

Research Paper



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TAX EVASION IN INDIA: A STUDY OF ITS IMPACT ON REVENUE OF THE GOVERNMENT

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ABSTRACT

Tax is a major source of government revenue and it contributes for the overall development and prosperity of a country. Raising government revenue in terms of income tax, custom duty, excise duty, entertainment tax, VAT, land revenue tax etc. from various sectors in order to initiate development and welfare programmes that are meant to improve the company's situation. But the country has been facing a massive problem with tax evasion. People who should be paying taxes have found ways not to pay them and, as a result, it may be said that the income of the country has been suffering. India is facing major problems like Tax Evasion, Black money, existence of parallel economy show that Indian taxation system requires some major reforms in the future ahead to address all this problems. In this backdrop the present paper explores the tax evasion concepts and examine amount of tax evasion in India. For this purpose the required data have been collected from secondary sources.

KEYWORDS: Tax Evasion, Tax Estimation, Revenue, GDP

INTRODUCTION

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.

REVIEW OF LITERATURE

Singh and Sharma (2007) made an attempt to study the perception of tax professionals with regard to Indian Income Tax System by collecting primary data from 100 tax consultants operating in Punjab and Haryana. They tried to investigate the role of tax consultants played in the revenue collection process by helping their clients in understanding the complex tax system and meeting their legal obligations. Factor Analysis of data showed that seven factors –reduction in tax evasion, extension of relief to taxpayers, incentives for dependents and honest tax payers, broadening the tax base, e-filing of returns, adequacy of deductions and impact of exempt tax system played an important role in determining the effectiveness of Indian tax system. While concluding the authors suggested for adjustment of income tax rates according to price level changes, broadening of tax base, strict measures against tax evaders, extensive use of TDS, consideration to

number of dependents for tax rate purpose and establishment of good relationship with tax payers .

Arora R.S. and Rani Vanita (2010) Studied the causes and Remedies for Tax evasion & corruption in the Indian Income tax system . They investigated the opinions of tax professionals from the different districts of Punjab regarding tax evasion and corruption in Indian Tax system. They pointed out the 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 opined that excessive discretionary powers available with income tax authorities, harassment to tax payers, lack of integrity on the part of income tax officials, lack of processes are the factors which lead to corruption. They suggested the 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.

Lalitwadhwa and Dr. Virender Pal 2012 They opined that high tax rates, corruption in public sector units, multiple tax rates and inefficient tax authorities are the main causes of tax evasion. They suggested that reduction in tax rates, simplifications of tax laws, remove loopholes in the tax system and some extent proper processing of information available the under the annual information return can be best tool for improving Indian tax compliance.



V. Kalpana 2015 (Tax Evasion - A Major Threat to Economic Development and Growth – Causes and Remedies) This review paper focused on highlighting the causes and ill effects of tax evasion in the overall development of the Indian economy. Low tax morale, low quality of services in return for taxes and low transparency and accountability of public institutions have led to high tax evasion in our country.

Mr. Nishant Ravindra Ghuge and Dr. Vivek Vasant Rao Katdare 2016, (A Comparative Study of Tax Structure of India with respect to other countries) The study found that Indian tax structure lags behind on almost every indicator. There is a strong requirement for a serious review and actions from the government are needed in simplifying the tax structure.

OBJECTIVES AND METHODOLOGY OF THE STUDY

This study is carried out with the following objectives:

- 1) To Study the concept of tax evasion
- 2) To find out the extent of income tax evasion.
- 3) To find out the impact of tax evasion in India

To meet the above objectives of the study, the required data have been collected from secondary sources, such as Internet, websites, professional magazines, referred journals, newspapers and conference books. In addition to books on income tax and reports published are also used. For the purpose of analysis of the data, the statistical tool like, Correlation Analysis and Regression Analysis have been employed. And these can be calculated by using the following formulae.

$$\text{Correl}(X, Y) = \frac{\sum (x - \bar{x})(y - \bar{y})}{\sqrt{\sum (x - \bar{x})^2 \sum (y - \bar{y})^2}}$$

HYPOTHESIS OF THE STUDY

H₁: There is no significant increase in the amount of Tax Evasion in India.

