TAX ADMINISTRATION REFORM IN INDIA
SPIRIT, PURPOSE AND EMPOWERMENT
(THIRD REPORT OF TARC)

TAX ADMINISTRATION REFORM COMMISSION
MINISTRY OF FINANCE, GOVERNMENT OF INDIA
NOVEMBER 2014
TAX ADMINISTRATION REFORM IN INDIA
SPIRIT, PURPOSE AND EMPOWERMENT

THIRD REPORT OF THE
TAX ADMINISTRATION REFORM COMMISSION
MINISTRY OF FINANCE, GOVERNMENT OF INDIA

NEW DELHI
NOVEMBER 2014
To

Shri Arun Jaitley
Hon'ble Minister of Finance
Government of India

Sir,

We submit herewith the Third Report of the Tax Administration Reform Commission (TARC).

Dr. Parthasarathi Shome
Chairman

Y. G. Parande
Member

Sunita Kaila
Member

M. K. Zutshi
Member

S. S. N. Moorthy
Member

S. Mahalingam
Member

M. R. Diwakar
Member
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### Preface

The TARC has produced two reports thus far covering six of its terms of reference. In this third report, it covers three more, thus covering nine out of its total twelve terms. The three covered in this report are:

1. To review the existing mechanism and recommend capacity building measures for preparing impact assessment statements on taxpayers' compliance cost of new policy and administrative measures of the tax departments.
2. To review the existing mechanism and recommend measures for deepening and widening of the tax base and taxpayer base.
3. To review the existing mechanism and recommend a system to enforce better tax compliance—by size, segment, and nature of taxes and taxpayers, that should cover methods to encourage voluntary tax compliance.

In tax administrations of advanced economies and several emerging economies, it is established practice to carry out impact assessment exercises of regulations arising out of new legislation or administrative action. Usually termed a regulatory impact assessment, the typical exercise is well defined, is carried out within a guided framework, considers various options, and calculates or assesses in quantitative or qualitative terms—in reflection of the nature of the problem at hand—the impact it would have on the financial cost of an affected business to meet new compliance requirements, the staff and other costs of the tax administration itself to ensure best design and delivery of the regulation, as well as wider ramifications on the economy, the environment, and other selected criteria of social relevance. India has not introduced this practice in any of its tax policy or administration policy reform formulation, and intelligent ex-ante or ex-post analysis of the issue or methodical consultation with stakeholders could be said to be virtually absent. In this light, the TARC has studied best international practices on impact assessment including detailed technical aspects, analysed India’s particular needs, and made a series of succinct recommendations, some of which could be implemented on an immediate basis and others taken up on a structural platform. It is clear that the need for reform in this area is deep and action to be taken immediate. This area comprises Chapter X with several appendices.

### Tax Base and Taxpayer Base Expansion

Tax base and taxpayer base expansion are crucial factors affecting the growth of tax revenue. Currently, there is a perceptible gap between the potential and the existing number of taxpayers. The taxpayer base could be almost doubled to six crore taxpayers from prevailing levels. The focus has to be on bringing in new taxpayers and targeting sectors that remain under-taxed or untaxed. It has given rise to a large cash economy which comprises mainly the unorganised sector that tends to include small businesses, as well as high net worth individuals. This requires policy as well as administrative and enforcement actions. Interestingly, in this field, some tax policy matters have direct impact on tax administration. For example, taxation of select agricultural income of large farm income setting aside small farmers below a high threshold could nevertheless...
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enhance the taxpayer base. Similarly, taxation of fringe benefits would enlarge the tax base and diminish tax evasion. Attention to such areas typically considered policy matters could actually improve voluntary compliance and thus should be considered in conjunction with administrative policy measures with the objective of expanding taxpayer base, tax base and improve the equity and neutrality in taxation. Similarly, a comprehensive review of a large number of exemptions and incentives provided in law could yield areas for possible rationalisation and reform which would have a direct impact on tax administration improvements. Vulnerable areas of tax evasion are required to be identified and a coordinated and integrated, and collaborative action taken to minimise tax avoidance and evasion. An environment of mutual trust between taxpayer and tax administration is a must, along with a strong political will to achieve positive outcomes. This should be accompanied by spreading tax awareness and stakeholder consultations. Last but not the least, there is an urgent need to set up an institutional structure that is to be termed the Knowledge, Analysis and Intelligence centre for carrying out research and analysis for the expansion of tax and taxpayer base. These matters that should be of central concern to the Indian tax administration, together with best international practices, are covered in Chapter XI which is supported by various appendices.

An important aspect of the reform of tax administrations across the world has been in their approach to their primary task, which is to ensure that the taxes due under law are collected with efficiency and effectiveness and in a manner that sustains society’s confidence in the tax administration. This has led the best practicing tax administrations to adopt a holistic compliance management philosophy that centres around effective management of compliance risks so that the tax gap can be minimized. Recognizing the limitations of a purely enforcement oriented approach, modern tax administrations have made the promotion of voluntary compliance the central element in their strategies. They have become much more customer focused, adopting trust as the foundational principle. Issues such as taxpayer convenience and compliance costs are central to their plans. They have transformed their governance to make the administration taxpayer friendly. At the same time, they deploy advanced risk management techniques, and increasingly sophisticated segmentation of the taxpayer population according to their compliance behaviours, for increasing the delivery and effectiveness of taxpayer services, audits and enforcement operations. The tax administrations’ efforts are buttressed by extensive reliance on multidisciplinary research and reliable measurements of the outcomes of their operations in the spirit of continuous improvement. Thus their strategies are well balanced, using the multiple tools at their command in a calibrated manner, so as to advance the cause of improving compliance levels in the environments in which they operate. The CBDT and CBEC need to tread a similar path and Chapter XII outlines the compliance management approach that they need to adopt. It is supported by several appendices.

The TARC formed Focus Groups following a similar process as in its earlier reports, whose members are listed in Annexure II. This format enabled participants to have intensive dialogue on each topic as well as contribute in a formal way their experiences
and views, many of which are fully represented in this report. Participants hailed from both the tax administration as well as from private professional practitioners. There were full-fledged discussion and debate on various issues on the basis of which the final conclusions and recommendations were drawn.

The TARC benefitted from co-operation of the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) in terms of occasional dialogue and the provision of selected data and information, as well as helpful feedback from the field formations of both departments in selected metros and smaller cities.

The TARC was supported by four research consultants who assisted the TARC’s work in various ways. The Editor carried out meticulous work to improve the presentation of the Report. The TARC’s administration comprised the function of the Secretary, Director and Under Secretary and office staff.

Dr. Parthasarathi Shome
Chairman
Tax Administration Reform Commission

New Delhi
30th November 2014
Tax Administration Reform Commission

Chairman
Dr. Parthasarathi Shome
Level of Minister of State

Members
- full time
Y. G. Parande
Ex-Member, CBEC
Sunita Kaila
Ex-Member, CBDT

Members
- part time
M.K. Zutshi
Ex-Chairman, CBEC
S.S.N. Moorthy
Ex-Chairman, CBDT
S. Mahalingam
Ex-Chief Financial Officer and Executive Director, TCS
M.R. Diwakar
Ex-Vice President, Taxation, Murugappa Group

Secretariat
Sanjay Kumar
Secretary
N.K. Jain
Director
Sukalyan Banerjee
Under Secretary

Research Consultants
Vrinda Jaju
Prativa Shaw
Md. Tarique Hasan Khan
Rohitash Chaudhary

Administrative Support
Tejpal
Consultant (Administration)
Deepak Chauhan
Consultant (Administration)
Jagdish
Assistant
Ankur Verma
Steno/Assistant
Tax Administration Reform Commission

Chairman
Dr. Parthasarathi Shome Level of Minister of State

Members - full time
Y. G. Parande Ex-Member, CBEC
Sunita Kaila Ex-Member, CBDT

Members - part time
M.K. Zutshi Ex-Chairman, CBEC
S.S.N. Moorthy Ex-Chairman, CBDT
S. Mahalingam Ex-Chief Financial Officer and Executive Director, TCS
M.R. Diwakar Ex-Vice President, Taxation, Murugappa Group

Secretariat
Sanjay Kumar Secretary
N.K. Jain Director
Sukalyan Banerjee Under Secretary

Research Consultants
Vrinda Jaju
Prativa Shaw
Md. Tarique Hasan Khan
Rohitash Chaudhary

Administrative Support
Tejpal Consultant (Administration)
Deepak Chauhan Consultant (Administration)
Jagdish Assistant
Ankur Verma Steno/Assistant
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Glossary of Technical Terms

AAR
Authority for Advance Rulings

ABAB
Administrative Burden Advisory Board

ABR
Australia Business Register

ACAP
Assisted Compliance Assurance Programme

ACES
Automation of Central Excise and Service Tax

AEO
Authorised Economic Operator

AIR
Annual Information Return

AO
Assessing Officer

APA
Advance Pricing Agreement

ASK
Aayakar Seva Kendra

ATG
Audit Techniques Guide

ATO
Australian Taxation Office

BAS
Business Activity Statement

BCTT
Banking Cash Transaction Tax

BEM
Business Economics Model

BIFR
Board for Industrial and Financial Reconstruction

BIN
Business Identification Numbers

BPO
Business Process Outsourcing

CA
Chartered Accountant

CAAP
Computer Assisted Audit Programme

CAG
Comptroller and Auditor General

CAR
Cost-driven Approach to Regulatory

CASS
Computer Aided Selection System

CBDT
Central Board of Direct Taxes

CBEC
Central Board of Excise and Customs

CBIN
Common Business Identification Number

CEB
Census Enumeration Block

CEIB
Central Economic Intelligence Bureau

CENVAT
Central Value Added Tax

CESTAT
Customs, Excise and Service Tax Appellate Tribunal

CFC
Certified Facilitation Centre

CIB
Central Information Branch

CID
Criminal Investigation Division

CII
Confederation of Indian Industry
## Glossary of Technical Terms

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<td>Australia Business Register</td>
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<tr>
<td>ACAP</td>
<td>Assisted Compliance Assurance Programme</td>
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<tr>
<td>ACES</td>
<td>Automation of Central Excise and Service Tax</td>
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<td>AEO</td>
<td>Authorised Economic Operator</td>
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<td>AIR</td>
<td>Annual Information Return</td>
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CHAPTER X

IMPACT ASSESSMENT
Chapter X
Impact Assessment

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Chapter X
Impact Assessment

X.1 Why impact assessment?

Improving the empirical basis for any decision on taxation – policy or administrative – through an analysis of its impact is a key function of a modern tax administration that aims to improve the process of decision making. Decision-making based on an empirical analysis of the positive and negative effects of a proposed measure or regulation helps ensure that the benefits of a tax action justify the cost of compliance imposed on taxpayers and the cost of administering such a tax. It also helps move towards better regulatory management. While a detailed cost-benefit analysis may not always be feasible, applying the principles of impact assessment helps ensure that decisions taken are practicable and feasible. Such impact assessment needs to be a continuous process to help think through the reasons for a tax change, to weigh various options to achieve desired objectives and to understand the consequences of a proposed change. Such analytical exercises help assess both the likely costs and benefits of a proposed policy change and the risks associated with the change that the policy seeks to achieve.

Tax policy or administrative changes, even if small, need to be followed by identification of cost to the tax department in delivering the change and its cost impact on taxpayers. To ensure effective and timely policy formulation, a tax impact assessment needs to be initiated as soon as policy ideas develop. These impact assessments will normally quantify the financial impact of a proposed measure on the exchequer, i.e., operational impact (how it affects the tax department), the financial impact on the taxpayer, i.e., the time and cost involved in understanding and filing new form, its economic impact such as distributional change (how it affects individuals, households or businesses of different segments – large, medium or small), etc. Simply put, impact assessment is a set of logical steps to be followed while preparing policy proposals to provide evidence to decision makers on the advantages and disadvantages of possible policy options by assessing their potential impact. The advantage of such an exercise is to help design better policies and laws, facilitate better-informed decision making and ensure early co-ordination within the tax administration across various units to implement the new policy. The process also ensures the coherence and consistency of policies keeping in view key objectives within the administration’s overall vision.
In developing impact assessment processes, therefore, a key element is the involvement of stakeholders, as recommended in Chapter II of the TARC report. Consultation with stakeholders through hearings or conferences or other means reveals new dimensions not realised at the time of policy formulation. This is particularly important from the perspective of differing classes/segments of taxpayers, and helps focus on issues such as encouraging compliance and broadening the tax base, customer orientation, and equity and certainty in the application of tax laws.

A key to good regulatory impact assessment is the quality of the base data. If data problems are significant, its resolution can be expensive and time consuming. Hence, analytical methods that are less data-intensive can also be applied as is done by various tax administrations. More simply, in the absence of relevant data, an impact assessment exercise can be attempted in a qualitative manner so that a culture of developing impact assessment in quantitative terms can be developed over time.

Impact assessment helps understand how taxpayer services should be geared to reduce the time and cost of compliance to the taxpayer to ensure that its impact on the economy and societal welfare is neutral. It could also provide pointers to the changes in risk/compliance and enforcement programmes that would help reduce the administration’s delivery cost.

Although impact assessment by itself does not determine decisions, the analysis and its placement within the decision making process can influence policy by widening and clarifying the factors relevant to a decision, revealing alternatives available to arrive at the intended goal at the least possible cost to both the tax department and the taxpayer. It should not be viewed as an add-on technical tool in the decision-making system, but as a method to arrive at a decision on whether an action should be taken or not.

This chapter explores the use of impact assessment methods as part of regulatory management, discusses global practices and provides a way forward to build the capacity of the Indian tax administration to integrate impact assessment as an essential and obligatory step in the decision making process as part of the governance framework discussed in Chapter III of the TARC report.

X.2 Current status

When considering a tax action, officers of the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC) analyse the proposal and present it to the competent authority for inclusion in the Finance Act in the case of a legislative change or to the Board if it involves an administrative practice. However, the analyses of proposals do not adhere to the practices of regulatory management touched upon in the previous section. A regulatory tax impact

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185 Section II.6.c of the TARC report: “There should be regular stakeholder consultations on the issues of tax disagreements and tax law changes. The Commission recommends a permanent body for stakeholder engagement.”
Assessment, as explained, has a wider ambit than the analysis that is done at present. For example, a pre-budget regulatory impact assessment can include issues such as the impact of a particular tax measure on the economy, which tax measures are likely to have the most significant effect on the Gross Domestic Product (GDP) and its various component sectors, what are the likely effects of tax changes on investment, consumption or retail sales. Similarly, a post-budget examination of policy changes can include an examination of the relative efficiency of various changes.

At present, neither of the two Boards carries out an ex-ante impact assessment of any tax action, either legislative or administrative, as a matter of routine. Some impact assessment is done by the Parliamentary Standing Committee on Finance on legislative measures. While carrying out such an assessment, it often takes into account the views of various stakeholders, i.e., taxpayers, businesses and business associations. But it may be pointed out that the assessment by the Parliamentary Committee is for the purpose of legislative action and not for the purpose of regulatory management. In any case, the Parliamentary Committee is part of the legislature whereas suo motu assessments by the CBDT or CBEC would be part of executive regulatory management. The two are mutually exclusive and there is no overlap between them.

Neither is an ex-post impact assessment carried out by the CBDT or CBEC or their directorates in a systematic manner. Some examples may exist where a particular directorate has carried out the impact assessment of a particular programme or an initiative but even those exercises are not inclusive of all stakeholders and do not carry out a cost benefit analysis. The Comptroller and Auditor General in India (CAG), of late, has increasingly embarked on performance audits, also called system’s audit, for programmes such as widening or deepening of tax base or taxpayer base, implementation of Information and Communication Technology (ICT) in the tax departments, and the issue of refunds or appeal processes. These audits are different from transaction audits, which relate mainly to checking the entries and checking for errors that may have led to loss of revenue or excess expenditure. As part of this practice of performance audit, the CAG identifies the function or programme to be audited, determines the audit objective and scope, arranges the resources for audit and carries out preliminary work to understand the system, controls, and risks involved in the process. After a proper study, the evidence gathered is evaluated, and limited testing is done to assess the results. Stakeholder meetings, particularly with the concerned department, are held for discussing the results in what is known as an “exit conference”.

A comprehensive report is prepared thereafter by the CAG and submitted to Parliament. These reports often provide an effective assessment of the outcome of the application of a piece of legislation. While these performance audits are useful to correct implementation deficiencies, they do not analyse the cost of compliance to taxpayers or the cost incurred by the tax administration to implement the tax action, and hence, do not analyse in detail either the tax policy design or associated tax administration measures. Besides, the CAG is an independent watchdog, outside the government, and conducts performance audits of only a few issues in a year. These may not cover 186 CAG’s Performance Auditing Guidelines, available at www.icisa.cag.gov.in, accessed in October 2014.

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all issues that the tax departments consider relevant. Besides, the CAG cannot be expected to carry out regulatory impact assessment on the policy dimension of tax actions as could be expected of the tax departments, which could be asked to carry out a transparent, analytical assessment on a regular basis.

X.3 International best practices

Most advanced economies arrive at their decisions – bringing in a new statute or changing an existing practice – on the basis of an impact assessment of proposals. Organisation of Economic Co-operation and Development (OECD) members have increasingly adopted regulatory impact analysis to improve the quality of new regulations and analyse their financial impact on business and administrative costs, the results of which are communicated to decision makers. Such analyses ensure that tax policy as well as administration initiatives are prepared on the basis of transparent, comprehensive and balanced evidence, and hence, these become aids to decision making but do not substitute for it. The objectives, design and role of administrative processes may differ among countries, but impact assessment has become an integral part of the decision making process. The differences in processes may reflect political traditions, administrative style or intrinsic differences in viewing the issue at hand. For example, the Netherlands depends more on consensus methods than most other countries, while the Internal Revenue Service of the US (IRS) and Her Majesty’s Revenue and Customs of the UK (HMRC) depend on empirical methods. Reflecting the virtual absence of the practice in India, it is of some importance to review international practices in the main body of this chapter.

X.3.a Impact assessment – a tool for decision making

Impact assessment has been used by various tax administrations to clarify a decision to bring about a change. The process is consultative where relevant technical details are discussed with stakeholders and tax experts. Impact assessment is also used as a tool to ensure that a change does not lead to an increase in the compliance costs imposed on taxpayers. This is often identified as the main objective. As part of the regulatory management, tax jurisdictions carry out impact assessments early or later, for example, along with the development of the legislative or policy proposal or when it reaches a more advanced stage. The understanding developed in this exercise often helps in fine-tuning the proposal in line with the lessons emerging out of the impact assessment. Thus, the overall framework should help in the development of essential tools for enhancing transparency in policy preparation and allows various actors to make their contribution.

The UK’s HMRC, for example, as part of its regulatory management, reviews, ex-ante, the effects of every possible change in tax policy, including its revenue impact, the administrative burden it imposes on the taxpayer and the tax department, and its impact on the wider economy. This evidence is presented to ministers to enable them to formally weigh the costs and benefits of possible policy options. A summary of the cost-benefit analysis and supporting evidence is published as a regulatory impact assessment for the initiation of public consultations.
The Australian Tax Office (ATO) carries out similar steps in its regulatory impact statements. While preparing for the introduction of Goods and Services Tax (GST), the ATO brought out a regulatory assessment statement giving the policy objective, identifying implementation options, giving the likely transitional measures, the absence of which might disrupt economic activities in the country, outlining the assistance programme to small businesses designed to enable them to upgrade their record keeping capacity so as to improve the financial information available to them and to reduce the compliance impact of the GST on them, reaching out to taxpayers through information and education programmes to enable them to voluntarily comply with the GST, and providing an assessment of the impact of the costs imposed on and benefits accruing to the exchequer for each implementation option. After such detailed work on policy and implementation options, consultations with various groups were held. The result of such an exercise showed that the cost of complying with the GST would be marginal for most businesses as the compliance requirements and accounting requirements were the same as in the case of income tax. The impact assessment carried out the by the ATO outlined the various options available to it to achieve compliance, and the costs and benefits, including the compliance cost, of each alternative, enabling the selection of the most appropriate method to achieve compliance at optimal costs.

The ATO, however, does not consider the preparation of an impact assessment mandatory for regulation if it

- is not likely to have a direct, or a substantial indirect, effect on business;
- is not likely to restrict competition;
- is of a minor or mechanical nature and does not substantially alter existing arrangements;
- is required in the interest of national security;
- is primary or delegated legislation that merely meets an obligation under an international agreement by repeating or adopting the terms of all or part of an instrument the agreement provides for; and
- is excluded from consultation.

