



Effectiveness of income tax law for prevention of tax evasion & black money generation: A study of its impact on Indian economy

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Abstract

Taxes are the major source of revenue to the government. The concept of tax has a long history. Since the beginning of human civilization, the tax seems to have been imposed by the state in one form or the other. A tax on income was one such source added to the system of taxation. A 'tax' is not a voluntary payment or donation, but an enforced contribution exacted pursuant to legislative authority. Taxation plays a critical and pivotal role in the process of advancement and growth of any Country. It was William Pitt who introduced personal income taxation in England in 1799, as 'shield money' to finance for the war. The Income Tax Bill 1961 was prepared on the basis of the Prof. Nicholas Kaldor Committee's recommendations. The Income Tax Act 1961 came into force on April 1, 1962. Tax evasion occurs when individuals deliberately fail to comply with their tax obligation. The resulting tax revenue loss may cause serious damage to the proper functioning of the public sector, threatening its capacity to finance its basic expenses. India is facing major problems like tax evasion, black money; the existence of parallel economy show the Indian taxation system requires some major reforms in future ahead to address all these problems. This study covers the overview of the effectiveness of Income tax law, tax evasion in India, delineating the number of factors responsive for income tax evasion and examining the possible remedies to reduce the problem of tax evasion.

Keywords: income tax law, income tax data, income tax revenue tax evasion & black money, GDP

Introduction

The effectiveness of Income Tax Law is a great tool for prevention of tax evasion and black money generation in India. "Tax on income" is defined in an inclusive manner by Article 366 under which the expression includes a tax in the nature of an excess profits tax. "Corporation tax" is defined by Article 366 to mean any tax on income, so far as it is payable by Companies. Article 265 of the Indian Constitution specifically states that no taxes shall be levied or collected except by the authority of law. Evasion of tax takes place when the people report dishonest tax includes declaring fewer gains, profits or income than what has been actually earned and they even go for overstating deductions from their income. Thus the amount which would have been used for economic and social development is used for anti-social activities. India has got some major taxes in the form of Corporation tax, Customs Duty, Excise Duty, Income Tax and Services tax which form the major source of its revenue. The tax to GDP ratio in India is even somewhat low at 16.5 % in FY 2015-16 which is 33 % for developed economies.

Tax evasion and black money

Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authority to reduce their tax liability. There is no uniform definition of black money in the literature or economic theory. "Black money" can be defined as assets or resources that have neither been reported to the public authorities at the time of their generation nor disclosed at any point of time during their possession. According to National Institute of Public Finance

and Policy (NIPFP) defines- "Black Money is the aggregate of incomes which are taxable but not reported to authorities."

Review of literature

Singh and Sharma (2007) ^[1] made an attempt to try 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, an extension of relief to taxpayers, incentives for dependents and honest tax payers, broadening the tax base, filing of returns, adequacy of deductions and impact of exempt tax system played an important role in determining the effectiveness of Indian tax system.

Lalit Wadhwa 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 under the annual information return can be best for improving Indian tax compliance.

Mr. Nishant Ravindra Ghuge and Dr. Vivek Vasantrao Katdare (2016) (A Comparative Study of Tax Structure of India with respect o 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.

Dr. Devarajappa S. (2017) ^[5] (Tax evasion in India: A study of

its impact on the revenue of the Government) opined that we should support the government by complying with the tax procedures and pay taxes promptly. So let us fulfill our duties first and claim our rights next. He also suggested that 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 and that they do not evade the tax and feel proud in discharging their duty to pay the taxes.

The objective and methodology of the study

This study is carried out with the following objectives:

1. To Study effectiveness of Income Tax Law for the prevention of tax evasion.

Government data on income tax

Details of Number of effective Assesses of income tax in India

Table 1

PAN Category	AY 2014-15	AY 2015-16	AY 2016-17**
Association of Person	1,59,520	1,79,539	1,85,235
Body of Individuals	7,020	7,465	8,035
Company	7,48,237	7,68,268	7,64,410
Firm	10,94,509	11,60,540	11,83,586
Government	338	483	708
Hindu Undivided Family	10,02,644	10,54,642	10,28,580
Artificial Juridical Person	10,576	11,114	11,074
Local Authority	7,160	7,552	8,063
Individual	5,39,58,653	5,78,37,733	5,92,73,878
Trust	2,17,660	2,31,144	2,28,392
Total*	5,72,06,317	6,12,58,480	6,26,91,961***

*The data is based on the number of income-tax returns entered in the System plus a number of cases where tax has been deducted at source from the income of the taxpayer but the taxpayers have not filed the return of income.

