

Tax Evasion & Corruption In The Indian Income Tax System: Causes And Remedies

*Vaneeta Rani
**Dr. R. S. Arora

INTRODUCTION

Tax evasion refers to the efforts by an assessee to evade taxes by illegal means. It involves dishonest tax reporting and hiding of income. Tax evasion is a serious concern of fiscal policy all over the world. It is closely related to corruption in tax system of a country. It is unethical and shows that public does not have respect for tax system of the country. It further implies that there is something wrong with the tax system of the country. It reduces public revenue and generates black money. It has been recognized that black money is not a fund, but a stream. Thus, the amount which would have been used for economic and social development is used for anti- social activities such as gambling, speculation in real estate or stock market, financial scams, smuggling etc. Therefore, it is not only detrimental to the economic progress of the country, but is also harmful for the society at large.

INDIAN SCENARIO

It is widely believed that tax evasion is a serious problem in our country. The number of taxpayers having income above ₹ 10 lakh in the country has been very small as could be seen from Table 1.

Table 1 : Profile Of Assesseees

1	2	3	4	5	6	7	8	9	10
Years	Company assesseees having above ₹ 10 lakh income	Total company assesseees	Percentage of company assesseees having above ₹10 lakh income to total company assesseees	Non company assesseees having above ₹10 lakh income	Total non company assesseees	Percentage non company assesseees having above ₹10 lakh income to total non company assesseees	Total assesseees having above ₹10 lakh income (2)+(5)	Total assesseees (3)+(6)	Percentage of total assesseees having above ₹10 lakh income to total assesseees
	Number in Lakhs			Number in Lakhs			Number in Lakhs		
2003-04	0.44	3.72	11.83	1.05	267.95	0.39	1.49	271.67	0.55
2004-05	0.54	3.80	14.21	1.22	267.95	0.45	1.76	271.75	0.65
2005-06	0.68	3.93	17.30	5.62	293.95	1.91	6.30	297.88	2.11
2006-07	0.68	4.00	17.00	5.79	308.96	1.87	6.47	312.96	2.07
2007-08	0.59	4.98	11.85	2.18	331.65	0.66	2.77	336.63	0.82
Compound Growth Rate	6.04	6.01		15.73	4.36		13.20	4.38	

Source: Report of Comptroller & Auditor General of India on Direct Taxes from year 2005 to 2009.

Table 1 reveals that the number of total assesseees has increased from 271.67 lakh in 2003-04 to 336.63 lakh in 2007-08 from 271.67 lakh in 2003-04 to 336.63 lakh in 2007-08 at a compound annual growth rate (CGR) of 4.38 per cent. The

*Assistant Professor, Govt. Bikram College of Commerce, Patiala, Punjab. Email: vaneeta142@yahoo.co.in

**Professor, Department of Commerce, Punjabi University, Patiala, Punjab. Email : radhasharnarora@gmail.com

number of assesseees having income above ₹ 10 lakh has increased at a compound annual growth rate of 13.20 per cent from 1.49 lakh in 2003-04 to 2.77 lakh in 2007-08. So, CGR is better in case of assesseees having income above ₹ 10 lakh as compared to total assesseees. Similarly, the number of company assesseees and other assesseees having income above ₹ 10 lakh has increased from 0.44 lakh & 1.05 lakh in 2003-04 to 0.59 lakh & 2.18 lakh in 2007-08 respectively. So, company assesseees and other assesseees having income above ₹ 10 lakh have increased at CGR of 6.04 per cent and 13.20 per cent respectively during this period. Further, the number of total assesseees have registered a continuous growth during this period. However, there was a sharp fall in the number of company assesseees and other assesseees having income above ₹ 10 lakh from 0.68 lakh & 5.79 lakh in 2006-07 to 0.59 lakh & 2.18 lakh in 2007-08 respectively, which has serious implications on govt. revenue. Thus, in a population of more than 100 crores in March 2008, there were total 2.77 lakh taxpayers having income above ₹ 10 lakh as a whole (0.82% of total tax payers) comprising of 2.18 lakh non-company taxpayers and 0.59 lakh corporate taxpayers. A study conducted by the American Express (2007) revealed that Mumbai alone had at least 25,000 dollar millionaires who had at least 4 - 5 crores investible liquid funds. The number of affluent individuals was estimated at 2,00,000 during 2005-06. This study further estimated that super rich class (having money in excess of ₹ 50 lakh to invest) had 60 billion dollars in liquid investible funds, which was equal to 4-5 times of FDI into the country. The report estimated that by 2009, India would have at least 10 lakh super rich people in Mumbai and Delhi alone. If this report about two cities is taken as a basis, then one can guess what may be the position in the whole country. So, if we compare these figures with Table 1, then it raises a suspicion in our mind- that lakhs of taxpayers who should have been covered under category of taxpayers having income above ₹ 10 lakh were successful in avoiding tax payments.