The ATO also considers an impact assessment process inappropriate if prior public consultation is likely to provide an opportunity for tax avoidance.\(^{187}\)

### X.3.b Methods of determining impact assessment

Different methods have been employed by tax jurisdictions to assess impact. Some of these methods are experimental and form the basis for future discussion. Often, data constraints such as sample size or the nature and thrust of surveys determine methodological choices. In general, a

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wide range of methodologies, for example, cost-benefit analysis, the survey method, or different estimated models based on cost are employed.

The OECD segregates two approaches to impact assessment: quantitative and qualitative. A quantitative statistical method involves the precise identification of baseline conditions, definition of objectives, target setting, rigorous performance evaluation and outcome measurement. A quantitative approach is limited by the measurability of impacts and do not allow cause and effect inference. It is useful, if achievable, since benefits and costs are expressed in monetary terms making it easy to compare the effects of different regulations or policy proposals. But, in many cases, this is not possible. A qualitative approach, thus, also forms an important method, suitable for investigating complex and/or sensitive issues. It generally requires high skill levels, and may be relatively costly. A potential problem with qualitative information is that it may be evaluated quite differently by different evaluators. Multi-Criteria Analysis is one qualitative method that is useful.

In sum, the OECD defines cost/benefit analysis, in general terms, as an approach to guide decision-making and as a specific methodology for conducting impact assessments. A general principle of such cost-benefit analysis is that regulation can be made only when the benefits of the regulation exceed the costs it imposes. Since water-tight numerical exercises may not always be possible, the OECD suggests that a degree of qualitative interpretation may be necessary in order to evaluate observed impact. Nonetheless, it suggests carrying out some degree of quantification so as to evaluate the success of an intervention and the magnitude of its adverse effects.

Many advanced countries, including the UK’s HMRC, have internal monitoring and evaluation as part of impact assessments. The learning from such monitoring and evaluation is integrated into the existing management information systems, making information immediately available to the staff. External impact assessments are also launched, sometimes on a pilot basis, involving independent investigators. These assessments are for specific purposes, for example, tax exemption impact assessment, impact of child tax credit, impact of duty inversion on industry, to name a few. These ex-ante assessments are often the basis to launch fuller monitoring and evaluation.

The HMRC also carries out post-implementation reviews. This is a key input to any evaluation of regulations relating to the statutory review obligation under the government’s policy on sunsetting. Thus, when a post-implementation review is carried out, its primary focus is on whether the policy is still required and if it has had the intended effect. Any unintended consequences that

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189 Multi-criteria analysis is a methodology that enables systematic and transparent conclusions when quantification of regulatory impact is not possible. It identifies the underlying policy objectives and determines the criteria for the achievement of these objectives. These criteria are ranked in terms of their relative importance and scored accordingly. Then weighted scores are added together to determine the best option to meet the policy objectives.
may have been observed are also detailed. In carrying out the post-implementation review, views of stakeholders about the effectiveness of the policy form another important aspect of assessment.

The HMRC has made a clear distinction between an impact assessment, and impact assessment for tax changes, called Tax Impact Assessment. For tax impact assessment, HMRC policy makers engage with Her Majesty’s Treasury (HMT) officials for a joint consultation and an impact assessment at an early stage. If the introduction of a new tax instrument is a favoured option, HMRC policy makers need to enter into a Tax Impact Assessment process.

The ATO provides detailed estimates of net cost to government of introducing a new regulatory process or an amendment in an existing law or procedure. They often provide numbers and levels of staff required, their salary costs, costs of other relevant items such as special advertising, accommodation, travel and enforcement costs. Costs also show ‘the paper burden’ or administrative costs to businesses associated with complying with and/or reporting on a regulatory requirement. Sources of government expenditure are delineated, revealing the administrative cost of any regulatory introduction. Information on the benefits to the government, consumers, businesses and stakeholder groups, and to the community at large is also similarly identified. Examples of such benefits could be in terms of reductions in compliance costs for businesses and administrative costs for the government; sometimes, benefits such as improvement in business environment, improvements in product or service quality, reductions in workplace accidents, improvements in public health, improvements in information access, or improvements in the environment may not be quantifiable. Thus, the ATO captures intangible effects in its assessment, and not just the financial impact of a measure.

**Impact assessment calculator**

The HMRC has developed a software called an impact assessment calculator to calculate equivalent annual cost\(^\text{190}\) to business in the form of different scores for different policies. The calculator helps in calculating net present value of costs shown by an impact assessment. The calculator can be used for appraisal periods of up to 100 years. The values are calculated on an annual basis, and the results are converted into an “overview” tab and split into transition,

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\(^{190}\) Equivalent annual cost relates to the annual cost of owning an asset over its entire life.
equivalent annual, and total, costs/benefits. Once the equivalent annual cost to business is obtained, the present value of other comparables is presented. A guidance flow chart of the calculator is given in Appendix X.2.

Australia has also developed a business cost calculator. This is a computer programme that uses an activity-based costing method to provide a consistent measurement of compliance cost for businesses. The calculator is also used for existing regulations.

**Impact assessment management**

The UK HMRC has developed an impact assessment template, which is filled in using quantitative and qualitative analyses. Figures from the impact assessment calculator are used for quantitative details. The Chief Economist of the HMRC is responsible for guiding, monitoring and presenting analysis and evidence to support the analysis on both tax policy as well as tax administration decisions. He also signs off on the regulatory impact assessment statements before the Secretary (minister for taxation) signs it. A sample of the template can be seen in Appendix X.3.

In the ATO, the Office of Regulation Review (ORR) provides advice to the relevant decision making body such as the Cabinet, the Prime Minister/Minister(s) or the Board on the adequacy of the regulatory assessment. For minor policy proposals and quasi-regulation, however, the relevant department or agency can consult the ORR on the need for an impact assessment. ORR also provides training and guidance to officials to help them meet the criteria required to complete the assessment work on regulatory proposals.

**X.3.c Methods for estimating cost of compliance**

While benefits to a tax administration are often linked to the generation of tax revenue, the cost of compliance is the cost that taxpayers incur to comply with different tax provisions by filing tax returns, filling up forms from time to time and paying taxes. The determination of those costs is thus an integral part of impact assessment. But the quantifiable or financial cost is the simplest view. The overall meaning of compliance is wider, moving away from a narrow law enforcement approach to a more comprehensive version relating to a taxpayer’s conformity to the wider objectives of society as reflected in tax policy. The imposition of taxes, which is essentially a transfer of resources from households and businesses to government, causes economic distortions and consequently, imposes a cost that taxpayers have to bear while meeting their tax obligations. For example, income tax can affect labour supply while indirect taxes can distort expenditure patterns. Compliance costs for long had been treated as the ‘hidden costs’ of taxation. However, of late, compliance costs have been estimated and increasingly been used in taking regulatory decisions by many tax administrations. Countries such as Australia, Canada, Germany, Ireland, the Netherlands, New Zealand, Singapore, Spain, Sweden, Switzerland, the UK and the US carry out empirical studies to determine compliance costs. The findings suggest that tax compliance

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191 See Chapter XII of the TARC report.
costs can be significant, tend to be regressive, and show significant variation among different types of taxes.

Diagram 10.1 illustrates different types of costs that regulations can impose on taxpayers and the tax administration. These costs can be classified into four types – direct financial cost, long-term structural cost, compliance cost on taxpayers, and costs of administration on the tax administration.

Direct financial cost is concrete and refers to the direct obligation for tax payments. Compliance cost includes ‘hassle cost’, reflecting time and resources spent in complying with tax laws, which could potentially affect business activities. Thus, the cost of compliance is what taxpayers incur in meeting new legal and administrative requirements. The focus of the Standard Cost Model (SCM), explained below, is on compliance costs. Administrative costs are those incurred by the tax department in delivery of the tax legislation or any tax regulation to the taxpayer. Long term structural costs are those that remain within the system even as taxpayers and tax officers get used to, and internalise, the other three costs over a period of time.

**Diagram 10.1: Costs of tax regulation**

**Standard cost model**

Initially developed in the Netherlands, the SCM is now extensively used in a wide range of countries including Austria, Belgium, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Latvia, Luxembourg, the Netherlands, Norway, Poland, Sweden and the UK. A key strength of the model is that it enables the following components to be measured:

- information obligations – obligations arising from a regulation to provide information to the public sector or third parties;
• data requirements – each element of data that must be provided in complying with an information obligation; and

• administrative activities – activities for each data requirement (for example, filling in information, sending information, or archiving information). Such activities may be carried out internally or outsourced.

The model estimates the costs of completing each activity on the basis of price, time and volume or quantity. For example, how much is the volume or stock of supply that needs to be newly labelled, how much time would be required from differently skilled workers, and what is the cost per hour of each category of worker? This enables identification of legislation that are particularly burdensome for businesses to comply with, on business processes where administrative costs are high and, in turn, where simplification would have the greatest effect so that the department or ministry could reduce such burdensome regulation.

The SCM enables cross-country comparisons, including benchmark studies. In the UK, it has been used to arrive at gross compliance cost estimates. It maps UK legislation to the activities that businesses undertake to be compliant. According to the estimate provided by the model modified for the UK by KPMG (of the original Dutch model), 86 per cent of the tax burden of UK tax regulation on businesses was due to 85 information obligations. On the basis of those findings, the HMRC initiated a Compliance and Enforcement Programme to lower the compliance burden and increase tax revenue.

The methodology for the SCM comprises breaking down every tax return into individual pieces of required information for the tax return to be filled, identifying the business population that needs to produce that information and specifying the time required to complete the obligation. This method does not focus on the policy objectives of a regulation, but on the administrative activities that must be undertaken in order to comply with the regulation. The strength of the SCM derives from the high degree of detail used in the analysis, taking into account each administrative activity and staffing and the associated cost to arrive at the compliance cost. Combining in a multiplicative manner wage costs and other costs for carrying out administrative activities (together called “costs”), the amount of time required to complete the administrative activity (called “time”), the size of the population of the businesses affected, and the frequency of that activity (called “quantity”) gives the basic SCM outcome. Appendix X.4 gives methodological details for measuring compliance costs through the SCM.

**General compliance cost model**

The ATO has also developed a compliance cost model, broadly based on aspects of the SCM. This model, discussed in the following section, is an alternative method for assessing and estimating compliance costs.
The ATO undertook a major compliance cost survey in 2011. Evidence from that survey suggested that the compliance costs increased since the last ATO survey in 1995. The survey also estimated the cost of the average time taken to complete a business income tax return and to complete fringe benefit tax return, and the average cost of managing tax affairs claimed by an individual. These findings helped the ATO in understanding taxpayer behaviour, influenced by economic, sociological, psychological, and other industry-specific factors and in advancing to a compliance model that would compute cost of compliance for different categories of taxpayers.

The ATO, based on the above surveys, has set up a General Compliance Cost Model which focuses on early intervention to encourage compliance and avoid the need for stronger measures against taxpayers turned tax evaders. It follows a risk differentiation framework, categorising segments of tax payers. This model helps in quantifying how much it costs people to comply with tax obligations and changes to tax law. The methodology to determine compliance cost involves six steps – to identify the taxpayers affected, to identify the possible behavioural responses, to describe implementation and ongoing impact, to rate the magnitude of the impact, to quantify the impact wherever appropriate, and to report the outcomes of the assessment.

The assessment methodology of the ATO revolves around three simple questions – who are affected, how are they affected and what is the magnitude of the impact. The process of assessment has three components – a qualitative component involving a descriptive assessment of compliance cost impact, a quantitative component involving the estimation of the potential compliance costs, and indicative assessment that focuses on the level of risk from high compliance costs. The qualitative assessment is conducted through a preliminary assessment that is structured around a series of guiding questions or prompts that are designed to ensure a comprehensive assessment using a consistent approach. It analyses the proposed change, assists in the identification of potential impact, supports quality assurance of the assessment and enables validation of outcomes. The quantitative component is closely linked to the preliminary assessment and is triggered when the latter finds that the potential compliance cost impact of a proposal could be a material increase or decrease in compliance cost. A recent introduction to this process has been indicative assessment, which complements but does not supplant the full quantitative assessment of compliance cost. It is a risk-based tool that assesses if a tax measure is likely to have a material effect on compliance cost.

**Other cost models**

Several advanced economies have used cost-benefit models to arrive at impact assessments. Normally, benefits are linked to the reason why certain tax policy changes take place (i.e. the main goals of the policy action at hand) and costs comprise the bulk of all direct costs generated by any tax action. While most use the SCM to measure tax compliance costs, there are variations. Denmark uses a cost-driven approach to regulatory burden (CAR), Sweden employs the total cost of regulations to businesses (TCR) model; Switzerland uses the regulatory check-up model.
(RCM), and so on. A key methodological variation in these different models is data collection techniques.\textsuperscript{192}

The CAR approach aims to overcome certain limitations of the SCM and to broaden its focus from administrative burden alone to the broader regulatory burden. While SCM takes as a starting point the total burden of a regulation, CAR examines the impact of regulations from the business’s perspective, taking into account the total burden for a business in complying with legislation and regulations. The CAR’s approach is different in that it looks at the real costs of compliance to a business as reflected in its account books, irrespective of which particular legislation resulted in imposing such cost. The objective of the CAR methodology is not to contribute to the realisation of reduction targets as such but to identify priorities and reduction measures that make a real contribution to a company’s bottom line, instead of assessing the impact of a regulation from a legislative point of view.

The TCR approach is only intended to measure the regulatory costs for businesses of existing (ex-post) legislation and regulations; it cannot assess proposed legislation (ex-ante). It produces a total figure of the regulatory costs on businesses, and is able to identify the legislative origin of the costs, which enables policy makers to discuss reduction possibilities. The total regulatory costs are defined as the total costs incurred by companies in complying with all requirements that have been encountered as a result of laws and regulations in the course of one year. These costs consist of three cost types – administrative costs, material costs and financial costs. Indirect effects are not included in the TCR approach as it was considered to be practically impossible, even if important.

The RCM model serves the purpose of estimating the costs borne by the private economy due to state regulations. This model aims to assess the direct regulatory costs borne by taxpayers resulting from obligations to meet, including, but not exclusively, information obligations. The SCM, on the other hand, is restricted to administrative costs, defined as costs incurred by private businesses due to information obligations to public authorities. This was considered insufficient in measuring the broader concept of regulatory costs that result from various kinds of obligations.

A multiplier approach has been used in Canada and the United States to estimate the total cost of compliance. The approach estimates that, for $1 that the public sector spends to administer a regulatory activity, the private sector spends $20 to comply with government regulation. Over the years, the approach has been criticised, but recent research by the Canadian Policy Research Initiative supports the notion that there is a significant relationship between government regulatory expenditures and the regulatory compliance costs imposed on the rest of the economy. The multiplier ratio is likely to depend on the specific national regulatory regime.

\textsuperscript{192}A review and evaluation of methodologies can be found in Working Paper No. 40, 2013, European Commission.
Survey method

Surveys have also comprised a method for capturing the cost of compliance. The South Africa Revenue Service (SARS) had conducted surveys of professional tax practitioners, small and medium-sized business taxpayers and informal firms to capture the costs of tax compliance to reduce unnecessary compliance burden and improve compliance. The surveys showed that small businesses outsourcing their tax work paid an average of about $1,000 per year to comply with four main taxes – corporate income tax, professional tax, Value Added Tax (VAT), and employee taxes. This figure varied among firms with turnover ranging from about $20,000 to $2 million per year.\(^{193}\) The survey data helped SARS to design a new, optional turnover tax regime for small and medium size enterprises (SMEs) and to decide on the new threshold for mandatory VAT registration.

The US IRS also conducts surveys to measure the time and money that individuals spend on pre-filing and filing activities. The survey data are used as an input to the Individual Taxpayer Burden Model. This model is a micro-simulation model that is based on econometrically estimated relationships between compliance burden and tax characteristics available from the associated tax returns of the taxpayers.

The Strategic Plan 2011-15 of Vision 2020 of the CBDT proposed a study on the ‘Barriers to Compliance and Cost of Compliance of Direct Taxes in India’ as an effort to promote voluntary compliance. This is being undertaken by an external institution.\(^{194}\) Hopefully, such studies will be undertaken as part of regular analytical activity by the tax administration.

The study first examines international compliance strategies and techniques adopted by other countries such as Australia and the UK to draw lessons from world class compliance programmes that can be adopted by the Indian tax administration. The study subsequently attempts to examine barriers to compliance and to estimate the gross compliance cost in India using a large sample size across different categories of stakeholders and cities. Since taxpayer perception is an important aspect that needs to be examined to correctly assess the impact of an administrative policy change or reform, the study also attempts to provide feedback on taxpayer satisfaction with taxpayer services such as the income tax website, Aayakar Seva Kendra (ASK), Large Taxpayer Units (LTUs), etc. The findings from the study are expected to help in informed policy formulation.

The methodology adopted in the study entails a three-pronged approach. The first is a primary survey of 6200 individuals across 16 cities in India, with 10 per cent of the sample being non-filers. Individuals in the sample include a mix of salaried, professional and self-employed groups, while businesses include 450 small and medium-sized enterprises and 50 large enterprises. Based on inputs from tax officials, national and international research scholars, and secondary analysis,

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\(^{193}\) Tax Compliance Cost Surveys, World Bank.

\(^{194}\) Indian Council for Research on International Economic Relations (ICRIER), New Delhi.
four questionnaires have been prepared for the survey of four categories of taxpayers (including
non-filers). The questionnaire draws from focus group interactions with academic experts,
taxpayers, tax practitioners and industry associations to gather information on specific industry-
related, legal and procedural issues that need to be taken into account as described below in Section
X.4. Stakeholder consultations in two cities involving participation from tax authorities and
taxpayers have also been used.

The survey is being administered using the multi-stage cluster sampling method.195 The data
collected will be used to estimate compliance cost for different categories of taxpayers using a
multivariate regression model and cross-tab analysis. This will also help identify factors that
inhibit compliance because of the associated costs and those that have a high probability of
becoming barriers to tax compliance.

X.3.d Estimating administrative cost

Administrative costs are those that tax administrations incur in enforcing a regulation. This cost is
an important factor in determining the regulatory burden. The cost of a regulation will be in terms
of money, time and complexity of the regulation. Such costs are for specific regulatory processes
and include budgets and manpower that the tax administration will require to meet requirements,
which can range from a simple outreach programme to inform taxpayers about the regulation to
potential legal punishment and monetary fines for violating a compliance regulation. As the
number of regulatory requirements grows and reporting requirements become more complex, this
cost to the tax administration rises and can be of utmost concern to itself. It can create unnecessary
barriers to trade and investment, as well as to economic efficiency and innovation,196 if they
become excessive in number and complexity,197 causing further concern to the tax administration.

A tax compliance burden case study was conducted by the US IRS’s Office of Research in 2003.
It reported that an accurate measurement of administrative burden required the determination of
activities which are essential to running a business, as well as incremental activities that were
carried out primarily for federal tax purposes.

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195 “Multi-stage cluster sampling” is an approved sampling technique used for a majority of household/individual level
surveys undertaken by different United Nations (UN) agencies in India. In this a village (in rural area) or a census
enumeration block (in urban area), is identified as the primary sampling unit (PSU). The first household is identified
randomly. Subsequently, using systematic random sampling, the required number of households to be covered in the
area is contacted and the required information is collected. Unlike in purposive sampling in which a household is
selected on the basis of specific criteria, the population is not chosen according to specific criteria in systematic random
sampling, which is a component of multi-stage cluster sampling. However, due to randomness, this segmented data is
still representative of the population from which the sample is taken. Hence, estimates provided by this technique are
robust.”

196 For a detailed treatment, see Section III. “Efficiency Effects of Taxation”, in Parthasarathi Shome (2014), “Taxation
Principles and Application — A Compendium”, LexisNexis, New Delhi, pp 207-287.

Ireland measures the administrative burden of regulation for both primary regulation as well as secondary regulation.

X.3.e Time-line for developing impact assessment

At present, assessments before the choice of a regulatory option are done only in Italy, the Netherlands, and the United Kingdom. The impact assessment process is divided into different phases, beginning at an early stage. Sweden attempts to ensure selective use of regulatory impact assessment as an effective policy making tool and not simply as a bureaucratic add-on. In Denmark, although preliminary impact assessments are conducted prior to the annual presentation of government legislation, they are actually developed just before a bill is presented to Parliament. Thus, the timing of assessment varies and usually depends on individual features of each case. The European Union provides a typical time-line, as shown in Diagram 10.2, to carry out impact assessment.