** Provisional

*** Returns for AY 2016-17 can be filed until 31.03.2018.

The Government data on the income tax shows that tax evasion by individuals is so huge and it can create major impediments to a country, which strives to offer a social security net to its citizens, build quality public infrastructure and eradicate poverty. If one looks at the Assessment Year 2015-16 figures, just about 5.78 crores people filed income tax returns, making it less than 5 percent of the population

2. To study the main reason behind the tax evasion & generation of black money.
3. To find out the impact of tax evasion & black money on Indian economy.
4. To find out remedial measures to curtail the tax evasion & Black money.

To meet the above objectives of the study, the required data have been collected from secondary sources, such as the internet, websites, professional magazines, research journals, and newspapers. In addition to books on income tax and reports published are also used.

(considering population at 125 crores). There is clear evidence here that a significant number of people who are liable to pay taxes aren't doing so. What these figures effectively telling us is that the domestic tax evasion is an even bigger concern for India than chasing the black money stashed abroad.

Table 2: Contribution of Direct Taxes to Total Tax Revenue (Rs. in crore)

Financial Year	Direct Taxes	Indirect Taxes	Total Taxes	Direct Tax As % Of Total Taxes
2012-13	558989	472915	1031904	54.17%
2013-14	638596	495347	1133943	56.32%
2014-15	695792	543215	1239007	56.16%
2015-16	741945	711885	1454180	51.03%
2016-17*	849818	861515	1711333	49.66%

Table 3: Direct-Tax GDP Ratio (Rs. in crore)

Financial year	Net Collection of Direct Taxes	GDP Current Market Price	Direct Tax GDP Ratio	GDP Growth Rate	Tax Growth Rate	Buoyancy Factor
2012-13	558989	10113281	5.53%	12.25%	13.16%	1.07
2013-14	638596	11355073	5.62%	12.28%	14.24%	1.16
2014-15	695792	12541208	5.55%	10.45%	8.96%	0.86
2015-16	741945	13567192	5.47%	8.25%	6.63%	0.80
2016-17*	849818	15183710@	5.60%	11.91%	14.54%	1.22

* Provisional and

@ Advance Estimates as per Press Release dated 31.05.2017 of MOSPI.

The composition of direct taxes has undergone considerable changes since 2012-13 but tax growth rate has been gradually declining up to 2015-16. During the financial year 2016-17 it again increases up to 14.54%.

Causes behind the tax evasion and generation of black money

Tax evasion and black money generation in India takes place through two sources. The first source includes those activities which are not permitted by law, such as crime, drug trade terrorism, and corruption. The second is a legally permissible activity but not accounted for and/ or reported to public authorities which may result in tax evasion. Tax evasion involves misreporting or non-reporting of the transactions in the book of account. The manipulation of financial statement results in the generation of unaccounted income that amounts to black money. There are many reasons for the creation of back money in India. Some of them are as follows:

