Impact of tax audit is positive for detecting tax evasion by means of alteration of accounting records and intentional misapplication of accounting principles.
   b. Impact of tax audit is positive to detected tax evasion by means of manipulation in revenues and expenses items.
   c. Impact of tax audit is positive for detecting tax evasion by manipulation in vouchers, receipts and bills.
   d. Recalculation of income for business and professions according to income tax act provisions, after application of appropriate accounting standards, lead to reducing the overstatement of some expenses.

2. There is a positive role for tax auditor for detecting tax evasion by the Assesees. This hypothesis has been tested through the following axes:
   a. There is no collusion from tax auditor to taxpayer.
   b. ‘Professional Skepticism’ and ‘Due professional care’ from tax auditor help in the detection of tax evasion by the Assesees.
   c. There is a positive relationship between Professional care, Professional Skepticism, competent skills of tax auditor team and detecting tax evasion.

3. There are implications of accounting standards on tax audit u/s 44 AB of income tax Act 1961. This hypothesis has been tested through the following sub-hypotheses:
   a. Majority of accounting standards are recognized in income tax law.
   b. There is a positive effect to curbing tax evasion when increasing convergence between accounting standards issued by ICAI and of income tax Act 1961 provisions.
   c. There is a positive relationship between accounting standards and tax evasion.
1-6-Scope of the study:--
The study is related to three selected cities Mumbai, Pune and Aurangabad only in Maharashtra state, but it will help to improve the taxation policy of India, The study covers five years from assessment year 2005-2006 to 2009-2010.

1-7-Research Methodology:--
The nature of this study is descriptive and analytical. In this section the researcher seeks to describe the design and methodology used in conducting the study. A methodology is a set of techniques and procedures employed by the researcher to construct a systematic plan to achieve defined research objective, Research design is defined as “an approach to integrate various elements of a research project in a consistent and coherent fashion in order to address a predefined set of study question” (Trochim& Land,1982,21)

A research design is the specification of methods and procedures for acquiring the needed information. It is the over-all operational pattern or framework of the project that stipulates what information is to be collected from which source by what procedures, Since there are various options for conducting research, this section seeks to justify the choice of research methods employed during the conducting of this research.

1-7-1- Research Design:--
Research is a process of collecting, analyzing and interpreting information to answer questions. Descriptive research attempts to describe systematically a situation, problem, phenomenon, service or program, or provides information about, say, living condition of a community, or describes attitudes towards an issue.

Research design is the conceptual structure within which research would be conducted. The function of research design is to provide for the collection of relevant information with minimal expenditure of effort, time and money. It has been determined that the most appropriate design for the study is mixed research method, which involves using a survey for gathering primary data for scientific purposes from a sample of a population, and theoretical study for gathering background information from literature, books, scientific references, periodicals, web-side, specialized magazines and previous studies relevant to the subject in order to study various aspects that are relevant to subject.

A mixed method research design is a procedure for collecting quantitative, qualitative and theoretical background information data in a single study and analyzing and reporting this
data based on a priority and sequence of information (Creswell, 2002).

The goal of the sequential explanatory design typically was to use qualitative results to help in explaining and interpreting the finding of a primarily quantitative study. This helped in explaining any unexpected results arise from a quantitative study. (Morse, 1991)

A sequential explanatory research strategy was employed in this study, The researcher collected primary data by way of questionnaire and interview, after that present the data by using tables and graphs, after that analyzed quantitative data obtained from the survey and finally interpretation of this data, The researcher has used excel, SPSS 18.0 program and also used Gretl1.8.0 program (Gun Regression, Economics and Time-series library) for data analysis of questionnaire, calculating all types of statistical techniques for testing the hypothesis of the study.

There are many advantages of survey research. It is valuable in describing the characteristics of a large population. One advantage of using a survey is the ability to reach a large number of respondents with little effort and resources.

The nature of this study called for the use of survey research method. A written questionnaire was used to collect the data in this study, as the topic of research is mainly related to tax auditing, some of respondents were apprehensive and the researcher had to convince them about the confidentiality of their feedback in order to get their opinions.

1-7-2-The data collection:-
The study is based on both primary as well as secondary sources of data as flowing:-

1- Primary data:-
Primary data are directly collected by the researcher from their original sources, the researcher collected the required data precisely according to his research needs and has used the follow instruments

1. Questionnaire
2. Interview
3. Field visits

2- Secondary data:- for collection of secondary data, the following important sources have been used:-

1. Books and theses from different libraries, like Jaykar library, University of Pune, (Pune); Library of National Institute of Bank Management ,(Pune); Goghle Institute
of Politics and Economics Library (Pune); Poona College of Art, Science and Commerce; Vaikunth Mehta National Institute of Co-operative Management and Brihan Maharashtra College of Commerce, (Pune).