Diagram 10.2: Time-line for carrying out regulatory impact assessment

[X.3.d Time-line for developing impact assessment]


X.4 Way forward

The discussion so far pointed to the experience that a regulatory impact assessment is already being used as a decision making tool and a method to systematically and consistently examine the potential impact of selected government tax actions, based on analysis, and stakeholder consultations, thus making the process transparent and inclusive, and improving government accountability. The process has been used by advanced tax administrations to improve the understanding of the real world impact of tax actions (legislative as well as administrative), arriving at both benefits and costs of the action.
The two tax departments – the CBDT and CBEC – have so far not embarked on a comparable process in a systematic manner. It is for these reasons the TARC recommended in Chapter III (Section III.4.d) of its report, “The development of policy options should be accompanied by detailed impact assessments, ex-ante as well as ex-post. The revenue projections of any new policy option could be based on careful data analysis and revisited periodically in the context of changes in economic trends.” It also pointed out in the same section that, for framing laws, rules and regulations, while initiating the proposal, the recommended Tax Policy and Analysis (TPA) unit should embark on the process by explaining “in economic terms with background technical analysis” the “rationale for the proposed law, regulation or change in regulation”, “demonstrating the need and justification for the proposed change and its nexus with the objectives sought to be achieved. Proper cost-benefit and impact analyses in quantitative terms, both in relation to taxpayers and the tax administration, should be undertaken, before the decision is taken to frame the regulation.” As part of the process of framing laws, rules and regulations, “A clear and detailed statement of objectives and reasons should invariably accompany any new regulation or amendment to regulation. This should state what the objective sought to be achieved is and how the proposed regulation will achieve it.”

The TARC also recommended that, “All proposed legislation and regulation should be put up on the website for public consultation and comments should be captured and duly considered while taking a final decision. A summary of the comments and their consideration should also be published when the regulations are finally published. A summary of the cost-benefit analysis should invariably accompany the publication of the regulation. Perhaps the only area where prior consultation may not be essential is in the exclusive case of a rate change since such a change does not carry with it multiple ramifications that a more complex change tends to bring.”

Hence, the impact assessment process, which aids decision making and increases the involvement and accountability of decision makers at all levels, including the ministerial level, and demonstrates how the decisions of the government will benefit society at large, should be initiated at the earliest.

To do that, proper capacity will have to be built at the level of the present Tax Policy and Legislation (TPL) unit of CBDT and Tax Research Unit (TRU) of CBEC (and in the recommended TPA) as well as at the field level (in the directorates) so that vertical and horizontal integration of the overall capacity and accountability of the two organisations – CBDT and CBEC – increase and impact assessment becomes part of the basic working process before taking any initiative at all levels. The entire process has to be seen as a management tool for tax action, be it legislative or administrative.

**X.4.a Impact assessment process as a management tool**

Impact assessment, as explained earlier, has been used as a tool to inform decision makers, including ministers, of the likely benefits and costs, identifying key factors that should affect the decision, strengthening the quality of analysis and making the policy inclusive. By clarifying the
impact assessments implicitly broadens the objective of policy makers from a singularly problem-solving approach to balanced decisions. This sets the policy change, whether legislative or administrative, against wider economic goals. The impact assessment exercise, thus, is a management tool to deal with linkages and trade-offs, involving different actors fitted in an efficient decision-making process, and arriving at a high-quality decision in a timely manner. This systematic process of questioning, probably at the beginning of the policy cycle, facilitates necessary reflection on the important range of details to be taken into account when designing and implementing any tax regulation. The process thus helps policy makers adopt more efficient policies by comprehensively assessing the impact and consequences of competing policies. Diagram 10.3 gives elements of impact analysis for decision making.

**Diagram 10.3: Elements of impact analysis**


Impact analysis has to be institutionalised in the check-list for policy framing, and the approach has to be long-term, rather than sporadic or unsystematic. A clear benefit of such a process makeover is that it increases the likelihood that the proposed tax action will achieve its policy objectives without imposing unnecessary or unintended economic costs. A well-designed impact assessment system, not only in terms of methodology but also in terms of the actual process, assists in promoting policy coherence, as mentioned above, by not only making transparent the trade-offs inherent in regulatory proposals, but also by identifying distribution of benefits from the regulatory change, and clarifying how risk reduction in one area may create risks in another area of government policy.

Impact assessment can be used as a tool to review existing regulations and assess their impact, thus improving the quality of the regulations. The review and updating of laws, rules, and other
instruments to decrease regulatory risk and uncertainty represent another important responsibility of the management of tax administration. This is to systematically streamline the legislative corpus and remove unnecessary charges and burdens that get imposed and embedded due to laws, rules and their practices. This was duly emphasised by the TARC in its first report.\textsuperscript{198}

However, there are several management challenges to implementing the process of impact assessment. These include:

i) Limited acceptance of impact assessment. A particular challenge may be a rigid, regulatory bureaucracy and vested interests that oppose such processes.

ii) Insufficient institutional support and staff with appropriate skills to conduct impact assessment.

iii) Lack of reliable data on which the management could initiate successful impact assessment.

iv) Lack of a coherent, evidence-based participatory policy process that even management cannot change easily.

v) Fear among top authorities including management regarding losing an easy control that rudimentary decision-making enables.

These challenges may rear their head as the road map for impact assessment implementation is defined and pursued.

X.4.b Stakeholder consultations

A strong trend toward more open and participative rule-making has emerged as an essential component of the process in advanced tax jurisdictions. Governments use a variety of methods to allow interested groups to participate. This is part of the basic framework to improve the openness, transparency, and responsiveness of tax administrations; other methods such as consulting a few experts or undertaking empirical exercises may be useful though they may turn out to be insufficient. A well-laid out impact assessment process exposes the merit of decisions and the impact of actions based on public consultation and it is for this reason that linking impact assessment process with policy debate and inclusion turns out to be such a successful tool in its own right, provided the consultations are built around the documents that state the goals and effects of proposed rules.

\textsuperscript{198} The TARC in Chapter III of the report stated that “each rule, regulation and other tax policy measure such as exemptions should be reviewed periodically to see whether they remain relevant to the contemporary socio-economic conditions and meet changing requirements. For this, a robust process should be institutionalised. As a first step, a thorough review of the existing rules, regulations and notifications should be undertaken. Going forward, it should be a standard practice to build a sunset clause in each rule, regulation and notification.” (Section III.4.d)
X.4.c  Methodology for impact assessment

The methods employed for deriving the impact form the key to the design and performance of impact assessment as has been already discussed. The methods could include surveys, benefit/cost analysis, compliance cost analysis or business impact tests. The choice of methods should be scaled to capacity and data availability. The CBDT and CBEC need to have a flexible, analytical approach to this. Appendix X.5 describes some of the methods. Since the analytical capacity is likely to be built over a period of time, it is important to ask the right questions to the right people (and thus create a framework for regulatory policy making) rather than obsess about technically precise impact statements. Since there is no single model that fits all situations, using the right method for the question/issue at hand and focussing on the key objective of improving evidence-based decision-making and integrating such evidence into policy making are of the essence.

It is also to be understood that ex-ante assessment of policies is a challenge because of lack of data, which means that a proposed regulation may not always be easily assessable, limiting the possibility of forecasting the effects and possible side-effects of a proposed policy change. The challenge is also to recognise and incorporate its indirect impact. Hence, it may be difficult to identify and fully assess all impact areas that are likely to be triggered and should ideally be considered for any impact assessment, vis-à-vis others that can be omitted since they may not have any relevant or significant impact.

Another dimension of complexity is in the aggregation of impact, as sometimes different kinds of impact are measured by different indicators and scales. Some countries attempt to monetise different kinds of impact, thus making aggregation easier. But in practice, arriving at such monetisation may not be straight forward. Cost saving also sometimes cannot be calculated because of methodological limitations.

Despite such limitations, the overall usefulness of impact assessment is universally accepted, and India should begin quickly and move ahead with it.

**Benefit calculation**

Benefit calculation is part of any impact assessment. Generally, benefits are classified as direct or indirect, meaning that they can affect the stakeholders targeted by the legislation or administrative action, or could go beyond the target groups and affect other groups. For example, direct benefits are taxpayers’ satisfaction or welfare, improved market efficiency which includes improvement in the allocation of resources, removal of regulatory or market failures, or cost savings generated by regulation. Indirect benefits or spill-over effects include improved compliance with tax laws by third parties (i.e., parties not affected directly by a proposed regulatory change).
The overall idea behind benefit assessment is the need to capture the total economic value of a given resource, including its use and non-use value. The main proxy used to estimate the valuation of benefits is an individual’s willingness to pay and willingness to accept compensation. Benefits are calculated as the sum of the willingness to pay or willingness to accept by all individuals affected by a given policy change. The two main methods used to measure willingness to pay and willingness to accept are stated preferences and revealed preferences.

A stated preference model uses responses by individuals to a survey that assesses the sample population’s willingness to pay the cost imposed by, or accept, a given regulatory change. The precision of these evaluations relies upon the capacity of the expert in designing and conducting a survey. A revealed preference model is based on the assumption that people’s behaviour, when spontaneous, is the best possible indication of the preference of individuals.

Another model used for valuation techniques is the benefit transfer approach which entails that officers in charge of estimating a given benefit rely on the results of previous studies where available, taken as proxies for the values to be estimated.

**Use of risk analysis in impact assessment**

An impact assessment of any tax action will contain an element of risk or uncertainty; hence, formal risk assessment may need to be carried out. Identification of risk, *a priori*, will help reduce or eliminate the risk and may suggest a strategy to deal with it either through policy design or by taking care of factors affecting the outcome. No doubt, risks can be rarely reduced to zero without incurring large costs, and risk analysis does not eliminate the risks but it is an efficient way to determine which measures can be used to reduce the probability of such an event occurring, or by limiting the extent of negative consequences if it does occur, or by a combination of both. Another role of risk analysis is to prioritise and classify the risks – identification of thresholds and tolerance levels for cost, schedule, staffing, and resources – through an iterative process and then determining which risks require development of mitigation strategies and/or a contingency plan. Thus, impact assessment should invariably include risk assessment.

The following three steps may be relevant for carrying out risk analysis in impact assessment:

- Identify relevant risks and provide a clear description of the origin of the risks and the consequences they may have. Definition of the problem and the circumstances under which it may occur will need to be specified.
- Determine the chance of risk occurrence and the extent of the harm that it will do.
- Identify alternative ways to reduce identified risks.

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The aim is to identify “how much” risk is acceptable, and the cost that can be agreed upon to achieve the extent of risk. An important objective of risk quantification is to separate objective risks from subjective risk perceptions and to arrive at an evidence-based assessment of risk.

**Ex-post review of impact assessment**

While ex-ante analysis is ideal for impact assessment, an ex-post review of impact has a positive impact on the overall quality of ex-ante analysis. As discussed, more countries have institutionalised ex-post over ex-ante impact assessment, an ex-post review of impact assessment gives a dynamic sense to the ex-ante review as it reveals systemic errors in the impact assessment methodologies, and helps correct them. This is why results of an ex-post review and conclusions from there need to be assessed and, if found relevant, need to be fed back into impact assessment guidelines. Methodologies for ex-post evaluation of impact assessment can be based on content tests, outcome tests and function tests, each test contributing to and complementing the other two. Content tests assess regulatory impact assessment on the basis of whether they contain the elements specified in impact assessment requirements, and in some cases, assess the quality of each of these elements. Outcome tests assess impact assessment in terms of the degree of consistency between their ex-ante and actual (ex-post) impact. Function tests assess impact assessment according to their outcome, i.e., their ability to facilitate the regulatory process and produce efficient and equitable regulations.

**X.4.d Timing for the process**

The impact assessment process, as shown in Diagram 10.2 commences even if the impact assessment is provisional and only covers a range of possible outcomes. Tax administrations sometimes consider the timing of the process of greater concern than even the methodology employed and, to make sure the issue is not lost sight of, a formal guideline is issued giving the timelines for impact assessment and public consultations. If the process starts late, it would be difficult to include the results of the exercise as inputs in the policy making process. A sound analysis of the costs, risks and benefits of regulatory action at the right stage can help reach the pre-defined policy objectives. Serious consideration to alternatives can be formulated only when it is timely. If it is undertaken when discussions are too advanced, the risk of regulatory non-capture is higher and it can become an administrative tool merely to justify decisions, failing the basic purpose of the process of impact assessment.

Overall, therefore, there is a need for the CBDT and CBEC to issue guidelines, indicating clear timelines for each activity of the impact assessment process. Since the impact assessment process will need to be planned dynamically, it is important that such guidelines are not considered immutable as there may be a need to adopt new information being made available during the

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200 Australia, New Zealand, and the UK identify and quantify “unacceptable hazard or risk” as a standard rationale for government intervention. In conducting threshold tests, the key concept in relation to risk is the distinction between acceptable and unacceptable risks.
process, which may require suitable changes in the timelines. However, this should not mean that the timelines are modified in a manner that precludes a decision within the overall stipulated period.

X.4.e Data collection

A comprehensive impact assessment analysis requires good quality of data, to correctly evaluate the impact. It is thus imperative that identification of data requirement and understanding of data availability are arrived at, at an early stage of the process. For these to happen, there is need to develop and put in place a systematic and functional approach to data collection so that essential, good quality data are not lacking. Often ad hoc strategies that cut cost in various ways including compressing the allowable time, fail.  

Before collecting data, it is imperative to carry out a context analysis to understand and analyse the universe of analytical techniques available, which ones are to be employed, the expected quality of data to be collected, the estimated cost of collection, the predicted non-response rates, the expected level of errors, and the length of time for data collection. Since data requirement is linked organically to the method used, an assessment of the techniques provides an assessment of the data requirement. This exercise also provides an insight into the strengths and weaknesses of various techniques and data aspects associated with those techniques. The methodological principles of data collection that underpin good practice are the following:

- Focus on the collection of data needed to improve estimates of key categories, which are the largest, have the greatest potential to change, or have the greatest uncertainty.
- Choose data collection procedures that iteratively improve the quality of the inventory in line with the data quality objectives.
- Put in place data collection activities (resource prioritisation, planning, implementation, documentation) that lead to continuous improvement of the data sets used in the inventory.
- Collect data at a level of detail appropriate to the method used.
- Review data collection activities and methodological needs on a regular basis to guide progressive and efficient inventory improvement.

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201 Denmark’s effort in collecting data to carry out cost-benefit analysis may be mentioned. Denmark has set up Business Test Panels to assess the burden of regulations for businesses. The Business Test Panels are used to request for information on the administrative burden of approved legislation. There are three panels consisting of 500 firms in each panel. Ministries have the discretion to use the test panel procedure but most have used them for legislation having significant business impact. Denmark also has Focus Panels, which are used to obtain information on the impact of legislative bills, with effects only on specific sectors of the economy. However, experience has shown the precision of test panel data to be low and the system is largely seen as an early warning mechanism for unanticipated major impact. A Model Enterprise Programme has also been introduced to provide more statistically robust data. Model Enterprises consisting of representative businesses in the industrial sector are used to measure the actual administrative burden on businesses. The identified burden on Model Enterprises can be applied in cases of similar regulatory proposals.
• Introduce agreements with data suppliers to support consistent and continuing information flows.

The quality of data collection is influenced by whether or not right information is being collected, by targeting a right collection point, i.e., targeting the right group or individual or institution, by targeting the right purpose, and identifying the skill of the data collector. It is, therefore, important that both the Boards adopt a careful and strategic approach to data collection, and issue strict guidelines for that purpose. The practice followed should be uniform, keeping in mind the need for high quality data, and with a clear understanding that this is one of the most difficult steps of the impact assessment process, and is often time and resource consuming. Inaccurate data would lead to inaccurate results and fundamentally alter the impact assessment. Consultation with external stakeholders should also not be ruled out to check the robustness of the data.

ICT systems already generate a considerable amount of data. These data or information need to be evaluated for their immediate suitability or suitability after some changes. Storage and protection of existing data, and enabling data creation through data mining are crucial at this stage in both the CBDT and CBEC. External data may also be gathered through general surveys, secondary data sources or archival data and interviews or stakeholder consultations during seminars and conferences.

Appendix X.6 briefly describes the current use of analytics in Enterprise Data Warehouse by CBEC. While it reveals progress in the use of data in the CBEC, deep challenges remain in both the CBEC and CBDT for the collection and use of data.

X.4.f Quality of impact assessment

Many systemic factors influence the quality of impact assessment and can potentially undermine their effectiveness. These factors include the design of the process and methodologies, incorporation of specific quality assurance mechanisms, and level of formal authority and overall support for the process. While the issue of integrating impact assessment into the policy-making process and administrative backing for the process are essential, quality assurance of the process is crucial. The quality depends on a range of other areas such as understanding of the statistical life of the data, use of sensitivity analysis, and treatment of risk element in the results. Other factors affecting quality include gaps or omission in data, inadequate evaluation techniques, complexity and fragmentation in this approach, failure to adhere to important rules, and poor integration with consultation processes.

Some quality issues can be corrected by the use of threshold tests. Threshold tests are conducted to identify the difficulty level of impact assessments. While several countries specify quantitative thresholds, others use qualitative thresholds. For example, Mexico specifies three levels of required regulatory impact assessment and distinguishes among them by a combination of both quantitative cost thresholds and qualitative judgments on whether the regulation would have non-negligible impact on productivity. But since, in practice, there is no fixed quality standard that
could be prescribed – given that it depends on the expectations of policy makers and taxpayers – the CBDT and CBEC should embark on a systematic exploration of quantitative data and qualitative information and build an orderly triangulation of the complete information picture to help assess the correctness of impact assessment.

Further, quality can be interpreted in different (yet not mutually exclusive) ways from the perspective of the stakeholder. A taxpayer will see the quality from his own perspective while the tax officer will view it from his or her own perspective and expectation. Thus, there is no “one-size-fits-all” notion as different stakeholders bring into the discussion different logic and criteria of quality and quality assurance; the logic is shaped by context and there is need to understand how it has materialised. Table 10.1 summarises the expectations of different stakeholders.

Table 10.1: Expectation from different stakeholders

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Experts</th>
<th>Tax officials</th>
<th>Political masters</th>
<th>Business firms</th>
<th>Taxpayers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Success</strong></td>
<td>Efficiency</td>
<td>Conformity to rules</td>
<td>Consensus</td>
<td>Cost-minimisation</td>
<td>Cost-effective protection from risk</td>
</tr>
<tr>
<td><strong>Logic of action</strong></td>
<td>Achieving goals in terms of real-world impact</td>
<td>Following legitimate procedures</td>
<td>Outcome of negotiation</td>
<td>Profit</td>
<td>Enabling regulation</td>
</tr>
<tr>
<td><strong>Logic of action</strong></td>
<td>Social sciences</td>
<td>Standard operating procedures</td>
<td>Negotiation</td>
<td>Logic of influence</td>
<td>Participation</td>
</tr>
</tbody>
</table>


Given that impact assessment costs money and institutional fatigue (people have to be persuaded and policy makers have to spend time in collecting and interpreting data), there is logic in questioning whether the estimates are accurate or perhaps a waste of time. Content tests on the quality of analysis follow the logic of cost-benefit analysis, which allows for checks on the predictive ability of impact assessment.

Keeping that in view, the process for quality check and improvement can be based on the following four steps:

a) Identify potential gaps.

b) Assess potential impact on quality and costs.

c) Approve plans.
d) Assess actual impact on quality.

While the above process follows a cost-benefit template, the guidance note for quality oversight should include the following aimed at improving the quality of impact assessment:

- Note the limitations in estimating benefits and costs.
- Present both best estimates and ranges for benefits, costs, and net benefits, or alternatively, ask to justify why that cannot be done.
- Require the quantification of benefits or costs that it is unable or unwilling to monetise, ask why that cannot be done.
- Expand the number of alternatives considered.
- Provide a clear executive summary along with a table that summarises what is known about the likely benefits and costs of the regulation in a standard format.
- Maintain a consistent format so that it is easier to obtain information from different impact assessments and to compare them.
- Include all the supporting documents required for impact assessment.
- Provide clear guidance on how to avoid problems.

The quality standards, although easy to set, are often difficult to adhere to. Hence, guidelines have to be issued by the highest authority so that they are implemented in every impact assessment process. The process is not only likely to improve the analysis significantly, but will also enhance its transparency.

**X.4.g Communicating results**

It is important to communicate the results of the impact assessment process to all stakeholders. This not only implies releasing the results, but also recording those cases in which the impact assessment has succeeded in weeding out inefficient regulatory proposals before enactment to draw lessons from the process. The process, thus, contributes to improving the quality of information about the regulation under review and provides a good basis for subsequent design improvement for better results. Communication is also part of the monitoring process for impact assessment. It ensures better allocation of scarce resources and provides tangible evidence to justify the process itself.