REVIEW OF LITERATURE

Over the years, various committees, commissions and researchers have studied the issue relating to tax evasion in India. Their studies are based on secondary data and estimates. In order to explore research gap in the subject, the related studies have been reviewed and crux of the same has been given in the following paragraphs.

Taxation Enquiry Commission (1953) was appointed by Government of India to carry out an in-depth study of central taxes on the issue of tax compliance under the chairmanship of John Matthai. The Commission found evidence of considerable tax evasion on the basis of statistics made available to it by the Central Board of Revenue. The difference between income originally returned and that disclosed to the tax department was as high as 600 per cent on an average. Kaldor (1956), at the behest of the Government, made an estimate of tax loss through evasion amounting to ₹ 200 crore to 300 crore during 1953-54 (50-80 per cent of tax revenue of Centre). He suggested an introduction of comprehensive reporting system for transactions of capital nature and lowering of the maximum rate of income tax to 45 per cent for checking tax evasion. Direct Taxes Enquiry Committee (1971) was appointed by Govt. of India under the chairmanship of Justice K. N. Wanchoo to recommend measures for unearthing black money and preventing tax evasion. The committee estimated that unreported income was ₹ 1400 crores during 1968-69 resulting in tax evasion amounting to ₹ 470 crores. The committee opined that high rate of taxes, donations to political parties, ineffective enforcement of law and deterioration in moral standards were the main reasons for tax evasion. The committee suggested for reduction in tax rates, regulation of donations to political parties and introduction of extensive system of intelligence. Acharya, Shankar and Associates (1985) made an analysis of various aspects pertaining to unaccounted income in Indian economy. The study noted that demonetization and voluntary disclosure schemes failed to check the generation of black money. The researchers suggested for reduction in tax rates, simplification of tax structure, strict enforcement of law and punishment to tax evaders for reining the generation of black income. Jha (1999) examined the reasons for tax evasion, black money and implications of offering amnesties to tax evaders in India. She reported that most important reason for tax evasion was that it provided economic benefits to tax evaders. The author opined that besides tax evasion, black income was also generated from illegal activities like smuggling, trafficking in illicit drugs and gambling etc. On the basis of various estimates, unaccountable income in India was reported to be in the range of ₹ 350-700 thousand crores, comprising of more than 50 per cent of the GDP. She recommended reduction in marginal income tax rates for individuals, firms and corporations, which could help in widening the tax base. She feared that amnesty schemes might lead to continued tax evasion with the hope of continuation of such schemes in future. Finally, she suggested that amnesty schemes should be eliminated to make tax administration more efficient. Global Financial Integrity (2008) (a wing of Centre for International Policy) reported that estimated volume of capital flight into global

tax havens from India ranged from \$22 billion to 27 billion annually for the time period 2002 to 2006. Ramanujam (2009) emphasized that the govt. should pursue investigation of Indian money kept in offshore banks. He highlighted that according to reports of International agencies, around \$1.5 trillion of Indian wealth was stashed away by Indians in offshore banks. He further estimated that taxes due from these secret accounts would amount to a sum equal to twice of our GDP. However, it is worth mentioning that most of these studies are based on estimation of tax evasion. None of the studies have tried to consider the perception of tax professionals regarding tax evasion and prevailing corruption in Indian Income Tax system. Since tax professionals have full knowledge of Income Tax System and attitude of taxpayers, their views would be helpful in understanding the problem more closely. Hence, an attempt has been made in this research paper to study the perception of tax professionals with regard to tax evasion and corruption in India.

OBJECTIVES OF THE STUDY

The present study has been carried out with the following main objectives:

- ✿ To identify the reasons of tax evasion and corruption as perceived by tax professionals; and
- ✿ To suggest measures for improving tax compliance.

RESEARCH METHODOLOGY

The universe of present study comprised of tax professionals i.e. Chartered Accountants practising in Punjab (India). A sample of 250 respondents has been taken by selecting 50 respondents from Patiala (L_1), Chandigarh (L_2), Ludhiana (L_3), Jalandhar (L_4) and Amritsar (L_5) each. The primary data has been collected with the help of a well structured questionnaire from January 2009 to July 2009. Chi-square test and percentage has been used for analyzing the data.

RESULTS OF THE STUDY

OPINION REGARDING TAX EVASION IN INDIA

With a view to understand the perception of tax professional on the issue of tax evasion, the respondents were asked to express their view on a five point scale (ranging from strongly agree to strongly disagree) with regard to the statement 'tax evasion is very high in India'. Their responses have been presented in Table 2.