- a) **Out of Book Transactions:** The most widely adopted methods of tax evasion, generally prevalent among the small shops, unskilled or semi-skilled service providers, etc. transactions that may result in taxation of receipts or income are entered in the books of account by taxpayer who either does not maintain books of account or maintains two sets or records partial receipts only. This method is a likely source of tax evasion and generation of black money across real estate, hotels, retailers, consumer markets, betting, etc.
- b) **Manipulations of Book of Accounts:** in case of mandatory requirement to maintain books of accounts by taxpayers under different laws, manipulation of books of accounts such as inflation of purchase/raw material cost, expenses like labour charges, entertainment expenses, and commission can be inflated or falsely booked to reduce profits and to evade taxes. In these cases, bogus bills may be prepared to show inflated expenses in the books. This method is a likely source of tax evasion and generation of black money across real estate, hotels, retailers, consumer markets.
- c) **Exorbitant rates of taxes in India:** Higher rates of taxes have resulted in a growing tendency of tax evasion among the taxpayers. Tax evasion is common in income tax, corporate tax, corporation tax, union excise duties, customs duties, sales tax, etc. if marginal rates are too high; tax payers are likely to find ways to evade tax.
- d) **Manipulation by through their subsidiary companies:** Inter-corporate transactions between their subsidiary companies belonging to the same group or owned and controlled by the same set of parties may be arranged and manipulated in a way that leads to evasion of taxes.
- e) **Ineffective enforcement of tax laws:** In India, the enforcement of tax laws in respect of income tax, sales tax, excise duty, stamp duty etc. is quite weak. This has led to enormous unrestrained evasion of taxes and piling up of black money. There is lack of simplicity/ transparency in tax laws.
- f) **Funding of political parties:** There is an upward tendency of supporting of political parties with the help of black money. Big trade houses are donating ruling party with the sole objective to tame the political leadership for deriving

undue profit by manipulating policy decisions.

- g) **Inefficient and high-level corruption:** In India corporate evades 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.
- h) **Capital Expenses manipulation for higher depreciation under income tax law:** Over-invoicing plant and equipment or any capital asset is an approach adopted to claim higher depreciation and thereby reduce the profit of the business.
- i) **Agricultural Income under income tax:** The big industrial houses, over the past few decades have entered the agriculture sector in a big way by acquiring big farms. The black money accrued from other sources is sought to be transformed into white by viewing it on the agricultural returns account.
- j) **Privatization:** Privatization has opened up a new area to the private sector as well as to ministers and bureaucrats for making black money. It is expected that many scams came to light for making black money through privatization.
- k) **Generation of Black money in Some Vulnerable Sections of the Economy:** Generation of black income in a country like India also results from other different activities like smuggling, property deals, bribery, kickbacks, commissions, concealment of income by professionals, artists etc. Land and Real Estate Transactions, Bullion and Jewelry Transactions, Financial Market Transactions, Public Procurement, Non-profit Sector, Informal Sector and Cash Economy, Trade-based Money Laundering (TBML), Tax Havens, Offshore Financial Centers In this way an enormous amounts of black income incessantly results in enhancement of the area and activities of parallel economy.

Government initiatives for prevention of tax evasion

The government has taken a number of steps to curb black money. Searches, seizures, surveys, and scrutiny of income tax returns are being done by the Income Tax Department. Amendments have also been made to the Finance Act time to time to intensify efforts to curb black money. For the smooth functioning of the economy, the following measures are suggested to combat the menace of the black money:

- a) **Demonetization:** In 1946, demonetization was resorted to but the Direct Taxes Enquiry Committee in its interim report observed, "Demonetization was not successful then because only a very small proportion of total notes in circulation were demonetized in 1946. On January 16, 1978, demonetization of high demonization notes was introduced. In the recent past, Prime Minister declared that five hundred and one thousand rupee note will no longer be legal tender from midnight, 8th November 2016. This move is expected to cleanse the formal economic system and discard black money and counterfeit notes. It may not curb black money fully, but definitely, it has a major impact in curbing black money to the large extent.
- b) **Voluntary Disclosure Schemes:** The Government has floated various voluntary disclosure schemes to determine

the black money. In 1951, a voluntary disclosure scheme with relaxation in panel provision was introduced. Finance Minister while presenting 1997- 98 budgets also announced a Voluntary Disclosure Scheme (VDS).

- c) **Special Bearer Bond Scheme:** Bearer bonds were most likely first used in the United States during the post- Civil War era to fund Reconstruction (1865–1885). Bearer bonds that are owned by whoever is holding them, rather than having registered owners like most other securities. Special Bearer Bonds Scheme (1981) was intended for canalizing unaccounted money for productive purposes.
- d) **Measures to Check Tax Evasion:** Dealing with tax evasion has always been one of the most difficult challenges for governments all around the world. Tax evasion is one of the basic causes to generate the black income. Therefore, various measures were undertaken to plug the loopholes in tax evasion. Most of these measures were based on the recommendations of various committees and commissions viz Taxation Enquiry Commission (1953), Administrative Reforms Commission (1969), Direct Tax Enquiry Committee (1971) etc. Most of these recommendations were an upgrading of tax laws.
- e) **Other Measures:** The Government has also introduced some measures to contain the growth of black income in the country which includes Deposit in the National Housing Bank in 1991, NRI foreign exchange remittance, issuing National Development Bonds in US dollars, controlling the election expenses incurred by the candidates, conducting searches, seizures, raids and other steps to plug loopholes in the tax administration etc.
- f) **Government recent measures:** Establish identity of persons (through Pan Card, Aadhar Card etc.) operating in the country citizens and foreigners. To minimize the cost of direct bank transfer including direct transfers of subsidies to the beneficiaries under Aadhar scheme through the implementation of NEFT/IMPS/RTGS and other formats.