Many advanced tax administrations use three clear disclosure options: (a) disclosing the impact assessment results for further consultations, (b) disclosing the impact assessment results only after consultations, and (c) not disclosing at all.\(^2\)

The communication should be clear regarding who

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\(^2\) Canada, Denmark, Finland, Italy, Mexico, New Zealand, Norway, Poland, Sweden, Switzerland, the UK and the US fall in the first category; Japan and Portugal disclose their impact assessment for consultation only in the case of major regulations or in selected cases. Australia, France, Iceland and the Netherlands disclose their impact assessment results only after consultations, and (c) not disclosing at all.\(^2\) The communication should be clear regarding who

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is affected by the regulation in question, so that the communication is well targeted. The communication must also include background information so that stakeholders are able to understand why a particular tax action is being introduced, while giving the full details of the impact assessment of the tax action itself.

X.4.h Institutional arrangement

There is no unique institutional model for carrying out impact assessment work. Different countries have different institutional frameworks. Some countries prefer a centralised structure, but others prefer a decentralised framework. A centralised approach relies on an oversight body for regulatory reform located at the centre of the administration/ministry, whereas a decentralised institutional framework does not rely on a specific oversight body, but relies on co-ordination between different entities to achieve desired policy objectives. Some OECD countries have a central body to be tasked with the impact assessment process to ensure consistency, credibility and quality, arguing that such units are more appropriate to carry out the job in the best possible manner and to achieve the desired quality.

The TARC in Chapter III recognised the importance of decentralised analytical units at the levels of verticals. The intent behind such a structure is to provide the Principal Chief Commissioner of each vertical the autonomy to institute policies and programmes that are useful for the furtherance of their work and responsibility, to evaluate its performance and to bring about changes to ensure better delivery and achieve the desired goal. The functional verticals recommended were Strategic Planning and Risk Management, Communication and Co-ordination, Taxpayer Services, Taxpayer Education and Communication, Compliance Verification including Audit/Scrutiny, Dispute Management, Quality Assurance and Continuous Improvement, Inspection, Tax Debt Recovery, and Enforcement.203

The TARC also recommended the creation of a Knowledge, Analysis and Intelligence Centre (KAIC).204 “The KAIC is to be a common service to be shared between the two Boards. Its purpose is to provide high analytical input to policy making and build capacity to handle “increasingly ambitious initiatives and programmes with an emphasis on analytics, innovation and breakthrough insights” and serve “the deep analytical needs of the other verticals such as customer services, compliance management, and enforcement.”

Each of the above verticals, to be headed by a Principal Chief Commissioner, is envisaged to work on “research, analysis and programme evaluation, needs analysis and international benchmarking, feedback analysis and programme evaluation and innovation”. The responsibility of these analytical units will be to “periodically evaluate the success of these policies and consider

results when regulations are submitted to their Parliament or the Council of Ministers. Italy circulates the impact assessment to affected groups but does not put it in the public domain.

203See Section III.5.a of the TARC report.

204See Section III.6 of the TARC report.
appropriate revisions in the light of changing needs, and set performance targets.” In this decentralised framework, the KAIC will be to give analytical support on initiatives and programmes that are complex in nature, define quality parameters, carry out deep analytics itself, and provide an oversight role.

Chapter III thus envisaged the KAIC as a hub and the verticals’ analytical units as spokes, with the KAIC playing a critical co-ordinating role, without which the work of the vertical analytical units will be isolated from one another. The role of the KAIC in the work relating to impact assessment will be to strengthen the quality of policy debate, ensure that policy outcomes are integrated and coherent, and provide enhanced technical capacity to verify the impact analysis. The KAIC will also have to act as a repository of such impact analyses so that any unit requiring support from it can find relevant material as well as technical support. Such support can be related to the elaboration of the method to analyse, as well as the scope of, issues being dealt with, refinements such as inclusion of risk assessments, evaluation of the impact and improvements to data collection methodologies, keeping in view that the learning process in impact assessment is iterative and cumulative. The KAIC capacity is to be of such a level that its views are well respected. That cannot come, however, unless the KAIC brings a higher level of expertise on the subject, is able to carry out detailed and deeper analytics, and be a repository of knowledge.

Informal mechanisms and networks to share experiences and good practices can supplement information exchange and support during the learning process. To make sure that the desired level of co-ordination, integration and learning are not lost, horizontal committees can be constituted by the KAIC to enable transfer of knowledge and learning, and to provide a forum for discussions to enhance thinking and improve participation.

The role of the KAIC will also be to facilitate capacity building for impact assessment processes. To do so, the KAIC should be tasked with drafting clear, concise and accessible guidelines where theory and practical methodology are adequately explored. These guidelines should be as complete as possible. They could be in the form of a living document, which can be continuously improved as experience and knowledge on impact assessment methods and processes accumulate and new techniques or methodological changes are embraced. Some elements of these guidelines can be advisory and some mandatory. The advisory part is to give flexibility for improvement to the verticals, while the compulsory part is to ensure strict adherence to basic and key processes.

The formation of the KAIC involving all – direct and indirect – taxes by combining and significantly expanding the TPL and TRU should be achieved/completed on an immediate basis. This is essential and forms a central pillar of the TARC’s menu of reforms.

**X.4.i Training**

Training and capacity building is of utmost importance for the success of impact assessment implementation and systematisation. Regular training programmes will need to be instituted to support the preparation of impact assessment programmes so as to familiarise officials with the
scope of impact assessment and the work involved, as well as the obligations during the impact assessment process. These training programmes should be run on two tracks – one for the KAIC staff and another for those working in the analytical units of each vertical. For the KAIC, the training will require to be on detailed methodologies of impact assessment, development of consultation mechanisms, and essential procedures so that they are ready to contribute to the impact assessment process.

For staff working in different verticals, the training should not be heavily theoretical, but should be tailored to take account of specific circumstances. This is particularly so because impact assessment is generally unknown in Indian tax administration and familiarisation would require both innovative and informal training to enhance comprehension of the process, understand the need to include stakeholders in decision making, and building the trust required for such a process to be successful. At a later stage, perhaps after six months of working in the analytical unit, they can be given training designed to impart skills needed to do high quality impact assessment as well as receive information on where to get assistance with more complex cases.

The impact assessment process normally throws up more practical problems than technical ones. Thus, training and familiarisation with techniques should have a practical orientation and resources should be made available to assist officials using the tool. In this regard, acknowledging other countries’ experiences and their practical challenges are key elements to foreseeing problems; therefore, international co-operation should be sought. The KAIC will thus have to develop a body of guidelines and references that are essential instruments for impact assessment training and familiarisation. In this respect, it will have to embark on the long term goal of drawing up autonomous guidelines specific to its own requirement.

This being a new area, there will not be enough expertise immediately available departmentally. The CBDT and CBEC need to recognise that there may be need to search other exogenous sources for which the KAIC may “need to develop close links and relationships with reputed national and international research institutes, universities and private sector bodies.”205 Such associations or links will be helpful, particularly because the methodology used in, and the processes of, impact assessment may need constant renovation and improvement. This will also facilitate the compilation of knowledge, data mining, and the development of tools for dissemination. The KAIC can, for instance, use webinars, making available training frameworks that give practical examples of impact assessment for staff working in different analytical verticals.

**X.5 Roadmap**

The first step for carrying out an impact assessment for any tax legislation or administrative action will be to decide whether these proposals have a significant economic, social or environmental impact. This will set out the planning for impact assessment work. This will require the setting up of a steering group for impact assessment, consulting interested parties, collecting expertise and

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205 Chapter III of the TARC report.
data, carrying out the impact assessment analysis, presenting the findings in the draft impact assessment report, scrutinising the report and framing possible recommendations on the draft report, consult stakeholders on the results, revising the draft report after taking into account the suggestions and data gathered during the consultations, preparing the final impact assessment report, and submitting it to the concerned authority. It is important that impact assessment captures the expected impact in both qualitative and quantitative terms. The alternative policy options will have to be evaluated in the context of relevance to the problem, effectiveness in achieving the objectives, coherence with wider socio-economic objectives, cost or resources required and the taxpayer friendliness of the policy option. The process can be summed up as shown in Diagram 10.4.

**Diagram 10.4: Impact assessment governance cycle**

The above process needs to be ingrained in administrative procedures so that due transparency in the process can be adhered to. It is important to not make it a one-off exercise and to recognise the need for public proposals, comments, complaints and communication and acting on them. Such mandatory public consultation can no doubt be a double-edged sword. On the one hand, it will enable increased participation by the general public in the early stages of the regulatory process, at the same time, it can also expose policy makers to the risks of lobbying and capture. Nevertheless, such diffusion of an evaluation-oriented culture will have a transformational role in reinventing the government, leading to a gradual transformation of the bureaucracy that hitherto has been implementing laws but has had a deleterious impact on taxpayers and the economy.
Another achievement of this transparent and inclusive process will be capacity building of stakeholders for participating in these regulatory processes. Institutional competition will further enhance the beneficial effects both in terms of overall transparency and efficiency.

Another dimension for developing a roadmap for an effective impact assessment process is to recognise that the process has to be evolutionary. While the questions for impact assessment can be targeted at specific sectors and may be narrow so that the results are easily arrived at, the overall approach has to be broader. Initially, it should be mandated by only a simplified procedure, which entails that the CBDT or CBEC estimate the impact of proposed legislation on the costs to be borne by the taxpayers. This should be with a view to reducing the compliance burden which, of late, has increased due to regulatory creep.

A roadmap has been laid down for achieving integration in the impact assessment process so that attention is given to often-ignored elements that play a key role in implementing any programme. These elements are training of staff, consultation with stakeholders, and effective regulatory governance, and have been addressed in the previous section. Ignoring these can lead to obscure and unreliable assessments. An impact assessment procedure may need to be introduced gradually, although in a transparent manner, reaching the desired planned complexity and comprehensiveness a few years later when appropriate capacity has been built up. Such a graded implementation plan has to be backed by guidelines for implementation.

The procedure should permeate overall policy framing and implementation strategy, with stakeholder consultation as an important component. Assessment should cluster the results within a comprehensive matrix focusing on the following key aspects – process and workflow impact, data management and ICT impact, organisational impact, marketing impact, and customer relationship impact.

Similarly, regulatory governance gives practical effect to regulatory policy. Effective regulatory governance maximises the delivery and influence of regulatory policy that would have a positive impact on the economy and meet underlying public policy objectives. A core challenge for effective regulatory governance is the co-ordination of regulatory actions, from the design and development of regulations, to their implementation and enforcement. Closing the loop with monitoring and evaluation informs the development of new regulations and the adjustment of existing regulations.

Political support for the process

An important challenge in carrying out impact assessment, as already mentioned, is to ensure political and higher administrative support for it. Lack of such support could adversely affect the quality of impact assessment. Further, it will be almost impossible to implement the outcome of such an exercise. It is, therefore, crucial that political and high level administrative support is given, and that the CBDT and CBEC embed impact assessment as an essential element in their decision making processes. This will require a cultural change in the governance process, which
should be characterised by the inclusion of stakeholders, involvement and accountability of decision-makers, creation and understanding of policy alternatives, and consequent improvement in tax compliance.

X.6 Recommendations

Recommendations are intrinsically linked to TARC’s main conclusions. The TARC concludes and recommends the following:

i) Why impact assessment

a) Impact assessment process aids decision making and increases the involvement and accountability of decision makers at all levels, including the ministerial level, and demonstrates how the decisions of the government will benefit society at large. It should be initiated at the earliest. (Section X.4)

b) Impact analysis should be used because it improves the empirical basis for any decision making process, be it legislative or administrative. These empirically based studies help maximise benefits and minimise overall costs, and inform better regulatory management. (Section X.4.a)

c) Applying the principles of impact assessment to regulatory decisions can form an analytical tool which provides practical judgement to the feasibility and cost of any policy intervention. (Section X.4.a)

d) Impact assessment is a method of systematically and consistently examining the potential impact of government tax actions and communicating the information to decision-makers. The process helps in weighing various options to achieve desired objectives and to understand the consequences of the proposed change. (Section X.4.a)

e) Impact assessment can be used as a tool to review existing regulations and assess their impact, thus improving the quality of the regulations. The review and updating of laws, rules, and other instruments to decrease regulatory risk and uncertainty represent another important responsibility of the tax administration management. This is to systematically streamline the legislative corpus and remove unnecessary charges and burdens that get imposed and embedded due to laws, rules and their practices. (Section X.4.a)

f) An important challenge in carrying out impact assessment is to ensure political and high-level administrative support for it. Lack of such support could adversely affect the quality of impact assessment. (Section X.5)

g) Proper capacity will have to be built in the Tax Policy and Legislation unit of CBDT and the Tax Research Unit of CBEC (and in the recommended Tax Policy and Analysis Unit) as well as at the field level (in the directorates) so that vertical and horizontal integration of the overall capacity and accountability of the two organisations – the CBDT and the CBEC – increase and impact assessment before taking any initiative becomes part of the basic working process at all
levels. The entire process has to be seen as a management tool for any tax action, legislative or administrative. (Section X.4)

**ii) How to do impact assessment**

**Stakeholder engagement**

h) Stakeholder consultation enhances the transparency of any decision making process, provides quality control on any tax action and improves the information on which decisions are based. Stakeholder consultation should not only form part of the decision making process, but should be considered an independent tool for decision making in its own right. (Section X.4.b)

**Analytical methods**

i) The method employed to calculate impact assessment is key to the design and performance of impact assessment. Since there is no single model that fits all situations, a view has to be taken on identifying the appropriate method for the question/issue at hand, the key objective of using evidence-based decision-making, and integration of such evidence into policy making. (Section X.4.c)

j) The usual methods for calculating compliance costs include surveys, benefit/cost analysis, compliance cost analysis and business impact tests, which should all be considered. The choice of method should be scaled to the specific capacity of the tax administration and to data availability. For these reasons, the CBDT and CBEC should have a flexible yet analytical approach to the choice of method. (Section X.4.c)

k) Aggregation of impact may be difficult as sometimes impact is measured by different indicators and scales. Keeping this in mind, costs and benefits – quantitative and qualitative – nevertheless need to be assessed. (Section X.4.c)

l) Benefit calculation is part of any impact assessment. Non-economic benefits of legislation may be difficult to assess and so cost saving cannot be easily calculated, because of methodological limitations. Nevertheless, tax benefits can be calculated. (Section X.4.c)

m) A discretionary change model should be developed to understand the impact on tax revenues due to a change. (Section X.4.c)

n) An impact assessment will contain an element of risk. If these risks involve possible irreversible damage on an uncertain scale, a formal risk assessment should be carried out. (Section X.4.c)

o) Identification of risk, *a priori*, will also reduce or eliminate the risk since it enables the development of a strategy to deal with it at inception, either through policy design or by taking care of the factors affecting the outcome. (Section X.4.c)

p) Another role of risk analysis is to prioritise and classify risks – identification of thresholds and tolerance levels for cost, schedules, staffing, resources and quality through an iterative process,
and then determining which risks require development of mitigation strategies and/or a contingency plan. (Section X.4.c)

q) Steps need to be taken to carry out risk analysis in impact assessment: identification of relevant risks, a clear description of the origin of every risk and the nature of the consequences it may have, the chance of its occurrence, the extent of harm it could cause, and identification of alternative ways to reduce it. (Section X.4.c)

r) While ex-ante analysis is a necessary step in impact assessment, ex-post reviews of impact have a positive impact on the overall quality of ex-ante analysis. Ex-post reviews of impact assessments impart dynamism to ex-ante analysis as they reveal systemic errors in impact assessment methodologies, and help in correcting these. Hence, results of the ex-post review and conclusions drawn need to be assessed and, if found useful, fed back into impact assessment guidelines. (Section X.4.c)

### iii) Timing of the process

s) The time to initiate the impact assessment process is as important as clearly stating the purpose and intent of the tax action under question. (Section X.4.d)

t) Looking at the importance of timing, the CBDT and CBEC must issue formal guidelines outlining the timelines for impact assessment and public consultation. (Section X.4.d)

u) The impact assessment process will need to be planned dynamically. Guidelines should not be looked upon as an immutable document as there may be a need to adopt new information that becomes available during the impact assessment process, which may require suitable change in the timelines. But this should not mean that timelines are modified in a manner that precludes a decision within the stipulated period. (Section X.4.d)

### iv) Data collection

v) A comprehensive impact assessment analysis requires good quality of data to correctly evaluate the impact. Thus, identification of data requirement and understanding of data availability should be arrived at, at an early stage of the process. (Section X.4.e)

w) Since data requirement is linked to the method used, an assessment of techniques provides an assessment of the data requirement. This exercise also provides an insight into the strengths and weaknesses of various techniques and data aspects associated with those techniques. (Section X.4.e)

x) There is need to develop and put in place a systematic and functional approach to data collection so that essential, good quality data are not lacking. Often ad hoc strategies that cut cost in various ways, including compressing the allowable time, fail. (Section X.4.e)

y) Before data collection is embarked upon, context analysis should be carried out so as to understand and analyse the universe of analytical techniques available, which ones are to be employed, the expected quality of data to be collected, the estimated cost of collection, the
predicted non-response rates, the expected level of errors, and the length of time for data collection. (Section X.4.e)

z) The quality of the impact assessment process is dependent on a range of other areas such as treatment of risk element in the results, use of sensitivity analysis, and understanding of the statistical life of the data. Other factors impacting quality include gaps or omission in data, inadequate evaluation techniques, complexity and fragmentation of approach, failure to adhere to important rules, and poor integration with the consultation process. (Section X.4.f)

aa) Some quality issues can be corrected by resorting to threshold tests. Threshold tests are conducted to identify the difficulty level of impact assessments. The process for quality check and improvement can be based on four steps: identify potential gaps, assess potential impact on quality and costs, approve plans, and assess actual impact on quality. (Section X.4.f)

bb) Since, in practice, there is no fixed quality standard that could be prescribed – given that it depends on the expectations of policy makers and taxpayers – the CBDT and CBEC should embark on a systematic exploration of quantitative data and qualitative information and build an orderly triangulation of the complete information picture to help assess the correctness of impact assessments. (Section X.4.f)

c) Both Boards must adopt a careful and strategic approach to data collection, and issue strict guidelines for that purpose. The practice followed should be uniform, keeping in mind the need for high quality data, and with a clear understanding that this is one of the most difficult steps of the impact assessment process, and is often time and resource consuming. Inaccurate data would lead to inaccurate results and fundamentally alter the impact assessment. Consultation with external stakeholders should also not be ruled out to check the robustness of the data. (Section X.4.e)

d) ICT systems already generate a considerable amount of data. These data or information need to be evaluated for their immediate suitability or suitability after some changes. Storage and protection of existing data, and enabling data creation through data mining are crucial at this stage in both the CBDT and CBEC. External data may also be gathered through general surveys, secondary data sources or archival data and interviews or stakeholder consultations during seminars and conferences. (Section X.4.e)

v) Communicating results

ee) It is important to communicate results of the impact assessment process to all stakeholders. Better communication and feedback contribute to improving the quality of information about the regulation under review and provide a good basis for subsequent improvement in design to obtain better results. (Section X.4.g)
vi) Preparing implementation

ff) A sound analysis of the costs, risks and benefits of regulatory action at an early stage can help formulate and eventually reach pre-defined policy objectives. Thus, the impact assessment process should commence even if the impact assessment is provisional and only covers a limited range of possible outcomes. If the process starts late, the results of the exercise could fail to be included as inputs in the policy making process. (Section X.4.d)

gg) A steering group for impact assessment should be set up for consulting interested parties, using expertise and collecting data, carrying out the impact assessment analysis, presenting the findings in a draft impact assessment report, scrutinising the report and framing possible recommendations based on the draft report, carrying out detailed stakeholder consultation, revising the draft report after taking suggestions into account, preparing the final impact assessment report, and submitting it to the concerned authority. (Section X.5)

hh) It should be mandated that the CBDT or CBEC estimate the impact of proposed legislation on the costs to be borne by the taxpayers. This should be with a view to reducing the compliance burden which, of late, has increased due to regulatory creep. It is important that the impact assessment captures the expected impact in qualitative and quantitative terms. (Section X.5)

vii) Role of KAIC in implementation

ii) The formation of the KAIC, to carry out deep analytics, involving all – direct and indirect – taxes by combining and significantly expanding the TPL and TRU should be achieved/completed on an immediate basis. This is essential and forms a central pillar of the TARC’s menu of reforms. (Section X.4.h)

jj) The KAIC should function as a hub and vertical analytical units as spokes, with strong co-ordination by the KAIC, without which the work of the vertical analytical units would be isolated from one another. (Section X.4.h)

kk) The role of the KAIC in the work relating to impact assessment will be to strengthen the quality of policy debate, to provide enhanced technical capacity to verify the impact analysis, and to ensure that policy outcomes are integrated and policies are coherent. (Section X.4.h)