2. Books, articles and PDF papers, from web-site.

3. Participating, presenting and discussing in national conferences organized in some places in India.

4. Periodicals, specialized magazines and previous studies relevant to the subject in order to study various aspects relevant to the subject.

5. The necessary data for the research were extracted from the databases of Indian public finance statistics between the years from 2000-2001 to 2009-2010.

6. Audit Guides note issued by Indian Institute of Chartered Accounting.

7. Circulars issued by the central government which belong for tax audit.

1-7-3- Survey Distribution:-

The approach most suited for gathering descriptive information. a survey package containing a paper version of the questionnaire ( appendix B ) a cover letter( Appendix A). The researcher visited the colleges and institutes and handed over the questionnaire to the respondents after obtaining permission from the Head of Department or Dean of Colleges, and he visited Individual chartered accounting and firms of chartered accounting, He was on his visits to them over and over again for getting back the questionnai re.

1-7-2-selection of the sample:-

Random sampling was used so as to have collect and reasonable data. The study population consists of the Accountancy Professors in commerce colleges and Individual chartered accountants and firms of chartered accountants in the three cities (Pune, Mumbai and Aurangabad). The population study was 5000, out which 2770 chartered Accountants and 2230 Professors. The sample study was representing only 13% of population, and these kinds of respondents are much related to the questionnaire of the study. In Pune city the study population consists of (2000) Professor and Chartered Accountants, Out of which (1120) are Chartered Accountants and (810) professors. In Mumbai city the study population consists of (2000) Professor and chartered Accountants, Out of which (1120) are Chartered Accountants and (810) Professors, In Aurangabad city population consists of (1000) are
Professors and Chartered Accountants, Out of which (530) are Chartered Accountants and (470) Professors

The sample was drawn from the Professors and Chartered Accountants who were available at the time of circulating the questionnaire in the colleges, among the firm's chartered Accountants and Individual chartered Accountants. 600 questionnaires were distributed to the respondents in three cities (250 in Mumbai, 250 in Pune and 150 in Aurangabad) out of which 441 questionnaires were returned back. The Percentage of Chartered accountants of the sample study was of 58%, whereas Professors were represented 42% of the sample study.

1-7-5 - Justification of sampling method:-
Sampling is used in practice for a variety of reasons such as:
1- Sampling can save time and money.
2-Sampling may enable more accurate measurements.
3-Sampling remains the only way when population contains infinitely many members.
4-Sampling usually enables to estimate the errors and, thus, assists in obtaining information concerning some characteristics of the population.

1-7-6- Contact Methods -: Information may be collected by Mail, Telephone and Personal interview

1-7-7- The survey questionnaire:-
It is important to remember that, a questionnaire should be viewed as a multi-stage process beginning with definition of the aspects to be examined and ending with interpretation of the results. Every step needs to be designed carefully in the questionnaire process. Survey methodology was employed to collect data as it is found to be the most cost effective way to reach the target population. The self-developed questionnaire was structured. Taking into account the types of questionnaire that should be used in like this study, the researcher used all kinds of questions, like open ended questions , close ended questions, multiple-choice questions, and the questionnaire contains Likert-scale like questions on a five-point scale and Respondents had to choose from a scale ranging from “strongly disagree” to “strongly agree”. Most of the questions were “closed” in order to ease the respondent’s task, and items were necessary to describe and reflect the actual image of impact tax audit in tax evasion. Questionnaires are a relatively economical and fast way of collecting large amounts
of standardized information. As questionnaires depend on people to provide the needed answers, a benefit-risk factor must be considered.

1-7-8-Design of the survey:-
Structured Surveys use formal lists of questions asked of all respondents in the same way. Researcher often used sample survey methodology to obtain information about a large aggregate or population by selecting and measuring a sample from that population, Information for this study was gathered through written questionnaires.

A Sample is a segment of the population selected to represent the population as a whole. A comprehensive survey design addresses four main components: target population, sampling, survey instrument, and data collection. The questionnaire consists of four sections. The researcher placed the two questions at the top of questionnaire for information of demographic.

First section:- This section of the questionnaire contained question No. 1 to question No.6. These questions were common questions. Most of these questions were two choice questions (yes or no) and Multiple-choice questions.