Existing legal provisions and administrative machinery to deal with black money under income tax law

A) Income Tax Act, 1961

The following sections and provisions of the Income Tax Act, 1961 are dealt with tax evasion and curb the black money in India.

Section 131: The powers u/s 131 of IT Act is co-existent with that of a Civil Court trying a suit. Under Section 30 of CPC read with Rule 12, 14 & 15 of Order – XI, the powers of a court are:-

- 1) Discovery and inspection - order XI
- 2) Summoning and attendance of witness - order XVI
- 3) Issue of commission to examine a witness - order XXVI (Rules 1 to 8)

Section 132: Search can only be authorized by an officer of the rank of Commissioner or above. Certain conditions are required to be fulfilled before authorizing a search. Powers under section 132 include the power to seize books, documents, cash, jewelry; other valuables etc. and the same can be retained for a certain period of time.

Section 133A & 133B: Survey at business premises for

inspecting books of accounts, tallying stock, verification of cash and collection of information etc.

Section 133: Power to requisition information from third parties.

Section 136: Declares income tax proceedings as judicial proceedings in case of:-

- 1) Section 193 of IPC – furnishing or fabricating false evidence;
- 2) Section 196 of IPC – using evidence known to be false;
- 3) Section 228 of IPC – intentional insult or interruption to public servant sitting in a judicial proceeding;
- 4) Section 195 of Cr PC – taking cognizance of an offence of giving false evidence, fabrication of evidence, abetment or criminal conspiracy to fabricate evidence.

Chapter XXI & XXII of the Income Tax Act,1961:

Provides for monetary penalties at different rates for various defaults such as concealment of income; failure to comply with statutory notices, file tax returns/sign statements, maintain/retain books of account or documents, deduct/collect taxes at the source; etc. Maximum penalty prescribed is 300% for the tax sought to be evaded. The maximum sentence is for 7 years rigorous imprisonment with fine under prosecution.

B) Wealth Tax Act, 1957

The Wealth Tax Act, 1957 contains provisions that are at par with different provisions under the Income Tax Act, 1961 as enumerated above.

C) Benami Transactions (Prohibition) Act, 1988

A Benami purchase is a purchase in name of another person, who does not pay the consideration but merely lends his name, while the control vests in another person who actually purchases the property and he is the beneficial owner. The Benami transactions are controlled through this Act.

D) Foreign Exchange Management Act (FEMA), 2002

Enforcement Directorate takes up investigations under FEMA in specific cases relating to contraventions in foreign exchange transactions, generally by persons resident in India. The unauthorized holding of funds outside India by any person resident in India, is a contravention of section 4 of FEMA.

E) Prevention of Money Laundering Act (PMLA), 2002

PMLA is a criminal law which came into force on 1.7.2005. Under the scheme of the Act, money laundering linked to the predicate scheduled offences is liable for punishment.

F) Prevention of Corruption Act & United Nations Convention against Corruption (UNCAC)

The Prevention of Corruption Act, 1988 (No.49 of 1988) has been enacted to consolidate and amend the law relating to the prevention of corruption and for matters connected therewith.

Impact of tax evasion & black money on the Indian economy

The Tax Evasion and Generation of black income and thereby establishment of black money has been creating the following serious impacts on the social and economic system of the

country.