ll) The role of the KAIC will also be to facilitate capacity building processes for impact assessment. (Section X.4.h)

mm) The KAIC will have to act as a repository of such impact analyses so that any unit requiring support from it can find relevant material as well as technical support. Such support can be for elaboration of the method as well as in the scope of issues being dealt with, refinements such as inclusion of risk assessment, evaluation of the impact and improvements to data collection methodologies, keeping in view that the learning process in impact assessment is iterative and cumulative. (Section X.4.h)
nn) The KAIC’s capacity should be of such a level that its views are well respected. This, however, cannot happen unless the KAIC brings a higher level of expertise on the subject, is able to carry out detailed and deeper analytics, and be a repository of knowledge. (Section X.4.h)

oo) To make sure that the desired level of co-ordination, integration and learning are not lost, horizontal committees can be constituted by the KAIC to ensure transfer of knowledge and learning, and to provide a forum for discussion to enhance thinking and improve participation. (Section X.4.h)

pp) The KAIC should be tasked with drafting clear, concise and accessible guidelines where theory and practical methodology are adequately incorporated. These guidelines should be as comprehensive as possible. (Section X.4.h)

qq) The guidelines could be in the form of a living document, which can be continuously improved as experience and knowledge on impact assessment methods and processes accumulate and new techniques or methodological changes are embraced. Some elements of these guidelines can be advisory and some mandatory. The advisory part is to provide verticals the flexibility to introduce improvement, and the compulsory part is to strictly ensure adherence to basic and key processes. (Section X.4.h)

rr) Regular training programmes will need to be instituted to support the preparation of impact assessment programmes to familiarise officials with the scope of, and the work involved in, impact assessment, and their obligations during the impact assessment process. (Section X.4.i)

ss) The KAIC will have to develop a body of guidelines and references that are essential instruments for impact assessment training and familiarisation. In this respect, it will have to embark on the long term goal of drawing up autonomous guidelines specific to its own requirement. (Section X.4.i)

tt) The training programmes should be run on two tracks – one for KAIC staff and another for those working in the analytical units of each vertical. For the KAIC, training will require to be on the detailed methodologies of impact assessment and related procedures, development of consultation mechanisms so that they are professionally ready to contribute to the impact assessment process. (Section X.4.i)

uu) For staff working in different verticals, the training should not be theoretical; it should be tailored to take account of specific circumstances. At a later stage, perhaps after six months of working in an analytical unit, they can be given training designed to impart skills needed to do high quality impact assessment as well as to receive information on where to receive assistance with more complex cases. (Section X.4.i)

vv) KAIC staff will be required to act as resource persons to provide training to those in the vertical analytical units. For example, it can use webinars, making available training frameworks that give practical examples of impact assessment to such staff. (Section X.4.i)

ww) The CBDT and CBEC may need to access exogenous information sources and to help them do so, the KAIC may need to develop close links and relationships with reputed national and
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The CBDT and CBEC may need to access exogenous information sources and to help them do so, the KAI may need to develop close links and relationships with reputed national and international research institutes, universities and private sector bodies. Such associations or links will be helpful particularly because impact assessment may need ongoing improvement in methodology as well as in processes. This will also facilitate the accumulation of knowledge, continuing compilation of data, and sharing and dissemination of information. (Section X.4.i)
CHAPTER XI

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Chapter XI
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XI.1 Introduction

Justice Wendell Homes once said, “With taxes, I buy civilisation’. It means that taxes are the cost paid for living in a society and for being part of civilisation. Taxes also need to be utilised to meet basic functions of the state like defence, law, justice, public services and good governance. Unfortunately, people take taxes only as a burden on their income and treat the filing of returns as a mere formality.

In the last ten years, direct tax collection has increased by more than 700 per cent (from Rs.69,198 crore to Rs.5,58,965 crore), but the number of taxpayers has grown by only about 35 per cent. The total number of taxpayers in the lowest income slab, (i.e. up to Rs.5 lakh) comprises 98.30 per cent of total taxpayers, from whom 10.1 per cent of the tax revenues are collected. The highest slab of above Rs.20 lakh comprises a meagre 0.38 per cent of total taxpayers, contributing 63 per cent of tax revenues. In FY2008-09, the numbers of corporate taxpayers in the Rs.0-100-crore slab was 463,507 and those above Rs.500-crore slab numbered just 186 taxpayers.206 This suggests that the income tax base in revenue terms is very narrow and adversely affects tax buoyancy.

India has a low taxpayer base even as a percentage of the total population. With a population of over 120 crore, only 17 crore have a PAN207 and of these, about 3.6 crore file income tax returns. Only 3.3 per cent of the population pays tax, which is very low compared to 39 per cent in Singapore, 46 per cent in the USA, and 75 per cent in New Zealand. This, of course, reflects India’s low income levels, which, for a large part of the population, falls below the basic income tax threshold; yet huge potential remains to expand the taxpayer base. However, due to various structural reasons that are explained later, the base could perhaps be doubled at most to say 7 per cent. A huge gap has also been noticed between the number of entities to which tax deduction and tax collection account number (TAN) has been allotted vis-à-vis the number of deductors filing income tax returns. A significant cause for the difference is that not all those allotted TAN file returns.

Even though widening the tax base has been one of the key action plan areas for the last several years, achievement has fallen short of targets. There, therefore, is an urgent need to enlarge the tax base as well as taxpayer base (which is not commensurate with the growth in income and wealth seen over the years) through both policy as well as enforcement action by bringing into the tax net

207 The Economic Times, July 4, 2013
high net worth assessees and potential tax payers. Even after allowing for agriculture households, dependent family members, and other relevant criteria, the tax base should be far larger than it is at present. It is possible to increase the number of income tax taxpayers from the present 3.5 crore to at least 6 crore. Assuming a family size of 5, there are 24 crore families in India. Assuming, further, that 30 per cent of the households earn only subsistence wages and another 20 per cent are below the income tax threshold, there will be 12 crore potential taxpayers. If one-half of this is assumed to derive income from agriculture, there will be 60 million or 6 crore potential taxpayers. There is, thus, significant scope to increase the tax payer base and a lot of this increase will need to come from both increasing the tax base and ensuring true income disclosures. Widening the tax base raises equity, because if all persons liable to pay tax are brought on tax records, the burden on existing taxpayers can be brought down. The overall level of compliance improves when a large number of persons who are legally required to file returns, do so. It also encourages others to comply with their legal obligation to pay their taxes dutifully.

A drop in the number of new taxpayers has come in spite of measures like making it mandatory to quote PAN for certain transactions, transactions over a specified value, collection of third party information, expanding areas of tax deduction at source, etc. Measures like withdrawal of excise exemption, imposition of excise duties on readymade garments, service tax on new services and a negative list approach for levy of service tax on the indirect tax side have also been aimed at bringing more people in the tax net but these have not been comprehensive enough to expand the taxpayer base.

The decline in taxpayers can be explained partly by the changes in the basic exemption limits for taxpayers, grant of additional exemptions, years of slowdown resulting in a slowing trend growth rate, closure of business, demise of the taxpayer, high incidence of retirement, huge unorganised (informal) sector, slack enforcement, lack of proper taxpayer education and a growing culture of large-scale cash transactions.

The focus has to be on bringing in new taxpayers, rather than putting a heavier burden on payers who are already in the tax net by targeting sectors that are currently untaxed, especially the informal/unorganised sectors. There also has to be a comprehensive review of exemptions, incentives, etc., with a view to rationalising them, which may require legislative changes. Attention has also to be given to minimisation of tax avoidance/evasion by developing a better understanding of the underground economy, both in terms of its size and the economic and behavioural factors that motivate players in the economy, identifying vulnerable areas of tax evasion, and coordination and collaboration with sister departments for exchange of information on a real time basis and its effective utilisation. Without impinging upon good taxpayers, tax avoidance needs to be examined very carefully in those identified areas and non-filers and stop-filers need to be targeted to widen the tax base. The tax administration needs to be oriented more towards customers, an idea adopted by many modernising tax administrations and recommended by the TARC in its report for improving voluntary compliance. This could go a long way in expanding the taxpayer base.
Further, it is necessary to explore avenues for tax reform that would lead to economic growth and resource mobilisation. Reports suggest that by implementing the GST (Goods and Services Tax), the economy will stand to gain $15 billion a year as it would boost exports, raise employment and promote overall economic growth by widening the tax base. The broadening of the tax base and greater compliance could boost tax collections, even while the overall tax rate could fall. A study by the National Council of Applied Economic Research (NCAER) also suggests that the GST could boost India’s GDP growth by 2-2.5 per cent.208

XI.2 Indian scenario

XI.2.a Central government tax revenue

Central government tax revenue comprises direct taxes and indirect taxes. Direct taxes include largely corporate tax, individual tax, and wealth tax. Indirect taxes consist of customs, excise and service tax. The year-wise collection from direct tax and indirect tax is given in Table 11.1 below.

Table 11.1: Year-wise total tax revenue (Rs. in crore)

<table>
<thead>
<tr>
<th>FY</th>
<th>Direct Tax</th>
<th>Indirect Tax</th>
<th>Total Tax</th>
<th>Direct Tax as % of total</th>
<th>Indirect Tax as % of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>3,33,818</td>
<td>2,69,433</td>
<td>6,03,251</td>
<td>55.34</td>
<td>44.66</td>
</tr>
<tr>
<td>2009-10</td>
<td>3,78,063</td>
<td>2,45,367</td>
<td>6,23,430</td>
<td>60.64</td>
<td>39.36</td>
</tr>
<tr>
<td>2010-11</td>
<td>4,46,935</td>
<td>3,45,127</td>
<td>7,92,062</td>
<td>56.43</td>
<td>43.57</td>
</tr>
<tr>
<td>2011-12</td>
<td>4,93,959</td>
<td>3,91,738</td>
<td>8,87,071</td>
<td>55.78</td>
<td>44.16</td>
</tr>
<tr>
<td>2012-13</td>
<td>5,58,965</td>
<td>4,74,209</td>
<td>10,31,174</td>
<td>54.01</td>
<td>45.99</td>
</tr>
</tbody>
</table>

Source: CBDT

---

The composition of central government’s tax revenue, expressed in terms of GDP reflects certain trends, as can be seen in Graph 11.2. First, corporate income tax has steadily increased while revenues from excise and customs have shown a declining trend. Second, the share of individual income tax has increased significantly, except in the most recent years. This has been because of the expansion of the taxpayer base as well as use of third party information and expansion in electronic filing. Third, service tax revenue has steadily increased as its base has expanded.209

Graph 11.2: Major sources of government tax revenue

(Selectively we have presented a table as well as graph for illustrative purposes)

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**XI.2.b Tax collections vis-à-vis growth**

**i. Direct taxes**

During the last five years, direct tax collection (net of refunds) increased by 67.45 per cent from Rs.333818 crore in FY2008-09 to Rs.558965 crore in FY2012-13 at an average annual rate of growth of 12.41 per cent. Total GDP increased at an average annual rate of growth of 15 per cent for the same period. Although direct tax collections grew by 1.1 per cent in FY2009-10 for every 1 per cent growth in GDP, the growth slowed down to 0.9 per cent in FY2012-13, the overall buoyancy being less than unity. The break-up of data relating to direct tax collection, GDP (at current market price) and tax-GDP ratio for the period FY2006-07 to 2012-13, is given in Table 11.2.

**Table 11.2: Direct tax collections**

<table>
<thead>
<tr>
<th>FY</th>
<th>Net collection of Direct Taxes (Rs. in crore)</th>
<th>GDP at current market price</th>
<th>Direct tax GDP ratio per cent</th>
<th>GDP growth rate per cent</th>
<th>Tax growth rate per cent</th>
<th>Buoyancy factor per cent</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>2,30,181</td>
<td>42,94,706</td>
<td>5.36</td>
<td>16.28</td>
<td>39.32</td>
<td>2.42</td>
</tr>
<tr>
<td>2007-08</td>
<td>3,12,213</td>
<td>49,87,090</td>
<td>6.26</td>
<td>16.12</td>
<td>35.64</td>
<td>2.21</td>
</tr>
<tr>
<td>2008-09</td>
<td>3,33,818</td>
<td>56,30,063</td>
<td>5.93</td>
<td>12.89</td>
<td>6.93</td>
<td>0.54</td>
</tr>
<tr>
<td>2009-10</td>
<td>3,78,063</td>
<td>64,57,352</td>
<td>5.85</td>
<td>14.69</td>
<td>13.25</td>
<td>0.90</td>
</tr>
<tr>
<td>2010-11</td>
<td>4,46,935</td>
<td>76,74,148</td>
<td>5.82</td>
<td>18.84</td>
<td>18.22</td>
<td>0.97</td>
</tr>
<tr>
<td>2011-12</td>
<td>4,93,959</td>
<td>89,74,947</td>
<td>5.50</td>
<td>16.95</td>
<td>10.52</td>
<td>0.62</td>
</tr>
<tr>
<td>2012-13</td>
<td>5,58,965</td>
<td>100,20,620</td>
<td>5.58</td>
<td>11.65</td>
<td>13.16</td>
<td>1.13</td>
</tr>
</tbody>
</table>

*Source: CBDT*

Net collections from corporate tax increased from Rs.213,395 crore in FY2008-09 to Rs.356,326 in FY2012-13 at an average annual rate of growth of 13.16 per cent, while net collection from non-corporate taxpayers, increased from Rs.120,034 crore to Rs. 201,795 crore, over the same period; at an average annual rate of growth of 11.80 per cent. The growth rate of corporate tax for FY2012-13 was 10.24 per cent and for personal income tax 18.16 per cent over the previous year.
The growth of total direct tax collections registered an increase from 6.93 per cent in FY2008-09 to 18.22 per cent in FY2010-11 but declined sharply to 10.52 per cent in FY2011-12. It once again increased to 13.16 per cent in FY2012-13. However, the tax-GDP ratio, which had reached a high of 6.26 per cent in FY2007-08, began to decline after that to 5.93 per cent in FY2008-09 and further to 5.5 per cent in FY 2011-12. The incremental growth of direct tax revenue for every one per cent rise in GDP fell from 2.21 per cent in FY2007-08 to 0.62 per cent in FY2011-12. Tax buoyancy, which is a key indicator of the efficiency of revenue mobilization in relation to growth in GDP, was less than one until the financial year FY2012-13, when it marginally went up to 1.13. This clearly indicates that the rate of growth of tax collection fell below the rate of growth of GDP, and recovered slightly in FY2012-13.

There has been a steady increase in total TDS collections (both corporate and non-corporate), from Rs.128,230 crore in FY2008-09 to Rs.210,654 crore in FY2012-13, that is by 64.28 per cent. TDS collections from corporate taxpayers increased from Rs.60,088 crore in FY2008-09 to Rs.91974
collections from corporate taxpayers increased from Rs.60 crore in FY2011-12, that is, by 53.07 per cent. However, in the subsequent year, FY2012-13, TDS collections went down to Rs.74,481 crore, that is, by 19.02 per cent over the previous year.

Table 11.4: Collections from corporate taxpayers

<table>
<thead>
<tr>
<th>FY</th>
<th>Total Direct tax Collections</th>
<th>TDS</th>
<th>TDS as per cent of Total Collection</th>
<th>Advance Tax</th>
<th>Self-Assessment Tax</th>
<th>Regular-Assessment Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>2,42,304</td>
<td>60,088</td>
<td>24.80</td>
<td>1,22,697</td>
<td>18,451</td>
<td>12,633</td>
</tr>
<tr>
<td>2009-10</td>
<td>2,88,162</td>
<td>60,850</td>
<td>21.12</td>
<td>1,48,791</td>
<td>20,159</td>
<td>24,995</td>
</tr>
<tr>
<td>2010-11</td>
<td>3,55,266</td>
<td>68,313</td>
<td>19.23</td>
<td>1,84,263</td>
<td>23,056</td>
<td>41,916</td>
</tr>
<tr>
<td>2011-12</td>
<td>3,98,116</td>
<td>91,974</td>
<td>23.10</td>
<td>2,08,886</td>
<td>13,632</td>
<td>40,030</td>
</tr>
<tr>
<td>2012-13</td>
<td>4,20,147</td>
<td>74,481</td>
<td>17.73</td>
<td>2,32,467</td>
<td>18,731</td>
<td>53,874</td>
</tr>
</tbody>
</table>

Source: CAG Report No. 10 of 2014 (Direct Taxes)

Graph 11.4: Collections from corporate taxpayers

(Take Table 11.4.)

TDS collections from non-corporate taxpayers increased steadily from Rs.68,142 crore in FY2008-09 to Rs.136,173 crore in FY2012-13, i.e., by 99.84 per cent. This shows that the increase in total TDS collections is mainly on account of increased TDS collections from non-corporate taxpayers. TDS collections increased from 58.83 per cent of total non-corporate collection in FY2011-12 to 62.81 per cent in FY2012-13. Advance tax fell from 23.51 per cent of total non-corporate collection in FY 2011-12 to 19.99 per cent in FY2012-13. Collections, after completion of regular
assessments,\textsuperscript{210} decreased from 6.33 per cent of the total non-corporate tax collection in FY2011-12 to 3.94 per cent in FY2012-13.

Table 11.5: Collection from non-corporate taxpayers

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|c|c|}
\hline
FY & Total Collections & TDS & TDS as per cent of Total Collection & Advance Tax & Self-Assessment Tax & Regular Assessment Tax \\
\hline
2008-09 & 1,16,225 & 68,142 & 58.63 & 20,635 & 12,328 & 8,704 \\
2009-10 & 1,36,551 & 84,885 & 62.16 & 24,626 & 12,349 & 8,279 \\
2010-11 & 1,58,632 & 1,00,356 & 63.26 & 28,275 & 13,831 & 9,922 \\
2011-12 & 1,81,383 & 1,06,705 & 58.83 & 42,640 & 14,016 & 11,482 \\
2012-13 & 2,16,785 & 1,36,173 & 62.81 & 43,327 & 20,739 & 8,544 \\
\hline
\end{tabular}
\caption{Collection from non-corporate taxpayers (Rs. in crore)}
\end{table}

Source: \textit{CAG Report No. 10 of 2014 (Direct Taxes)}

Graph 11.5: Collection from non-corporate taxpayers

\textsuperscript{210} Section 143 of the I-T Act, 1961 deals with the concept of assessment. In common parlance, regular assessment refers to assessment made under section 143(3) of the I-T Act. The procedure for assessment is laid down in sections 139 to 158 of the I-T Act.
ii. Indirect taxes

The gross indirect tax revenues rose from Rs.6,05,298 crore in FY2008-09 to Rs.10,36,460 crore in FY2012-13, that is, by 71.23 per cent. Indirect tax as a percentage of gross tax revenue and as a percentage of GDP is shown in Graph 11.6 below.

Graph 11.6: Indirect tax revenue receipts

![Graph 11.6: Indirect tax revenue receipts](image)

Source: CAG Report No. 8 of 2014

Table 11.6 below depicts the relative performance of various indirect tax components in terms of revenue and relative to GDP growth for the period FY2009 to FY2013. All the components showed varied growth during the five years.