H₂: There is no significant association between Estimated Revenue (ER), Actual Revenue (AR) and Amount of Tax Evasion (TE).

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 recognized 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).

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.

EFFECTS OF TAX EVASION

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

The important effects are;

1. 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 salaried employee in the organised corporate sector earns the same reported as the 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
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. 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.
4. Tax evasion being under-reporting of income implies underestimation of GDP and all its commensurate macro economic 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.
- 5) Tax evasion has been causing reduction in country's economic growth
 - 6) The direct effect of tax evasion is the loss of revenue, and increase in inflation
 - 7) Black money has resulted in transfer of funds from India to foreign countries through clandestine channels which decrease country's reputation globally.
 - 8) Tax evasion leads to poor standards of living of the rural masses and the people BPL as the government cannot undertake welfare measures at the national level.
 - 9) It also brings disequilibrium in the economic condition of the country resulting in the rich becoming richer and the poor becoming poorer.
 - 10) Due to tax evasion of majority of the rich population, the government is forced to increase the rates of tax every assessment year for increasing its revenue which results in increased tax burden of those who pay taxes promptly.

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. 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. 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. 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. 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.

6. Changes in Penal Provisions

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 experiences 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.

Table-1: showing estimated amount of tax evasion for last 15 year (Rs in Crores)

Year	Revenue Estimated (ER)	Actual Revenue Collection (AR)	Estimated Tax Evasion (TE)
2000-01	74467	68305	6162
2001-02	73972	69198	4774
2002-03	82445	83088	-643
2003-04	103400	105088	-1688
2004-05	134194	132771	1423
2005-06	170077	165216	4861
2006-07	229272	230181	-909
2007-08	304760	312213	-7453
2008-09	345000	333818	11182
2009-10	387008	378063	8945
2010-11	446000	446935	-935
2011-12	500651	493947	6704
2012-13	565835	558658	7177
2013-14	636318	638543	-2225
2014-15	705628	695797	9831

Source: Annual Report of ministry of finance,
Government of India 2016

**Table-2: Correlation Co-efficient(*r*) between ER, AR and TE.**

	Estimated Revenue	Actual Revenue	Tax Evasion
Estimated Revenue	1	--	--
Actual Revenue	0.999707524	1	--
Tax Evasion	0.246339186	0.222828383	1

Source: Compiled from Table-1

Table: Regression Analysis of ER, AR and TE

Inputs	Multiple R	R Square	Adjusted R Square	Standard Error	Observations
ER to TE	0.246	0.061*	-0.012	217106.395	15
AR to TE	0.223	0.050*	-0.023	217106.395	15

Source: Compiled from Table-1 *5% level of significance

From the table-1, shows the Estimated Revenue, Actual Revenue and the amount of tax evasion from 2000-01 to 2014-15. During the study period, the maximum Tax Evasion is found in 2008-09, i.e., 11182 crore, followed by 2014-15, 2012-13 and 2000-01 were also significant of amount recorded. To find the association between estimated revenue, actual revenue and amount of tax evasion, Correlation coefficient has been calculated, from the table-2, it can be said that, there is a less degree of positive relationship between ER, AR and ER (r , 0.246, 0.222). Further, to test the **Hypothesis 1**, there is no significant increase in the amount of Tax Evasion in India, Regression coefficient has been employed, the calculated R^2 in both the cases (ER to TE-0.06, AR to TE-0.05 > 0.05) is greater than 5% level of significance, therefore it can be conclude that, Tax evasion significantly increased on account of increase in the revenue of the government.

CONCLUSION

Having been aware of the ill effects of tax evasion, it becomes each one of our responsibility to support the government by complying with the tax procedures and pay taxes promptly. As it is rightly said that every drop of water makes an ocean, it can also be said that our small contribution makes a huge difference in the growth of the economy. Instead of expecting for change to happen, let us be the change agents who can bring in a drastic development by just fulfilling our responsibilities promptly. If each one of us speaks the same

language, then there will be least or no scope for us to be exploited by any institution or authority. So let us fulfill our duties first and claim our rights next.

Further there is also a need to educate the people about Indian Tax law and create such an environment in which they pay their due taxes, do not evade the tax and feel proud in discharging their duty to pay the taxes.

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