Table 2 : Opinions Of Tax Professionals Regarding Tax Evasion In India

Opinion/ Location	L_1	L_2	L_3	L_4	L_5	Total
Strongly Agree	21	12	20	15	15	83
	(42)	(24)	(40)	(30)	(30)	(33.2)
Agree	28	36	26	35	29	154
	(56)	(72)	(52)	(70)	(58)	(61.6)
Neither Agree Nor Disagree	1	0	3	0	2	6
	(2)	(0)	(6)	(0)	(4)	(2.4)
Disagree	0	2	1	0	4	7
	(0)	(4)	(2)	(0)	(8)	(2.8)
N	50	50	50	50	50	250
	(100)	(100)	(100)	(100)	(100)	(100)
Chi-square value = 19.6. d. F. =12 Not Significant At 5 Per Cent Level Of Significance						

Note: 1. N in this table and all the tables to follow represents total number of respondents.

2. Figures in parentheses in this table and all the tables to follow represent percentages while figures without parentheses represent simple frequencies.

Table 2 reveals that vast majority of the respondents (94.8%) have agreed or strongly agreed with the statement 'tax evasion is very high in India'. It is followed by the respondents who have disagreed with this statement (2.8%) and have neither agreed nor disagreed (2.4 %). Location- wise analysis shows that majority of the respondents from location L_4 (100%), L_1 (98%), L_2 (96%), L_3 (92%) and L_5 (88%) have agreed or strongly agreed with this opinion. Further, Chi-square test at 5 per cent level of significance reveals that no significant opinion differences exist among

the respondents from various locations with regard to tax evasion in India.

REASONS FOR TAX EVASION IN INDIA

237 respondents who have agreed or strongly agreed with the earlier statement (see Table 2) were further requested to identify the probable reasons for this. Their responses have been presented in Table 3.

Table 3 : Reasons Listed By The Respondents For Tax Evasion In India

Reasons/ Location	L ₁	L ₂	L ₃	L ₄	L ₅	Total
High tax rates	30	38	25	30	34	157
	(61)	(79)	(54)	(60)	(77)	(66)
If caught, it could be managed.	30	31	26	30	35	152
	(61)	(65)	(57)	(60)	(80)	(64)
Social acceptance of tax evasion	23	30	31	19	24	127
	(47)	(63)	(67)	(38)	(55)	(54)
Ineffective penalty & prosecution provisions	10	12	12	10	11	55
	(20)	(25)	(26)	(20)	(25)	(23)
Inefficiency in income tax department	17	20	19	26	22	104
	(35)	(42)	(41)	(52)	(50)	(44)
Tax payers' perception that govt. does not spend tax revenue prudently	18	9	20	14	16	77
	(37)	(19)	(43)	(28)	(36)	(32)
Low probability of detection	25	26	23	22	20	116
	(51)	(54)	(50)	(44)	(45)	(49)
Low tax morality	16	23	25	21	16	101
	(33)	(48)	(54)	(42)	(36)	(43)
Multiple taxes	33	42	29	36	35	175
	(67)	(88)	(63)	(72)	(80)	(74)
N	49	48	46	50	44	237

Note: Percentages Are More Than 100 Because Of Multiple Choices.

Table 3 shows that majority of the respondents have identified 'Multiple taxes' (74%), 'High tax rates' (66%), 'If caught it could be managed' (64%), 'Social acceptance of tax evasion' (54%), 'Low probability of detection' (49%), 'Inefficiency in income tax department' (44%) and 'Low tax morality' (43%) as main reasons responsible for tax evasion in India. The reasons which have been given less weightage are 'Ineffective penalty & prosecution provisions' (23%) and 'Tax payers' perception that govt. does not spend tax revenue prudently' (32%). Location-wise analysis reveals that majority of the respondents, irrespective of their locations, have identified three basic reasons i.e. 'Multiple taxes', 'If caught it could be managed' and 'High tax rates' responsible for tax evasion. Besides these, other important reason has been 'Social acceptance of tax evasion' as it has been pointed out by majority of the respondents from locations L₃ (67%), L₂ (63%) and L₅ (55%). It can also be observed that the respondents from locations L₂ (54%), L₁ (51%) and L₃ (50%) have identified 'Low probability of detection' as one of the reasons for tax evasion. 'Inefficiency in income tax department' has been identified as an important reason only in two locations L₄ (52%) and L₅ (50%). 'Low tax morality' has been held as important because of tax evasion only in one location L₃ (54%). 'Taxpayers' perception that govt. does not spend tax revenue prudently' and 'Ineffective penalty & prosecution provisions' have been considered important reasons for tax evasion only by few of the respondents in all the locations.