Table 11.6: Revenue collection from indirect taxes

(Rs. in crore)

<table>
<thead>
<tr>
<th>FY</th>
<th>GDP</th>
<th>Customs Revenue</th>
<th>Central Excise Revenue</th>
<th>Service Tax Revenue</th>
<th>Customs revenue as per cent of GDP</th>
<th>Central Excise revenue as per cent of GDP</th>
<th>Service Tax revenue as per cent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>56,30,063</td>
<td>99,879</td>
<td>1,08,613</td>
<td>60,941</td>
<td>1.77</td>
<td>1.93</td>
<td>1.08</td>
</tr>
<tr>
<td>2009-10</td>
<td>64,77,827</td>
<td>83,324</td>
<td>1,02,991</td>
<td>58,422</td>
<td>1.29</td>
<td>1.59</td>
<td>0.9</td>
</tr>
<tr>
<td>2010-11</td>
<td>77,95,314</td>
<td>1,35,813</td>
<td>1,37,701</td>
<td>71,016</td>
<td>1.74</td>
<td>1.77</td>
<td>0.91</td>
</tr>
<tr>
<td>2011-12</td>
<td>90,09,722</td>
<td>1,49,328</td>
<td>1,44,901</td>
<td>97,509</td>
<td>1.66</td>
<td>1.61</td>
<td>1.08</td>
</tr>
<tr>
<td>2012-13</td>
<td>1,01,13,281</td>
<td>1,65,346</td>
<td>1,75,845</td>
<td>1,32,601</td>
<td>1.64</td>
<td>1.74</td>
<td>1.31</td>
</tr>
</tbody>
</table>

Source: CAG Report No. 8 of 2014 (Indirect Taxes)/CBDT
The share of service tax in gross tax revenues increased from 10.07 per cent to 12.79 per cent, as shown in Table 11.7, during FY2008-09 to FY2012-13. During FY2012-13, service tax revenues grew by close to 36 per cent over the previous year. Service tax revenues expressed as a percentage of GDP touched a high of 1.31 per cent in FY2012-13.

\[ \text{Service Tax}\ as\ per\ cent\ of\ GDP} = \frac{\text{Service Tax Revenues}}{\text{GDP}} \]

\[ \text{Gross Tax Revenues} = \text{ST as per cent of GDP} \times \text{GDP} \]

\[ \text{ST as per cent of Gross Tax Revenue} = \frac{\text{Service Tax Revenues}}{\text{Gross Tax Revenues}} \]

\[ \text{FY09} := 2008-09, \text{FY10} := 2009-10, \text{FY11} := 2010-11, \text{FY12} := 2011-12, \text{FY13} := 2012-13 \]

**Table 11.7: Growth of service tax revenue**

<table>
<thead>
<tr>
<th>FY</th>
<th>Service tax revenue</th>
<th>per cent growth over previous year</th>
<th>GDP</th>
<th>Service Tax as per cent of GDP</th>
<th>Gross Tax Revenues</th>
<th>ST as per cent of Gross Tax Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>60,941</td>
<td>18.79</td>
<td>56,30,063</td>
<td>1.08</td>
<td>6,05,298</td>
<td>10.07</td>
</tr>
<tr>
<td>2009-10</td>
<td>58,422</td>
<td>(-)4.13</td>
<td>64,77,827</td>
<td>0.9</td>
<td>6,24,527</td>
<td>9.35</td>
</tr>
<tr>
<td>2010-11</td>
<td>71,016</td>
<td>21.56</td>
<td>77,95,313</td>
<td>0.91</td>
<td>7,93,307</td>
<td>8.95</td>
</tr>
<tr>
<td>2011-12</td>
<td>97,509</td>
<td>37.31</td>
<td>90,09,722</td>
<td>1.08</td>
<td>8,89,118</td>
<td>10.97</td>
</tr>
<tr>
<td>2012-13</td>
<td>1,32,601</td>
<td>35.99</td>
<td>101,13,281</td>
<td>1.31</td>
<td>10,36,460</td>
<td>12.79</td>
</tr>
</tbody>
</table>

(Source: CAG Report No.8 of 2014 (Indirect Taxes))
The share of service tax in gross tax revenues increased from 10.07 per cent to 12.79 per cent, as shown in table 11.7, during FY2008-09 to FY2012-13. During FY2012-13, service tax revenues grew by close to 36 per cent over the previous year. Service tax revenues expressed as a percentage of GDP touched a high of 1.31 per cent in FY2012-13.

(Table 11.7: Growth of service tax revenue (Rs. in crore))

<table>
<thead>
<tr>
<th>FY</th>
<th>Service tax revenue (Rs. in crore)</th>
<th>Per cent growth over previous year</th>
<th>GDP (Rs. in crore)</th>
<th>Service tax as per cent of GDP</th>
<th>Gross tax revenues (Rs. in crore)</th>
<th>Service tax as per cent of gross tax revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>60,941</td>
<td>18.79</td>
<td>56,30,063</td>
<td>1.08</td>
<td>6,05,298</td>
<td>10.07</td>
</tr>
<tr>
<td>2009-10</td>
<td>58,422</td>
<td>-10.18</td>
<td>64,77,827</td>
<td>0.91</td>
<td>6,24,527</td>
<td>0.97</td>
</tr>
<tr>
<td>2010-11</td>
<td>71,016</td>
<td>21.56</td>
<td>77,95,314</td>
<td>0.91</td>
<td>7,93,307</td>
<td>0.91</td>
</tr>
<tr>
<td>2011-12</td>
<td>71,016</td>
<td>21.56</td>
<td>77,95,314</td>
<td>0.91</td>
<td>7,93,307</td>
<td>0.91</td>
</tr>
<tr>
<td>2012-13</td>
<td>1,32,601</td>
<td>35.99</td>
<td>101,13,281</td>
<td>1.31</td>
<td>10,36,460</td>
<td>12.79</td>
</tr>
</tbody>
</table>

Source: CAG Report No.8 of 2014 (Indirect Taxes)

Central excise revenue showed positive growth in the period from FY2008-09 to 2012-13, except for the year FY2009-10. During FY2012-13, central excise collections grew by 21.36 per cent over the previous year. The share of central excise in gross tax revenues decreased from 17.36 per cent in FY2010-11 to 16.97 per cent in FY 2012-13. Central excise revenue as a percentage of GDP declined from 1.77 per cent in FY2010-11 to 1.6 per cent in FY2011-12 and then went up to 1.74 per cent in FY2012-13.211

(Table 11.8: Growth of central excise collection (Rs. in crore))

<table>
<thead>
<tr>
<th>FY</th>
<th>CE(PLA)</th>
<th>Per cent growth over previous year</th>
<th>GDP (Rs. in crore)</th>
<th>CE as per cent of GDP</th>
<th>Gross Tax Revenues (Rs. in crore)</th>
<th>CE as per cent of gross tax revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>1,08,613</td>
<td></td>
<td>56,30,063</td>
<td>1.93</td>
<td>6,05,298</td>
<td>17.94</td>
</tr>
<tr>
<td>2009-10</td>
<td>1,02,991</td>
<td>(-)5.18</td>
<td>64,77,827</td>
<td>1.59</td>
<td>6,24,527</td>
<td>16.49</td>
</tr>
<tr>
<td>2010-11</td>
<td>1,37,701</td>
<td>33.7</td>
<td>77,95,314</td>
<td>1.77</td>
<td>7,93,307</td>
<td>17.36</td>
</tr>
<tr>
<td>2011-12</td>
<td>1,44,901</td>
<td>5.23</td>
<td>90,09,722</td>
<td>1.61</td>
<td>8,89,118</td>
<td>16.3</td>
</tr>
<tr>
<td>2012-13</td>
<td>1,75,845</td>
<td>21.36</td>
<td>101,13,281</td>
<td>1.74</td>
<td>10,36,460</td>
<td>16.97</td>
</tr>
</tbody>
</table>

Source: CAG Report No.8 of 2014 (Indirect Taxes)

XI.2.c  Tax rates and threshold limits

The threshold limits in India are relatively low in terms of per capita GDP, when compared with similarly placed economies. This hurts the lower income groups while mollycoddling the higher income groups due to a low top marginal tax rate (see next paragraph). India’s tax bands compare unfavourably with other emerging economies. Brazil’s maximum rate of 27.5 per cent, for example, applies only at an income of over $23,071 while India’s slightly higher maximum rate of 30 per cent applies from an income level $18,283.212

The actual incidence is complicated further by the fact that various rebates are offered to taxpayers who invest in a range of insurance and savings schemes, housing loans and equity and mutual funds, which makes compliance procedures complicated. The more complicated a tax system is, the more the scope for corruption. If thresholds are raised and the rebate system ended, together with a super-rich tax rate that would compare with other countries, it would make the structures equitable without adding complexity. At Rs.10 crore, the marginal tax rates are 35 per cent in USA, 40 per cent in South Africa, 45 per cent in China and Germany, and 50 per cent in the UK. In India, it remains at 30 per cent plus surcharge, or equivalent to 33 per cent approximately.213 It is time now that the tax net is strengthened to encompass the big income earners meaningfully instead of repetitive squeezing of small and medium companies, the salaried and the middle class. It is surprising that the draft Direct Tax Code also failed to address the crucial point of a super-rich tax rate.

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It is true that income tax rates have come down over the years from a peak of 60 per cent 25 years ago to 30 per cent plus a surcharge of 10 per cent now. But the rates for corporate tax remain among the highest in the world. It should be the other way round. However, corporate tax rates can be lowered only slightly due to the revenue constraints. Things would also improve enormously with corruption free and more efficient collection systems.

The deepening of the tax base can be done through an analysis of direct and indirect tax collections for policy decision support. Thresholds could be rationalised for all indirect tax laws implemented by the central and state governments, and local bodies to a single, uniform level, especially those that are expected to be merged in GST and those that are likely to be repealed. Higher thresholds promote the tendency to bifurcate businesses under different legal entities created to avoid full compliance, in turn leading to poorer risk management by the administration and lower tax collection.

**XI.2.d Tax-GDP ratio**

In FY2012-13, the tax-GDP ratio stood at 5.58 per cent for direct taxes and 4.7 per cent for indirect taxes. The then FM had said that the peak rate of 11.9 per cent in FY2007-08 (for central taxes) can be achieved but that would not be enough for the economy to be on the path of inclusive growth and sustainable development. The prevailing view is that it would require a tax-GDP ratio of at least 18 per cent to achieve those objectives.

At about 16 per cent for central plus state taxes, India has one of the lowest tax-GDP ratios among comparable countries. Even some lower middle-income countries reported tax-GDP ratios of around 18 per cent.

**Graph 11.10: Direct tax-GDP ratio**

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct Tax-GDP Ratio</th>
<th>GDP Growth Rate</th>
<th>Tax Growth Rate</th>
<th>Buoyancy Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>39.32</td>
<td>5.38</td>
<td>6.93</td>
<td>2.42</td>
</tr>
<tr>
<td>2007-08</td>
<td>35.64</td>
<td>5.42</td>
<td>6.26</td>
<td>2.21</td>
</tr>
<tr>
<td>2008-09</td>
<td>16.12</td>
<td>16.28</td>
<td>12.89</td>
<td>13.25</td>
</tr>
<tr>
<td>2009-10</td>
<td>14.69</td>
<td>14.69</td>
<td>5.93</td>
<td>0.54</td>
</tr>
<tr>
<td>2010-11</td>
<td>18.84</td>
<td>18.84</td>
<td>5.85</td>
<td>0.90</td>
</tr>
<tr>
<td>2011-12</td>
<td>16.95</td>
<td>10.52</td>
<td>5.82</td>
<td>0.97</td>
</tr>
<tr>
<td>2012-13</td>
<td>11.65</td>
<td>5.5</td>
<td>5.5</td>
<td>0.62</td>
</tr>
</tbody>
</table>

*Source: CBDT*

There was a decline in tax buoyancy after FY2007-08, which could partly be on account of the economic meltdown together with the accompanying fiscal stimulus that took effect in FY2008-
09. High inflation affected corporate profitability, which, in turn, affected corporate tax collections adversely. Thus, the revenue realised fell further below revenue potential. Much remains to be done to improve the horizontal equity of the tax system by extending the tax net by bringing in potential taxpayers, who have remained outside the tax net. This would also help reduce tax evasion. A concerted action plan for both widening the tax net through innovative means and targeting high net worth individuals or association of persons or those hiding under trusts needs to be evolved. This exercise should be done in a structured manner involving all stakeholders to ensure that raising the tax-GDP ratio to 18 per cent can be realistically explored. The FM in his budget speech for 2014-15 has said, 'there is an urgent need to generate more resources to fuel the economy. For this, the tax to GDP ratio must be improved.'

Based on international practices, other economies have increased their tax to GDP ratio by simplifying tax structures and improving tax administration and not by increasing rates, realising that voluntary compliance holds the key. On the lines of such trends in developed as well as developing countries, tax rates have been reduced in India both in the case of personal income tax as well as tax on corporations. The existing rates of the former are competitive and are on par with or lower than that of other nations. If tax preferences, which lead to significant revenue loss and economic distortions, are eliminated, then effective tax rates would rise appropriately. The Tax Expenditure Statement of the Union Budget 2013-14 shows that aggregate revenue foregone from central taxes (both direct and indirect) is Rs.568,234.7 crore for FY2012-13 and is Rs.572,923.3 crore for FY2013-14. Besides, the total revenue foregone from central taxes has shown an upward trend. Thus, it is conceivable that the headline corporate tax rate can be brought down if incentives are cut back significantly.

The sector-wise composition of GDP in India, China and Brazil is shown in the Table 11.9 below. The services sector is the largest contributor to India’s GDP, having contributed 56.27 per cent in 2012 and 57.03 per cent in 2013, thus showing an increasing trend (it was about 54 per cent in 2008). Information Technology (IT) and Business Process Outsourcing (BPO) are contributors in this sector. Agriculture too has a significant contribution in the Indian economy, 17.52 per cent in 2013. The contribution of the industrial sector, however, has been much lower as compared to, for instance, China. In 2013, the contribution of the industrial sector to GDP was only 25 per cent, a level similar to Brazil, while the industrial sector contributed 44 per cent to China’s GDP in the same year. The share of the industrial sector in India’s GDP has steadily declined from 28 per cent in 2008 to 25 per cent in 2013.

Table 11.9: Sector-wise composition of GDP

<table>
<thead>
<tr>
<th>Year</th>
<th>Brazil</th>
<th>China</th>
<th>India</th>
<th>Brazil</th>
<th>China</th>
<th>India</th>
<th>Brazil</th>
<th>China</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>5.91</td>
<td>10.73</td>
<td>17.78</td>
<td>27.90</td>
<td>47.45</td>
<td>28.29</td>
<td>66.18</td>
<td>41.82</td>
<td>53.93</td>
</tr>
<tr>
<td>2009</td>
<td>5.63</td>
<td>10.33</td>
<td>17.74</td>
<td>26.83</td>
<td>46.24</td>
<td>27.76</td>
<td>67.54</td>
<td>43.43</td>
<td>54.50</td>
</tr>
<tr>
<td>2010</td>
<td>5.30</td>
<td>10.10</td>
<td>18.21</td>
<td>28.07</td>
<td>46.67</td>
<td>27.16</td>
<td>66.63</td>
<td>43.24</td>
<td>54.64</td>
</tr>
</tbody>
</table>
sector to China’s GDP in the same year. The share of the industrial sector was much lower as compared to agriculture, for instance, 20.32 per cent in 2008. The contribution of the industrial sector, however, has been increasing over the years. Agriculture too has a significant contribution in the Indian economy, 17.52 per cent in 2008. Information Technology (IT) and Business Process Outsourcing (BPO) have also shown a significant growth in recent years. The sector can be seen as the driver of the economy, as seen in the contribution of the industrial sector, which has been increasing from 54 per cent in 2012 to 57.03 per cent in 2013, thus showing an increasing trend.

The sector that has been affected due to the economic slowdown is the agriculture sector. The revenue foregone from agriculture has increased from Rs.5,68,234.7 crore in FY2012-13 to Rs.5,72,923.3 crore in FY2013-14. The revenue forgone from the corporate sector has increased from Rs.45,034 crore to Rs.72,881 crore over the period FY2006-07 to FY2009-10. It came down to Rs.57,912 crore in FY2010-11 but has shown an increasing trend thereafter. The revenue forgone in the non-corporate sector, which comprises individuals, HUFs and firms, has also been increasing from FY2010-11 to 2012-13. In this regard, the Public Accounts Committee (PAC) of the Parliament in its 87th report, has stated that there should be a comprehensive review of exemptions resulting in revenue forgone of Rs.500 crore or more in the last ten years to assess how and whether it has served an economic or social purpose. The TARC also feels that such a review should be undertaken and can be done once the

<table>
<thead>
<tr>
<th>Year</th>
<th>Brazil</th>
<th>China</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>5.46</td>
<td>10.04</td>
<td>17.86</td>
</tr>
<tr>
<td>2012</td>
<td>5.32</td>
<td>10.08</td>
<td>17.52</td>
</tr>
<tr>
<td>2013</td>
<td>5.71</td>
<td>10.01</td>
<td>18.20</td>
</tr>
</tbody>
</table>

Source: World Bank, World Development Indicator

XI.2.e Revenue foregone

(i) Direct tax

The core objective of any tax system is to raise revenues necessary to fund government expenditures. The amount of revenue raised is determined to a large extent by tax bases and tax rates. It is also a function of a range of special tax rates, exemptions, deductions, rebates, deferrals and credits that affect the level and distribution of tax collected. These measures are usually referred to as “tax preferences”.

The Income Tax Act, inter-alia, provides for tax preferences to promote savings by individuals, exports, balanced regional development, creation of infrastructure facilities, scientific research and development. It also seeks to encourage the co-operative sector. It further promotes various sectors by offering accelerated depreciation at different rates for capital investment. As stated earlier, many of these tax benefits can be availed of by both corporate and non-corporate taxpayers.

The aggregate revenue foregone from central taxes (both direct and indirect) has increased from Rs.5,68,234.7 crore in FY2012-13 to Rs.5,72,923.3 crore in FY2013-14. The revenue forgone (direct taxes) has increased from Rs.77177 crore in FY2006-07 to Rs.113475 crore in FY2012-13. In the FY2012-13, revenue forgone (direct taxes) from the corporate sector was Rs.67,995 crore and from individuals Rs.45,480 crore. In the case of indirect taxes, total revenue forgone in FY2011-12 was about Rs.4, 32,442 crore, which increased to Rs.4,60,155 crore in the following fiscal.

The revenue foregone from the corporate sector has increased from Rs.45,034 crore to Rs.72,881 crore over the period FY2006-07 to 2009-10. It came down to Rs.57,912 crore in FY2010-11 but has shown an increasing trend thereafter. The revenue foregone in the non-corporate sector, which comprises individuals, HUFs and firms, has also been increasing from FY2010-11 to 2012-13. In this regard, the Public Accounts Committee (PAC) of the Parliament in its 87th report, has stated that there should be a comprehensive review of exemptions resulting in revenue forgone of Rs.500 crore or more in the last ten years to assess how and whether it has served an economic or social purpose. The TARC also feels that such a review should be undertaken and can be done once the

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214 68th report of the Standing Committee on Finance (2012-13).
Knowledge, Analysis and Intelligence centre (KAIC) centre is set up as recommended in Chapters III of the TARC report.

The revenue foregone in respect of corporate and non-corporate sectors is given below.

Table 11.10: Revenue foregone — direct taxes

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate</td>
<td>45,034</td>
<td>62,199</td>
<td>66,901</td>
<td>72,881</td>
<td>57,912</td>
<td>61,765</td>
<td>67,995</td>
</tr>
<tr>
<td>Non-corporate</td>
<td>32,143</td>
<td>38,057</td>
<td>37,570</td>
<td>45,142</td>
<td>36,826</td>
<td>39,375</td>
<td>45,480</td>
</tr>
<tr>
<td>Total Direct Tax</td>
<td>77,177</td>
<td>1,00,256</td>
<td>1,04,471</td>
<td>1,18,023</td>
<td>94,738</td>
<td>1,01,141</td>
<td>1,13,475</td>
</tr>
</tbody>
</table>

*Projected

Source: 87th report of Public Accounts Committee, 2013-14

Graph 11.11: Revenue foregone - direct taxes
Table 11.11: Total corporate tax collection and revenue foregone

<table>
<thead>
<tr>
<th>Year</th>
<th>Corporation Tax Collection (Actuals) (in Rs. crore)</th>
<th>Revenue Forgone in Case of Corporate taxpayers (in Rs. crore)</th>
<th>Revenue Forgone as a percentage of Actual Corporate Tax Collection</th>
<th>Effective Rate for Corporate Sector (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>144318</td>
<td>45035</td>
<td>31.2</td>
<td>20.55</td>
</tr>
<tr>
<td>2007-08</td>
<td>192910</td>
<td>62199</td>
<td>32.24</td>
<td>22.24</td>
</tr>
<tr>
<td>2008-09</td>
<td>213395</td>
<td>66901</td>
<td>31.35</td>
<td>22.78</td>
</tr>
<tr>
<td>2009-10</td>
<td>244725</td>
<td>72881</td>
<td>2978</td>
<td>23.53</td>
</tr>
<tr>
<td>2010-11</td>
<td>299386</td>
<td>57912</td>
<td>19.34</td>
<td>24.1</td>
</tr>
</tbody>
</table>

Source: 87th report of the Public Accounts Committee (2013-14)

That various tax exemptions and concessions extended under the tax law eat up a considerable portion of tax collection is borne out by the data on revenue foregone. Indeed, in terms of percentages, tax exemptions increased by 22.75 per cent from FY2006-07 to 2010-11. As stated earlier revenue forgone, which decreased in FY2010-11 in the case of both personal and corporate sectors, increased substantially in FY2011-12 and FY2012-13. This indicates a rise in tax concessions and exemptions provided in the law, which have an adverse impact upon the tax buoyancy. Continuing with such exemptions not only leaves scope for evading tax but also prompts taxpayers to resort to unwarranted tax planning.