1. **Effect on GDP of the country due to less tax collection:** Black income has been causing underestimation of GDP in India. The direct effect of black income is the loss of revenue to the state exchequer as a tax evasion
2. **Increase the prices of land & houses:** Due to the black money, there is the artificially inflating the prices of an entire area for which who have this. Black money has resulted in the diversion of resources for the purchase of real estate and luxury housing.
3. **Transfer of Indian Funds Abroad to Safe Havens:** The black money has resulted in transfer fund in the foreign tax havens through clandestine channels
4. **Preferring Leisure to work:** The availability of black incomes with businessmen and capitalists and the consequent inequalities of income place a large number of funds at their disposal.
5. **Parking black money into the precious metals & stones:** A part of the black incomes is held in cash and as a result, there is an abundance of liquidity which becomes available through the addition of savings held in the form of cash, metals & stones etc.
6. **Encourages Anti-Social Activity:** Money evaded by the illegitimate way is spent in undesirable and vulgar manner. Virtues like hard work and honesty are underestimated. Black money is always promoting anti-social activities in the society.
7. **Enhance in the Inflation:** The direct effect of tax evasion is the loss of revenue, an increase in inflation. This causes the prices of commodities to increase to a level beyond normal. The amount of black money present upsets the move, resulting in some sort of pressure on the economy.
8. **Leads to Mass Poverty and social disparity:** The distribution of wealth and income in our country has been severely affected by the growth of the underground economy. It also brings disequilibrium in the economic condition of the country resulting in the rich becoming richer and the poor becoming poorer.
9. **Higher tax rate on existing taxpayer:** 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 suggested for curb the tax evasion & tackle black money generation

There are two dimensions of the issue of black money – first, its generation and, second, its consumption and use, including laundering of black money back to the mainstream economy. The Strategies to tackle black money are as under:

- 1) **Preventing generation of black money:** The Goods and Services Tax Act, 2017 should be expeditiously implemented, as the spin-off from its implementation would provide adequate resources to more than compensate the loss apprehended by certain state governments. There should also be sharing of real-time data under Foreign Contribution Regulation Act (FCRA) and DGIT (Exemption) and coordination amongst various enforcement agencies. The registration under section 12AA and approvals under sections 10(23C)/10

(21)/35/80G of the Income Tax Act for charitable organizations are required to be in accordance with international best practices.

- 2) **Discouraging use of black money:** To reduce the element of black money in transactions relating to immovable properties, provision for NOC should be introduced in the Income Tax law with safeguards to reduce administrative complications and increased ease of compliance, so that an appropriate and uniform database is also set up. The electronically generated NOC, within a specified period, would also act as a tax clearance certificate.
- 3) **Effective detection of black money:** Income Tax Department, which has a large database of financial transactions, should immediately set up the Directorate of Risk Management for proper data mining and risk analysis. The third-party reporting mechanism of the Income Tax Department should be made computer-driven and cover most high-value transactions in the financial sector.
- 4) **Effective investigation & adjudication:** Government must consider ways to mitigate the manpower shortage issues which are seriously hampering the functioning of various agencies particularly the CBDT and CBEC. These need to be taken up and implemented on a fast track basis to show the Government's resolve to tackle the issue of black money.
- 5) **Direct Tax Code, 2010 (DTC):** The DTC bill pending before the parliament should be passed. It will streamline the entire system of direct Taxes by improving tax structure, mitigating room for litigation, plugging the loophole that leads to tax avoidance and tax evasion. General Anti-avoidance Rules (GAAR) under Chapter XXIV will also help minimize the tax evasion.
- 6) **Double taxation avoidance agreement (DTAA) vis-a-vis domestic Law:** The DTAA's, partially like the one between India and Mauritius, have become a source of tax evasion and litigation. The DTC will help to resolve the conflict tax law and DTAA.

Conclusion

Effectively implementation of the Income Tax Law can curb tax evasion. Income Tax plays the vital role in the development of Indian economy. It is suggested that reduction in tax rates, simplifications of tax laws, removal of loopholes in the tax system and to some extent proper processing of information available under the annual information return can be best tool for improving Indian tax compliance. Therefore, there is a need for creating transparent, responsive and less discriminatory administrative system. 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. Over the past 70 years, the government has at various times announced several schemes offering opportunities to bring black money overboard but the result is not so effective. To pass the DTC Bill, 2010 is need of time for the effectiveness of Income Tax Law for the prevention of tax evasion.

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