Second section:- The second section of questionnaire was designed to measure impact of tax audit under section 44AB of Income Tax Act, 1961, on tax audit. This section included five types of questions, two option questions, open ended questions, close ended questions, Multiple-choice questions, and Likert scale Questions. This section was to test first hypothesis, The questions in this section were question NO. 7 to question No.46 and this section represent the main objective of our study.

Third section:- This section of questionnaire was designed to measure the role of tax auditor in tax evasion for detected tax evasion. This section was for test second hypothesis. The questions in this section were question No. 47 to question No.64. It included the same types of questions as in the first section.

Fourth section:- This section of questionnaire was designed to measure implication of standards accounting on tax audit. This section was to test the third hypothesis. The questions in this section were question No. 65 to question No.91, and included all kinds of questions.

1-7-9- Piloting of the questionnaire:-
The researcher conducted a pilot study in an attempt where the questionnaire items achieved the desired qualities of measurement, piloting and evaluation of the content and format of the
questionnaire is an essential step to identify the problematic issues in the questionnaire. The piloting process enable the researcher to determine whether he/she was asking the right question in the most effective way and whether the participants were able to answer the questions properly. For the purpose of the study, the survey instrument was tested for both validity and reliability. The questionnaire was distributed to the participants after explaining to them in a separate cover letter.

1-7-10- Evaluation of the research:-

Validity means that correct procedures have been applied to find answers to a question. Reliability refers to the quality of a measurement procedure that provides repeatability and accuracy.

1-7-10-1- Validity:-

Means that we are measuring what we want to measure. The idea of validity of the questionnaire design refers to the steps taken by the researcher to ensure clarity, wording, and ordering of the questions. “The degree to which a study accurately reflects or assesses the specific concept that the researcher is attempting to measure”( Sudman & Bradburn.1982). To ensure face validity, some guides in Poona College were given the questionnaire for comparisons and to comment on the clarity of items. The questionnaire was revised by English teacher for correcting a mistake in English grammar.

1-7-10-2- Reliability:-

Refers to the degree to which the instrument measures phenomena in a consistent manner. According to Oppenheim (1966), “reliability refers to consistency to obtaining the same results again”. This consistency can itself be measured in the form of a statistical coefficient of reproducibility, reliability that one step toward ensuring consistent measurement is that each respondent in a sample is asked the same set of questions and that the questions should all mean the same thing to all respondents. Reliability is concerned with the consistency, stability, and dependability of the result. To ensure that this was the case with this questionnaire, all questions were first pilot tested with a number of specialists in Accountancy and Commerce.

1-7-11- The Administration of the questionnaire:-

The self-administered paper and questionnaire was given by my hand to all respondents (Accountancy professors and chartered accountants), along with a cover letter explaining to them the purpose of the study. The researcher was vesting all respondents each second day
and was phone call daily, the final questionnaire were distributed to sample members in Pune, Mumbai and Aurangabad. All respondents were asked to complete and the researcher have collect the questionnaire from them.

**1-7-12 - The Data Analysis:**

Data analysis was provided through the use of excel program, the statistical package for the social sciences (SPSS) for Windows version18.0 and also used Gretl1.8.0(Gun Regression, Economics and Time-series library).

Procedures of data analysis consists of following steps, first step editing, coding, classification of data from questionnaire, and then presentation of data in tables, graphs and charts.

The researcher did data analysis through Descriptive of (SPSS) for show measures of central tendency (Mean, Median and mode) and show measures of dispersion (standard deviation, S.e.mean, variance, and range). The researcher used the following tool for data analysis from (SPSS) Frequencies, Descriptive, Explore, Crossable, Multiple response and Graphs.

**In order to test hypothesis of the study:**

The researcher utilized one-sample T test analysis and Pearson’s test and Spearman’s correlation coefficient has been calculated between all the variables. The researcher also used some Equations and also utilized Gretl for drawing some charts for testing hypotheses in this study. Pearson’s test. Spearman’s correlation coefficient has been calculated between all the variables.

**1-8-Limitations of the study:**

1- This study is only of impact of tax audit on tax evasion in India.
2- The period of study is covering 5 years A.Y.2005-06TO2009-2010.
3- This study is related to three cities selected, Mumbai, Pune and Aurangabad.

**1-9- Summary**

This chapter explained the methods and procedures to be used in this study. The design and significance of the study, objectives of the study, hypotheses of the study, scope of the study and research design and lastly detailed data collection procedures and data analysis procedures are explained in this chapter.