In a positive move, however, many deductions, which were profit-linked, have been allowed to lapse or have been phased out from the Income Tax Act in recent years. These changes reflect the views concerning exemptions that engaged the attention of various committees/advisory groups such as the Shome Committee for tax policy and administration for the Tenth Plan and the Kelkar Committee for Direct and Indirect Tax reform set up by the government over the last two decades. As a follow up action, the then Finance Minister had pointed out in the 2002 Union Budget that, “Some of the exemptions and deductions currently provided in the Income-tax Act have become redundant and are not in harmony with the moderate tax regime. The Advisory Group on tax policy and tax administration for the tenth plan has recommended deletion of a number of such exceptions. I, therefore, propose to withdraw or discontinue the exemptions which are not required any longer”. The TARC appreciates that successive governments have proposed some reform measures in the right direction but, since the implementation of the recommendations contained in the draft Direct Taxes Code will take time, the government needs to consider serious interim measures to phase out unwarranted tax exemptions/deductions that continue in the form of various tax preferences.
(ii) Indirect tax

The levy of excise duty is according to the tariff rates specified in the First and Second Schedules to the Central Excise Tariff Act 1985. The central government can issue, under Section 5A(1) of the Central Excise Act, 1944, exemption notifications in public interest so as to prescribe duty rates lower than the tariff rates prescribed in the schedules, called “effective rates”. The difference between duty that would have been payable but for the exemption notification and the actual duty paid in terms of the relevant notification is projected as “revenue forgone” in budget documents. Beside the powers to issue general exemption notifications under Section 5A(1), the Central Government also has the powers to issue special orders for granting Excise duty exemption on a case-to-case basis under circumstances of an exceptional nature vide Section 5A(2) of the Central Excise Act.

Table 11.2 shows figures of central excise related tax expenditures in recent years. The tax expenditure for FY2012-13 in respect of excise duties was Rs.2,06,188 crore (Rs.1,87,688 crore as general exemptions and Rs.18,500 crore as area-based exemptions), which is 117 per cent of revenues from Central Excise.

**Table 11.12: Tax expenditure (Central excise)**

<table>
<thead>
<tr>
<th>FY</th>
<th>Total Tax expenditure (TE)</th>
<th>TE as % of GDP</th>
<th>TE as % of GTR</th>
<th>TE as % of CE</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>1,35,496</td>
<td>2.41</td>
<td>22.38</td>
<td>12475</td>
</tr>
<tr>
<td>2009-10</td>
<td>1,69,121</td>
<td>2.61</td>
<td>27.08</td>
<td>164.21</td>
</tr>
<tr>
<td>2010-11</td>
<td>1,92,227</td>
<td>2.47</td>
<td>24.23</td>
<td>139.6</td>
</tr>
<tr>
<td>2011-12</td>
<td>1,95,590</td>
<td>2.17</td>
<td>21.99</td>
<td>134.98</td>
</tr>
<tr>
<td>2012-13</td>
<td>2,06,188</td>
<td>2.04</td>
<td>19.89</td>
<td>117.26</td>
</tr>
</tbody>
</table>

Source: CAG Report No. 8,2014 (Indirect Taxes- Central Excise)
Graph 11.12: Tax expenditure (Central excise)

In its report no. 17 of 2013, the CAG had pointed out that the government should endeavour to analyse the outcome of policy level general exemptions including abatements as well as specific exemptions aimed at promoting any special cause within a reasonable period of time. Such analysis must be made available as a part of the budget documents or as special reports which should be in the public domain. Such a system would ensure transparency and enable informed public debate on the need for continuation of regular/ad hoc tax concessions.

In respect of service tax, it has been observed, from the CAG Report No. 6 of 2014, that revenue foregone figures are not available mainly due to absence of adequate data. This, as observed by the CAG, would imply that the department would not be in a position to do a gap analysis. In respect of central excise, the approach of the department has been to extrapolate data from ACES (duty forgone due to area-based exemptions scheme has been obtained separately from the concerned Central Excise zones). Similarly, for service tax, the department should consider ways to estimate revenue foregone figures and do a gap analysis.

XI.2.f Effective tax rate for companies

The effective rate of taxation in the case of companies could be defined as the ratio of tax payable to the total profit before tax, expressed as a percentage. The difference between the effective rates of taxation and statutory rate of taxation is mainly on account of various direct tax incentives. These incentives reduce the amount of tax payable, lowering the effective rate of tax. The major tax incentives provided to the companies are - (a) profit-linked deductions, (b) deductions on scientific research, (c) accelerated depreciation and (d) investment-linked deductions. It is these incentives that are primarily responsible for a low effective rate of taxation. The effective tax rate for FY2010-11 was 24.1 per cent and 23.9 per cent in FY2009-10, which were substantially lower than the statutory tax rate of 33.9 per cent. Two hundred sixteen companies with profits before taxes (PBT) of Rs. 500 crore and above accounted for 55.8 per cent of the total PBT and 53.4 per
cent of the total corporate tax payable. Hence, there was slight regressivity among companies in their payment of corporate income tax.

Out of the entire revenue foregone, the largest portion is accounted for by profit-linked deductions, (Rs.19,881 crore) and accelerated depreciation (Rs.33,243 crore). Together, these amounted to Rs.51,000 crore out of a total foregone revenue of Rs.57,000 crore. It needs to be pointed out that these work more to the benefit of larger companies in the corporate sector. This issue is proposed to be addressed in the Direct Taxes Code (DTC) by phasing out profit-linked deductions, and opting for investment-linked deductions. By its very nature, there cannot be a study of the ‘projected revenue gain’ after phasing out profit linked deductions. This is because growth of new businesses and expansion of existing businesses depend upon several inter-related macro-economic factors such as GDP growth rate, demographics, exploitation and exploration of natural resources, general business climate, international business climate etc. from which isolating a specific direct tax measure and estimating its impact would not be a feasible exercise. However, as a rough estimate, it can be seen that the current effective tax rate of the corporate sector is about 24 per cent whereas the statutory rate is 30 per cent. Therefore, at the same level of corporate tax, if profit-linked deductions and accelerated depreciation were to be totally phased out, the rise in the effective tax rate would give some indication of whether the rise has been noticeable.

While the revenue forgone in the non-corporate sector has been going up, the revenue forgone in the corporate sector has come down from 58.35 per cent to 54 per cent over the period FY2006-07 to FY2010-11. Although the corporate sector has expanded manifold during these years, revenue growth from the sector has not increased proportionately as the statute is still riddled with exemptions/incentives given specifically to this sector.

**XI.2.g Growth in the number of taxpayers**

Over the past few years, the CBDT in its Central Action Plan has been targeting a 15 per cent increase in new taxpayers vis-à-vis taxpayers added during the previous year. The taxpayer base increased from 319.03 lakh taxpayers in FY2006-07 to 337.38 lakh taxpayers in FY2010-11, registering an increase of 5.8 per cent with an average annual rate of growth of 1.5 per cent. The total direct tax collections increased by 94.2 per cent during the same five-year period. Thus, the increase in tax collection was around 16 times as compared to the increase in the taxpayer base. This indicates a very limited widening of the tax base over these years while the pressure on existing taxpayers has increased manifold.

In FY2011-12, taxpayers in the income slab of up to Rs.5 lakh made up 98.38 per cent of total taxpayers, while those in the above Rs.20 lakh slab constituted only 1.30 per cent of total taxpayers. This suggests that the income tax base is narrow with a constrained revenue yield, which has adversely affected tax buoyancy. Even the target of adding 15 per cent to the number of taxpayers has not been achieved in FY2010-11. Details of corporate and non-corporate taxpayers and new taxpayers added are provided in Table 11.13.
Expanding the Base

Table 11.13: Total direct tax taxpayer base

<table>
<thead>
<tr>
<th>Financial Year</th>
<th>No of corporate taxpayers</th>
<th>No of Non-corporate taxpayers</th>
<th>Total Taxpayer base</th>
<th>Target of addition in new taxpayers</th>
<th>New taxpayers added</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>3.98</td>
<td>315.05</td>
<td>319.03</td>
<td>21.83</td>
<td>21.28</td>
</tr>
<tr>
<td>2007-08</td>
<td>4.98</td>
<td>331.64</td>
<td>336.62</td>
<td>24.47</td>
<td>17.64</td>
</tr>
<tr>
<td>2008-09</td>
<td>3.27</td>
<td>323.22</td>
<td>326.49</td>
<td>20.28</td>
<td>17.84</td>
</tr>
<tr>
<td>2009-10</td>
<td>3.67</td>
<td>337.17</td>
<td>340.84</td>
<td>20.51</td>
<td>16.75</td>
</tr>
<tr>
<td>2010-11</td>
<td>4.96</td>
<td>332.42</td>
<td>337.38</td>
<td>19.26</td>
<td>14.82</td>
</tr>
</tbody>
</table>

Source: 87th report of Public Accounts Committee, 2013-14

As shown in Table 11.14 below, 98 per cent taxpayers comprised of total taxpayers in the Rs.0-5 lakh income slab without commensurate tax yield. The Rs.10-20 lakh income slab has 4.30 per cent taxpayers. Tax collected in the Rs.0-10 lakh segment is Rs.36,986 crore and corresponding figure for Rs.10 lakh-Rs.20 lakh is Rs.17,858 crore. In the Rs.20 lakh and above segment, Rs.93,229 crore has been collected from only 1.30 per cent taxpayers. This shows that internationally our threshold is quite low but we collect a small amount on per capita basis from our lowest income tax slab. This keeps our taxpayer base as large as practically possible but does tend to transfer the tax pressure on upper slabs. Therefore, it is important to analyse (a) the extent to which taxpayers actually belong to higher slabs than they reveal in their tax returns, and (b) the extent of non-filers who should be brought into the tax net to expand the taxpayer base as quickly as possible. The taxpayer segments and their revenue yields suggest that the income tax base in terms of the proportion of contribution to revenue is rather narrow, which has adversely affected tax buoyancy.

Table 11.14: No. of taxpayers in India and their slabs - FY 2011-12

<table>
<thead>
<tr>
<th>Tax slab</th>
<th>No. of taxpayers (in crore)</th>
<th>Per cent of taxpayers</th>
<th>Tax Collection (Rs. in crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-5 lakh</td>
<td>3.38</td>
<td>98.30</td>
<td>15,010</td>
</tr>
<tr>
<td>5-10 lakh</td>
<td>0.18</td>
<td>5.50</td>
<td>21976</td>
</tr>
<tr>
<td>10-20 lakh</td>
<td>0.14</td>
<td>4.30</td>
<td>17,858</td>
</tr>
<tr>
<td>&gt;20 lakh</td>
<td>0.04</td>
<td>1.30</td>
<td>93,229</td>
</tr>
</tbody>
</table>


The number of effective assessee under the direct taxes is given in Table 11.14.215

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215 Table 11A.4 in Appendix XI.4 gives details of tax return filers and stop filers for AY2012-13.
Table 11.15: Number of effective assessees

<table>
<thead>
<tr>
<th>Year</th>
<th>Company</th>
<th>Individual</th>
<th>HUF</th>
<th>Firm</th>
<th>Trust</th>
<th>Others</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-97</td>
<td>227,228</td>
<td>976,1426</td>
<td>412,470</td>
<td>1,158,319</td>
<td>49,629</td>
<td>34,471</td>
<td>11,643,543</td>
</tr>
<tr>
<td>1997-98</td>
<td>274,319</td>
<td>11,194,953</td>
<td>437,251</td>
<td>1,172,647</td>
<td>51,865</td>
<td>37,701</td>
<td>13,167,736</td>
</tr>
<tr>
<td>1998-99</td>
<td>295,327</td>
<td>15,135,956</td>
<td>469,730</td>
<td>1,228,023</td>
<td>83,847</td>
<td>41,328</td>
<td>17,254,211</td>
</tr>
<tr>
<td>1999-00</td>
<td>309,627</td>
<td>17,653,745</td>
<td>507,843</td>
<td>1,272,217</td>
<td>87,165</td>
<td>46,427</td>
<td>19,877,024</td>
</tr>
<tr>
<td>2000-01</td>
<td>334,261</td>
<td>20,662,926</td>
<td>553,194</td>
<td>1,336,861</td>
<td>63,999</td>
<td>51,035</td>
<td>23,002,276</td>
</tr>
<tr>
<td>2001-02</td>
<td>349,185</td>
<td>23,734,413</td>
<td>607,519</td>
<td>1,378,706</td>
<td>97,272</td>
<td>58,784</td>
<td>26,225,879</td>
</tr>
<tr>
<td>2002-03</td>
<td>365,124</td>
<td>25,935,556</td>
<td>644,489</td>
<td>1,345,232</td>
<td>117,304</td>
<td>57,224</td>
<td>28,464,929</td>
</tr>
<tr>
<td>2003-04</td>
<td>372,483</td>
<td>26,624,224</td>
<td>654,848</td>
<td>1,338,613</td>
<td>154,276</td>
<td>57,952</td>
<td>29,202,396</td>
</tr>
<tr>
<td>2004-05</td>
<td>373,165</td>
<td>24,792,999</td>
<td>620,468</td>
<td>1,235,373</td>
<td>71,375</td>
<td>65,190</td>
<td>27,158,561</td>
</tr>
<tr>
<td>2005-06</td>
<td>382,021</td>
<td>27,370,659</td>
<td>642,759</td>
<td>1,234,424</td>
<td>74,543</td>
<td>58,077</td>
<td>29,762,483</td>
</tr>
<tr>
<td>2006-07</td>
<td>398,014</td>
<td>29,355,248</td>
<td>761,439</td>
<td>1,241,642</td>
<td>75,610</td>
<td>71,184</td>
<td>31,903,137</td>
</tr>
<tr>
<td>2007-08</td>
<td>498,066</td>
<td>30,868,243</td>
<td>780,853</td>
<td>1,368,373</td>
<td>74,077</td>
<td>73,189</td>
<td>33,662,801</td>
</tr>
<tr>
<td>2008-09</td>
<td>327,674</td>
<td>30,101,260</td>
<td>768,845</td>
<td>1,310,849</td>
<td>71,145</td>
<td>70,854</td>
<td>32,650,027</td>
</tr>
<tr>
<td>2009-10</td>
<td>367,884</td>
<td>31,384,084</td>
<td>806,236</td>
<td>1,354,330</td>
<td>76,898</td>
<td>95,994</td>
<td>34,085,426</td>
</tr>
<tr>
<td>2010-11</td>
<td>496,872</td>
<td>31,035,394</td>
<td>761,911</td>
<td>1,229,722</td>
<td>119,378</td>
<td>95,847</td>
<td>33,739,124</td>
</tr>
<tr>
<td>2011-12</td>
<td>584,966</td>
<td>33,189,567</td>
<td>766,207</td>
<td>1,559,895</td>
<td>143,648</td>
<td>101,711</td>
<td>36,345,994</td>
</tr>
</tbody>
</table>

Source: CBDT

The number of assessees fluctuates due to various reasons such as the closure of a business, demise of a taxpayer, retirement, change in economic activity affecting taxable income, etc. Additionally, several provisions of the Income Tax Act such as grant of additional exemptions/deductions, and increase in the basic exemption limit (for individuals & HUFs) also affect the number of taxpayers. As explained, with inflation, an increase in the basic exemption limit may indeed be necessary over time. That is why a policy to expand the taxpayer base from the self-employed as well as an increase in the rate structure at the top are needed to improve revenue performance.

The non-corporate taxpayer base has shown an annual average growth rate of 3.40 per cent for the period of FY2007-12. If one goes into various bands, the variation in the numbers is not apparent. For example, those with income of Rs.10 lakh and above decreased sharply from 5.79 lakh in FY2007 to 2.18 lakh in FY2008 but increased gradually to 6.57 lakh in FY2012. However, there is a more steady increase in the number of taxpayers in the categories of Rs. 5-10 lakh and Rs. 2-5 lakh, with a significant rise in the latter from 38.36 lakhs in FY2011 to 60.26 lakhs in FY2012. However, for taxpayers with income below Rs. 2 lakh, there is a moderate fluctuation in the number of taxpayers for the period FY2007-12. These patterns could be due to various reasons and an analysis of data in the hands of the income tax department could provide an explanation.
and an analysis of data in the hands of the income tax department could provide an explanation.

However, the number of taxpayers for the period FY2007-08 to 3.28 lakh in FY2008-09, reflecting the global economic downturn that year, but thereafter increased gradually to 5.85 lakh in FY2011-12. Corporate taxpayers with income of below Rs.50,000 decreased sharply from 3.16 lakh in 2008 to 1.67 lakh in 2009 and then increased gradually to 2.95 lakh in 2012. For other categories, there is some variation in the number of taxpayers for the same period.

**Table 11.16: Non-corporate taxpayers**

<table>
<thead>
<tr>
<th>Category taxpayers (Income)</th>
<th>No. of Non-Corporate taxpayers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td>FY 07</td>
</tr>
<tr>
<td>Below Rs. 2 lakh</td>
<td>273.3</td>
</tr>
<tr>
<td>Rs. 2 lakh to Rs. 5 lakh</td>
<td>20.91</td>
</tr>
<tr>
<td>Rs. 5 lakh to Rs. 10 lakh</td>
<td>6.96</td>
</tr>
<tr>
<td>Rs.10 lakh and above</td>
<td>5.79</td>
</tr>
<tr>
<td>Search and Seizure assessments</td>
<td>2</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>308.96</strong></td>
</tr>
</tbody>
</table>

Source: CAG Report No. 15 of 2013 (Direct Taxes)

The corporate taxpayer base grew at an annual average growth rate of 10.35 per cent for the period FY2007-12. The total number of corporate assessees sharply decreased from the 4.98 lakh in FY2007-08 to 3.28 lakh in FY2008-09, reflecting the global economic downturn that year, but thereafter increased gradually to 5.85 lakh in FY2011-12. Corporate taxpayers with income of below Rs.50,000 decreased sharply from 3.16 lakh in 2008 to 1.67 lakh in 2009 and then increased gradually to 2.95 lakh in 2012. For other categories, there is some variation in the number of taxpayers for the same period.

**Table 11.17: Corporate taxpayers**

<table>
<thead>
<tr>
<th>Category of Taxpayers (Income/Loss)</th>
<th>No. of Corporate Taxpayers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td>FY 07</td>
</tr>
<tr>
<td>Below Rs. 50,000</td>
<td>2.05</td>
</tr>
<tr>
<td>Rs. 50,000 to Rs. 5 lakh</td>
<td>0.78</td>
</tr>
<tr>
<td>Rs. 5 lakh to Rs. 10 lakh</td>
<td>0.47</td>
</tr>
<tr>
<td>Rs.10 lakh and above</td>
<td>0.68</td>
</tr>
<tr>
<td>Search and Seizure assessments</td>
<td>0.02</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td><strong>4</strong></td>
</tr>
</tbody>
</table>

Source: CAG Report No. 15 of 2013 (Direct Taxes)

There were 7.2 lakh working companies registered with the Registrar of Companies (ROC) as on March 31, 2011 and 8.01 lakh on March 31, 2012. However, the number of corporate taxpayers, according to the Income Tax Department’s records, was 3.76 lakh and 5.85 lakh, respectively, in the two years, leaving an unreconciled number of 3.44 lakh and 2.16 lakh companies respectively, even though all of them are legally required to file returns mandatorily. It is most important, therefore, for the department to pursue this lead to identify companies that are registered but have not filed returns.
### Table 11.18: Gap in corporate taxpayers

<table>
<thead>
<tr>
<th>Year</th>
<th>Total corporate taxpayers</th>
<th>Number of working companies as per RoC as on 31st March</th>
<th>Gap in no. of corporate taxpayers</th>
<th>Year</th>
<th>Total corporate taxpayers</th>
<th>Number of working companies as per RoC as on 31st March</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>4</td>
<td>7.44</td>
<td>3.44</td>
<td>2006-07</td>
<td>4</td>
<td>7.44</td>
</tr>
<tr>
<td>2007-08</td>
<td>4.98</td>
<td>7.69</td>
<td>2.71</td>
<td>2007-08</td>
<td>4.98</td>
<td>7.69</td>
</tr>
<tr>
<td>2008-09</td>
<td>3.28</td>
<td>7.5</td>
<td>4.22</td>
<td>2008-09</td>
<td>3.28</td>
<td>7.5</td>
</tr>
<tr>
<td>2009-10</td>
<td>3.68</td>
<td>8.4</td>
<td>4.72</td>
<td>2009-10</td>
<td>3.68</td>
<td>8.4</td>
</tr>
<tr>
<td>2010-11</td>
<td>3.76</td>
<td>7.2</td>
<td>3.44</td>
<td>2010-11</td>
<td>3.76</td>
<td>7.2</td>
</tr>
</tbody>
</table>

Source: CAG Report No. 15 of 2013 (Direct Taxes)

### Graph 11.13: Gap in corporate taxpayers

**Tax base in service tax**

Table 11.19 below depicts data on the number of persons registered with the Service Tax Department for the period FY2008-09 to 2012-13. The number of registered persons increased by about 50 per cent in this period. Those filing statutory returns had been rising steadily up to 2012. However, in 2013, the number of taxpayers who filed returns fell short of the previous year’s figure by approximately 1 lakh. Further, only 33 per cent of registered persons filed returns in 2013. The sharp fall is a matter of concern and needs to be investigated analytically.