CORRUPTION

Corruption and taxation have always been associated in the history of mankind. It is the biggest block in the way of

proper implementation of law, which leads to tax evasion. It erodes the confidence of public in tax system. In order to verify the perception held by the respondents, they were asked on a five point scale (ranging from strongly agree to strongly disagree) to comment on the statement 'Corruption is prevalent in the income tax system'. The responses so obtained have been presented in Table 4.

Table 4 : Opinion Of Respondents Regarding Prevalent Corruption In The Income Tax System

Opinion/ Location	L ₁	L ₂	L ₃	L ₄	L ₅	Total
Strongly agree	20	5	10	21	12	68
	(40)	(10)	(20)	(42)	(24)	(27.2)
Agree	28	32	38	26	33	157
	(56)	(64)	(76)	(52)	(66)	(62.8)
Neither agree nor disagree	2	2	1	3	5	13
	(4)	(4)	(2)	(6)	(10)	(5.2)
Disagree	0	11	1	0	0	12
	(0)	(22)	(2)	(0)	(0)	(4.8)
N	50	50	50	50	50	250
	(100)	(100)	(100)	(100)	(100)	(100)

Chi-Square Value = 58.767

d. f. =12

Significant at 5 per cent level of significance

Table 4 reveals that 90 per cent of the respondents have agreed or strongly agreed with the statement 'Corruption is prevalent in the income tax system'. Only 4.8 per cent have disagreed with this. However, 5.2 per cent have neither agreed nor disagreed with the given statement. Location-wise analysis indicates that a major proportion of the respondents, irrespective of their locations i.e. L₁ & L₃ (96% each), L₄ (94%), L₅ (90%) and L₂ (74%) have agreed or strongly agreed with the given statement. None of the respondents from locations L₁, L₄ and L₅ have disagreed with the statement. Surprisingly, 22 per cent of the respondents from location L₂ and 2 per cent from L₃ have disagreed with this statement. Further, Chi-square test at 5 per cent level of significance reveals that significant opinion differences exist among the respondents from various locations with regard to the statement 'Corruption is prevalent in the Indian Income Tax System'.

REASONS FOR CORRUPTION

225 respondents, who believed (have agreed or strongly agreed with the opinion) that corruption is prevalent in the income tax system, were further requested to point out various reasons for corruption. Their responses have been presented in Table 5. Table 5 shows that majority of the respondents (77%) have specified 'Excessive discretionary powers available with income tax authorities' as the most significant reason for corruption. It is followed by the reasons such as 'Lot of harassment to tax payers' (62%), 'Lack of integrity on the part of tax officials' (61%), 'Lack of awareness regarding rights available with tax payers' (55%) and 'Time consuming and costly judicial process' (52%). A very low percentage of the respondents feel that 'Complicated documentation' (24%) and 'Low pay of income tax employees' (9%) have been responsible for it. Location-wise, the analysis reveals that majority of the respondents irrespective of their location have pointed out that 'Excessive discretionary powers available with income tax authorities' and 'Lot of harassment to taxpayers' have been the significant reasons responsible for corruption. 'Lack of integrity on the part of income tax officials' has also been considered a significant cause by the respondents from all the locations except location L₁. Even, 'Time consuming & costly judicial process' has been indicated as a significant reason for corruption by the respondents from all the locations except location L₄. Further, the respondents from locations L₂ (73%), L₃ (65%) and L₄ (53%) have identified 'Lack of awareness regarding rights available with taxpayers' as a reason for corruption. Reasons 'Complicated documentation' and 'Low pay of income tax employees' have been considered important reasons for corruption only by few respondents, irrespective of their locations.

Table 5: Reasons (Listed By The Respondents) Responsible For Corruption

Reasons /Location	L ₁	L ₂	L ₃	L ₄	L ₅	Total
Excessive discretionary powers available with income tax authorities	35	27	39	39	33	173
	(73)	(73)	(81)	(83)	(73)	(77)
Lack of integrity on the part of income tax officials	20	28	30	36	23	137
	(42)	(76)	(63)	(77)	(51)	(61)
Complicated documentation	11	5	15	17	7	55
	(23)	(14)	(31)	(36)	(16)	(24)
Lot of harassment to tax payers	34	27	24	29	25	139
	(71)	(73)	(50)	(62)	(56)	(62)
Time consuming & costly judicial process	26	20	26	15	31	118
	(54)	(54)	(54)	(32)	(69)	(52)
Lack of awareness regarding rights available with taxpayers	20	27	31	25	21	124
	(42)	(73)	(65)	(53)	(47)	(55)
Low pay of income tax employees	4	1	7	3	6	21
	(8)	(3)	(15)	(6)	(13)	(9)
N	48	37	48	47	45	225

Note: Percentages Are More Than 100 Because Of Multiple Choices

MEASURES FOR IMPROVING TAX COMPLIANCE

The effectiveness of any law can be measured from its compliance. Surprisingly, 95 per cent of the respondents have pointed out that tax evasion is very high in India (see table 2). Further, 90 per cent of the respondents have pointed out that corruption is prevalent in the Indian tax system (see table 3). Both of these problems result in low tax compliance. Thus, there seems to be an urgent need to curb evasion & corruption in Income Tax System and increase tax compliance. Hence, the respondents were asked to suggest measures for improvement in tax compliance. The responses obtained have been exhibited in Table 6. Table 6 shows that majority of the respondents (77%) have recommended 'Reduction in tax rates' for dealing with tax evasion. In addition to this, they have also recommended 'Extensive use of TDS system' (69%), 'Simplification of tax laws' (68%) and 'Proper utilization of information available under the Annual Information Return' (57%). The moderate proportion of the respondents have also suggested 'Increase in publicity' (42%), 'Widening of Annual Information Return network' (36%) and 'Implementation of voluntary disclosure scheme' (33%). However, a very low percentage of respondents (10%) have suggested 'Intensive use of coercive recovery' in this regard. Further, location-wise analysis indicates that majority of the respondents, irrespective of their locations, have emphasized on three measures i.e. 'Reduction in tax rates', 'Simplifications of tax law' and 'Extensive use of TDS system' for improving tax compliance. Moreover, comparatively large number of the respondents from locations L₅ (86%) and L₂ (84%) have suggested for 'Reduction in tax rates' and 'Extensive use of TDS' respectively. Further, majority of the respondents from locations L₃ and L₅ (68% each) have suggested 'Proper utilization of information available under the Annual Information Return' in this respect. Similarly, 66 per cent of the respondents from location L₂ have also suggested 'Increase in publicity'. Whereas, a small number of respondents from all the locations has suggested 'Implementation of voluntary disclosure scheme' and 'Widening of Annual Information Return network' in this regard. Only few respondents from all the locations have recommended 'Intensive use of coercive recovery' as a measure for improving tax compliance.

Table 6 : Measures Suggested By The Respondents For Improving Tax Compliance

Measures/ Location	L1	L2	L3	L4	L5	Total
Reduction in tax rates	38	39	39	33	43	192
	(76)	(78)	(78)	(66)	(86)	(77)
Simplification of tax law	31	39	37	34	29	170
	(62)	(78)	(74)	(68)	(58)	(68)
Increase in publicity	18	33	23	20	12	106
	(36)	(66)	(46)	(40)	(24)	(42)
Extensive use of TDS system	31	42	40	30	30	173
	(62)	(84)	(80)	(60)	(60)	(69)
Implementation of voluntary disclosure Scheme	14	13	20	17	19	83
	(28)	(26)	(40)	(34)	(38)	(33)
Widening of Annual Information Return network	22	15	15	19	19	90
	(44)	(30)	(30)	(38)	(38)	(36)
Proper utilization of information available under AIR	23	27	34	25	34	143
	(46)	(54)	(68)	(50)	(68)	(57)
Intensive use of coercive recovery	2	6	6	6	4	24
	(4)	(12)	(12)	(12)	(8)	(10)
N	50	50	50	50	50	250

Note: Percentages are more than 100 because of multiple choices

SUMMARY AND SUGGESTIONS

The present study has investigated the opinion of tax professionals regarding tax evasion and corruption in the Indian Income Tax system. Tax professionals are of the opinion that tax evasion & corruption is prevalent in the Indian Income Tax System. They have pointed out that multiple taxes, high tax rates, corruption, social acceptance of tax evasion, low probability of detection and low tax morality are the main causes of tax evasion. Further, they have opined that excessive discretionary powers available with income tax officials, harassment to tax payers, lack of integrity on the part of income tax officials, lack of awareness among the taxpayers and time consuming judicial processes are the factors which lead to corruption. They have suggested for rationalization of tax rates, simplification of tax laws, extensive use of TDS system and proper processing of information available under the Annual Information Return for increasing tax compliance. Thus, there is a need for creating transparent, non discriminatory and taxpayer friendly administrative system for honest taxpayers. Further, there is a need to educate citizens about tax laws and create a culture whereby they pay due taxes and feel proud of discharging their duty to the fellow citizens.

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