### Table 11.19: Tax base in service tax (FY2009-13)

<table>
<thead>
<tr>
<th>FY</th>
<th>No of taxable services</th>
<th>No. of ST registrations</th>
<th>Per cent growth over previous year</th>
<th>No. of assessees who filed returns</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>106</td>
<td>12,26,100</td>
<td>_</td>
<td>7,641</td>
</tr>
</tbody>
</table>
### Table 11.18: Gap in corporate taxpayers (In lakh)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total corporate taxpayers</th>
<th>Number of working companies as per RoC as on 31st March</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>47.44</td>
<td>3.44</td>
</tr>
<tr>
<td>2007-08</td>
<td>7.44</td>
<td>7.69</td>
</tr>
<tr>
<td>2008-09</td>
<td>3.28</td>
<td>7.5</td>
</tr>
<tr>
<td>2009-10</td>
<td>3.68</td>
<td>8.4</td>
</tr>
<tr>
<td>2010-11</td>
<td>3.76</td>
<td>7.2</td>
</tr>
</tbody>
</table>

*With effect from July 1, 2012, most activities involving consideration with a few exclusions/exceptions are liable to ST.*

Source: CAG Report No. 15 of 2013

### Graph 11.14: Percentage of non-filers under service tax

The Director General of Service Tax prepared and circulated a Plan of Action to the Chief Commissioners on May 26, 2003. The plan required the field formations to obtain information on unregistered service providers from different sources such as Yellow Pages, newspaper advertisements, regional registration authorities and websites, information from municipal corporations and major taxpayers including PSUs and private sector organisations regarding various services being availed by them. Subsequently, CBEC issued instructions to create a special cell in each Commissionerate to identify potential taxpayers.

### Tax base in central excise

After introduction of self-assessment, the return filed by a taxpayer is the only instrument to check the correctness of central excise duty paid to the government. Graph 11.14 indicates that more than fifty per cent of registered taxpayers are not filing returns. There is a need to build a strong...
mechanism to ensure filing of return by all registered taxpayers but it is equally necessary to investigate and analyse why the percentage of return filed is so low compared to the number of registrations.

**Graph 11.15: Percentage of non-filers under central excise**

![Graph showing percentage of non-filers under central excise]

*Source: Source: CAG Report No. 8 of 2014 (Indirect Taxes-Central Excise)*

The following table depicts the number of registered taxpayers of central excise between FY2009-13. The growth of registered taxpayers has been negative in FY2011-12 and there is a drop in the number of taxpayers compared to the previous year. However, in FY2012-13 there is a growth rate of 3.73 per cent.

**Table 11.20: Tax base in central excise**

<table>
<thead>
<tr>
<th>FY</th>
<th>No. of registered taxpayers</th>
<th>Per cent growth over previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>2,95,222</td>
<td>--</td>
</tr>
<tr>
<td>2009-10</td>
<td>3,15,171</td>
<td>6.76</td>
</tr>
<tr>
<td>2010-11</td>
<td>3,44,753</td>
<td>9.39</td>
</tr>
<tr>
<td>2011-12</td>
<td>3,35,759</td>
<td>-2.61</td>
</tr>
<tr>
<td>2012-13</td>
<td>3,48,294</td>
<td>3.73</td>
</tr>
</tbody>
</table>

*Source: CAG Report No. 8 of 2014 (Indirect Taxes-Central Excise)*

The top 100 taxpayers (in terms of revenue contribution), comprising oil sector companies, tobacco products, automobile, cement, steel and tyre manufacturers, contribute 70 per cent of central excise revenues. But broadening of tax base is necessary to ensure further growth of revenue. With increasing reliance on voluntary compliance, it becomes important for the
department to put in place an effective mechanism to collect information from various sources to identify persons who are liable to pay but have avoided payment and bring them in the tax net. A robust data analysis should form the backbone of such a mechanism. Having identified potential taxpayers, efforts to collect the tax by the department should be devoid of harassment; instead, such effort should be in the form of assistance to taxpayers to comply with law. This approach would promote voluntary compliance.

**Gap between PAN card holders and number of taxpayers**

Further, PAN has been allotted to around 17 crore entities while I-T returns have been filed by only 3.5 crore entities. The gap between PAN card holders and number of taxpayers is growing over time. While the number of PAN card holders increased by 175 per cent during FY2005-06 to FY2010-11, the number of taxpayers in the same period rose only by 17 per cent. Of the total 12.11 crore PAN card holders during FY2010-11, the number of taxpayers stood only at 3.48 crore and has remained almost constant thereafter. To a significant extent, this reflects the use of PAN card as a proof of identity for various stipulated economic functions that have no relation to tax. Nevertheless, the gap must have a bearing on the efforts to widen the tax base as also the efficacy of the PAN card distribution system. A huge gap has also been noticed between the number of entities to whom tax deduction account number (TAN) has been allotted vis-à-vis number of deductors filing TDS returns/submissions. The reasons need to be comprehensively identified for such a widening gap and whether there is room to enhance the I-T base from the information thus obtained.

Vigorous efforts are required both in terms of policy and enforcement in widening the tax base, which as seen above is not commensurate with the growth in income over the years. The reasons for this include India’s huge rural and underground economies, which present severe logistical constraints with respect to collecting tax. There is a flourishing underground economy, where transactions are in cash and people simply pay no taxes. Further, tax collectors have failed to raise as much as they should from high-income sections of society – doctors, lawyers, designers – and other independent, self-employed professionals whose tax is not deducted at source. Even a large number of rich farmers, who earn more than salaried employees in the cities, get away with paying no tax at all in view of the government’s lack of will to consider an agricultural income tax.

Ultimately, TARC’s consultations led to the conclusion that the tax system is not only complicated, confounding and contradictory, it is also affected by corruption, inefficiency and incompetence. Even ordinary taxpayers need to hire a tax consultant for tax payment, which costs them money, and, therefore, they become willing tax avoiders. Compliance systems should be made simple and user-friendly so that more people are encouraged to pay taxes, not avoid them.

**XI.3 Current practices and their analysis**

India has gradually shifted to a moderate tax regime, and in the words of the then Finance Minister in his June 1988 Budget Speech, “it is a well-accepted tenet of taxation policy that moderate rates
of taxes only make sense if the net is wide and the scope of evasion progressively minimised.” A number of efforts have been made to widen the tax net. Some of these measures are discussed in the following paragraphs.

XI.3.a Collection, dissemination and use of information

The I-T Act contains statutory provisions for the collection of information regarding specified transactions from specified persons and compulsory quoting of PAN. Instructions have been issued from to time in this regard. These have been discussed in detail in Chapter IX of TARC report.

Briefly, the Income Tax Department collects information through the Annual Information Return (AIR) and third party information through the Central Information Branch (CIB). Transmission of data to the department by various agencies on specified financial transactions in the form of AIR has been stipulated as a measure to assist in widening the tax base. It has been in place from April 1, 2005, when the concept of AIR was introduced. According to the provision of Section 285BA of the Income-tax Act, 1961, AIR of ‘high value financial transaction’ is required to be furnished by ‘specified persons’ in respect of ‘specified transactions’ registered or recorded by them during a financial year. Information is collected under various codes from persons such as Banks, Mutual Funds, Companies, the Registrar of Properties, credit card companies etc. National Securities Depository Limited (NSDL) is the authorised agency to receive the AIR. Information was to be used for identification of non-filers and to enhance filing of tax returns. However, as of today, there is no monitoring of the information received, leave alone its analytical use through further data mining. Whether the information has been filed by all the specified persons, or the information furnished is complete and correct is not known.

Information is also collected from third parties by the CIB and this information is required to be related to the respective PAN numbers. The CIB has been converted into the Directorate of Income Tax (Intelligence) and has been conferred powers of verification of information, which it did not have earlier. Apart from these, with mandatory e-filing of TDS statements, data about tax deduction at source (TDS) is also linked with the PAN ledger. This information is to be utilised for the widening of the tax base, identification of new taxpayers and selection of cases for scrutiny under Computer Assisted Scrutiny Selection (CASS), an algorithm based software that picks returns from AIR inputs against PAN numbers. The individual transactions statement report brings together information from multiple sources against a PAN in a single report and gives a comprehensive financial profile of a taxpayer.

XI.3.b Compulsory quoting of PAN for certain specified transactions

Section 139A(5) of the I-T Act, read with Rule 114B of the I-T Rules, stipulates compulsory quoting of PAN for certain specified transactions above certain specified values such as sale/purchase of immoveable property; sale/purchase of motor vehicles; FDRs with banks; units/shares debentures in mutual funds, and companies; payments to hotels/restaurants;
sale/purchase of securities; cash payment on foreign travel; opening of bank accounts, application for telephone connection etc. (detailed in Chapter IX of the TARC report).

Quoting of PAN has also been made mandatory on all 15G/15H declarations filed for non-deduction of tax at source. This was to help the department club all the declarations made by a taxpayer in an Assessment Year (AY) against a single PAN and identify non-filers/stop filers. However, this exercise, as on date, is not being carried out in a structured manner and on a regular basis. If done, this could contribute to the expansion of the taxpayer base.

XI.3.c Identification of PAN

Due to lack of a monitoring mechanism, information is not collected from all sources, and a large amount of information collected is without PAN and thus has zero value. Further, there are few checks in place to ensure that persons furnishing the information have included all the relevant transactions in their report and that the reported information is correct. Analysis of data on PAN holders appearing in AIR, CIB and Form 26AS information and issuance of verification notice in cases prioritised on the basis of specified criteria/rule based algorithms has been recently attempted in a limited way. Special focus was accorded to verification of non-PAN AIR data during the last quarter of the FY2011-12. A software, Multi-Iterative Phonetic Pattern Recognition Algorithm (MIPPRA), was used on a pilot basis to search for the PAN of persons in respect of transactions where PAN was not quoted in the AIR filed. The matching percentage of PAN to such transactions was only around 20-22 per cent. Based on this experience, the use of MIPPRA was shelved. But no alternative was explored to meet the important requirement of PAN identification. These issues have reportedly begun to be addressed under a data warehousing and business intelligence programme (discussed in detail in Chapter IX of the TARC report), although more investigation is warranted.

XI.3.d Non-filers monitoring system

The non-filers monitoring system was conceptualised to prioritise action on non-filers with potential tax liabilities. Data analysis was carried out in January 2013 to identify non-filers about whom information was available in AIR, CIB data and TDS/TCS return. Algorithms were applied in January 2014 and 22.09 lakh non-filers with potential tax liabilities were identified. Instructions have been issued to the field authorities to take appropriate action against non-filers for Assessment Years (AY) 2008-09 to 2010-11 (in cases where a TDS deductor had made payments of Rs.5 lakh and above after deducting tax at source, but recipients of income or deductees did not file their income tax returns). Data analysis identified 34.28 lakh non-filers with potential tax liabilities (2.19 lakh cases in 2013 and 22.09 lakh cases in 2014).216

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216 Appendix XI.5 gives data on I-T return filers and stop filers for the assessment year 2012-13.
XI.3.e Tax deduction at source

Another important device for widening the tax base is Tax Deduction at Source (TDS). TDS is an important measure to bring incomes that might go unreported for tax purposes to tax. Tax reforms were initiated after 1991 together with economic liberalisation and commensurate reform in many areas. A number of provisions for deducting tax at source were initiated and the list has grown over time.

Although provisions relating to TDS have been introduced to cover a number of transactions, often, taxes are not deducted properly or are not deducted at all. Sometimes, taxes are deducted but not paid to the government. It is necessary that the TDS provisions are followed strictly. TDS returns must be thoroughly scrutinised to detect potential taxpayers who do not file returns of income, although they are required to do so by law. Further, more areas should be considered to be brought under the cover of TDS. This will not only result in widening the tax base but also in the effective collection of taxes.

The provision for tax deduction at source (TDS) had already existed on the statute prior to 1991 for payments made towards salary, interest on securities, dividends, winnings from lottery, payments to contractors, insurance commission, etc. As a major effort to prevent leakage of revenue and for broadening, the tax base, deduction at source for payments made for commission and brokerage, fees for technical and professional services, including transportation and advertisement contracts and rent, have been included in the post-1991 period. The provisions for penalty/prosecution for failure to deduct tax or to pay it were strengthened to achieve better compliance and ensure that deducted tax reached the government treasury promptly.

In FY2007-08, 35.29 per cent of total direct tax was collected as TDS, and 53.30 per cent as Advance Tax. The collection from TDS has shown tremendous growth since then. As mentioned earlier, there has been a steady increase in total TDS collections (both corporate and non-corporate) from Rs1,28,230 crore in FY2008-09 to Rs.2,10,654 crore in FY2012-13, that is, by 64.28 per cent. TDS collections from corporate taxpayers increased from Rs.60,088 crore in FY2008-09 to Rs.91,974 crore in FY2011-12, that is, by 53.07 per cent. However, in the subsequent year, FY2012-13, the TDS collection went down to Rs.74,481 crore, that is, by 19.02 per cent over the previous year.

XI.3.f Taxation of fringe benefits

A major gap in the I-T base has been the inability to include perquisites adequately. One attempt to do so had been taxation of fringe benefits. The Fringe Benefit Tax (FBT) was introduced as part of the Finance Act, 2005, as an additional income-tax and came into force from April 1, 2005. The introduction of FBT was a major step towards widening the tax base and bolstering direct tax collections. In the FY2004-05, about Rs.4,000 crore was collected under this head. However, legislators and government officials were out of the purview of the FBT. This violated the principle of horizontal equity since some taxpayers enjoyed these benefits without attracting levy of tax,
while others had to pay tax. The Finance Act, 2009, abolished FBT with effect from assessment year (AY) 2010-11 on the ground that it increased the compliance burden on employers. Thus, a good tax that had the potential to reduce tax evasion and collected Rs.6,000 crore annually in revenue had to be abolished due to lack of horizontal equity and commensurate pressure from powerful lobbies who paid FBT. Re-introducing FBT, without the distinction that had been made earlier by keeping specific sections out of its purview, would be an effective measure to widen the direct tax base. This is a good temporary administrative measure for enhancing tax collection, until rising income tax collection makes it unnecessary.

XI.3.g  Minimum alternate tax (MAT) on companies

The Finance Act, 1996, introduced the minimum alternate tax (MAT) on companies, making it obligatory for them to pay tax on at least 30 per cent of economic income (book profits). The companies were asked to pay tax on income computed under regular provisions of the Act (including deductions, etc.) or on 30 per cent of book profits computed as per the Indian Companies Act, whichever was higher. The aim of this provision was to bring to tax companies that had book profits but were paying nil or negligible tax due to tax planning and incentives enjoyed.

With effect from April 1, 2007, the MAT payable was 10 per cent of book profits but it has steadily risen to the current rate of 18.5 per cent. The effective rate of MAT, after taking into account surcharge and education cess, works out to more than 20 per cent, thus bringing it close to the effective rate of corporate income tax itself, which, was in the range of 22.66 per cent to 31.08 per cent of the profits before tax in AYs 2000-01 to 2002-03.217 The statutory rate is almost 33 per cent including surcharge.

The Finance Act, 2012, extended the applicability of MAT to specified non-corporate taxpayers. The draft Direct Tax Code, however, suggested that MAT should be applied on change in the valuation of assets, and not on book profits.

XI.3.h  Banking cash transaction tax (BCTT)

BCTT was introduced with effect from June 1, 2005, through the Finance Act, 2005, to track unaccounted money and trace its source and destination. It remained on the statute book for about four years and was withdrawn with effect from April 1, 2009. While withdrawing the levy, the Finance Minister, in his Budget speech, had stated, “BCTT has served a very useful purpose in enlarging the information system of the Income Tax Department. Since the information is also being gathered through other instruments introduced in the last few years, I propose to withdraw this tax with effect from April 1, 2009.”

BCTT was levied in respect of cash withdrawals in a day exceeding Rs.50,000 in the case of an individual or HUF and Rs.1,00,000 in the case of other persons from their bank accounts, other

than savings accounts. The TARC is of the opinion that it had enlarged the information system of the Income Tax Department. There is no other instrument at present by which such information is being captured. With its withdrawal, an important source of information to monitor transactions of unaccounted money has dried up. The availability of information that was being collected through BCTT would certainly help the department widen the information base. This could be done through the revision of Rule 114E of the Income Tax Rules, 1962\(^{218}\) (dealing with Annual Information Returns) to include in its ambit cash withdrawals exceeding specified amounts (Rs.50,000 in the case of individuals and HUFs and Rs.1,00,000 in the case of other persons) made in a day from bank accounts, other than savings accounts. This will not inconvenience the taxpayers by making them liable to a fresh levy with all its procedural requirements. Alternatively, BCTT should be reinstated as an effective administrative measure.

**XI.3.i Presumptive taxation**

The concept of presumptive taxation was introduced to bring a number of businesses and service providers, irrespective of their area of operations, earning substantial income within the tax net. Presumptive taxation involves use of indirect means to ascertain tax liability. The basis of presumption can be turnover, asset of the business, physical indicators such as size, weight, chemical composition of inputs and outputs and the like. Such firms and individuals are usually small in size, and do not keep adequate accounts and records but can potentially (and legally) be taxable. For them, use of presumptive taxation is compliance simplification. There can, however, also be firms and individuals whose activities are clearly large enough to fall within the scope of the tax system but who evade taxes. These entities often opt for presumptive tax in lieu of regular taxation to appear as being in the tax net, yet not show their actual income or turnover.

In India, presumptive tax under Section 115K of the I-T Act was introduced through the Finance Act, 1992, with effect from April 1, 1993. This provision was applicable to all non-tax paying retail traders above the taxable income threshold but under a turnover ceiling of Rs.5 lakhs. There was initially an explicit presumption of taxable income at 7 per cent of turnover, with all those eligible and opting for the scheme deemed to be at the turnover ceiling. At the rates of income tax then prevailing, this worked out to a tax liability of Rs.1400. Later, the presumption with respect to turnover was dropped, and the applicability of the scheme was linked to the level of taxable income, on which too income tax payable worked out to Rs.1400. Along with this, the occupational coverage of the scheme was also widened. However, later, through the Finance Act, 1997, it was discontinued. To quote the then Finance Minister, “the existing presumptive scheme under Section 115K, popularly known as Rs. 1400 scheme, which has not yielded the desired results, being discontinued”.

Soon after abolition of the Rs.1400 scheme, the government introduced a one-by-six criteria scheme in 1998. Under that, those covered by any one of the criteria, such as holding a credit card,

\(^{218}\) Rule 114E requires furnishing of AIR in respect of transactions of the nature and value specified by specified persons.
subscription to a telephone (mobile phone), possession of immovable property, expenditure on foreign travel, ownership of a motor vehicle, and membership of a club where entrance fee charged is Rs. 25,000 or more were to file a tax return, even if he/she had no taxable income. This led to a substantial increase in the number of registrations as well as taxpayers. Graph 11.15 demonstrates that there was a substantial increase in the number of taxpayers from FY 1996-97 to FY 2005-06, when the compounded annual growth rate was more than 10 per cent. From FY 2005-06, the scheme was discontinued and it will be noticed that, from FY 2005-06 to 2011-12, the compounded annual growth rate fell to 2.8 per cent, with further dips in some years.

Graph 11.16: Number of effective assesses

![Graph 11.16: Number of effective assesses](image)

*Source: CBDT*

There are still a large number of individuals in businesses, trade, services and professions (especially in the unorganised informal sector and sectors where large scale transactions take place in cash) who are outside the tax net. The presumptive tax, therefore, needs to be reviewed so that the tax net is enlarged. To increase the growth rate of the number of effective individual taxpayers, there is a need to bring hidden tax payers under the tax net and one way of bringing hard-to-tax groups under the tax cover is presumptive taxation. The Kelkar committee had identified professionals like lawyers, doctors, accountant, architects, as the “missing middle”. For these professionals, a presumptive profit estimation scheme could be considered.

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XI.3.j Transfer pricing regulations

With the opening up of the Indian economy, a number of multinational companies have set up subsidiaries in India. Multinational companies are capable of shifting tax incidence from high-tax countries to low-tax countries through pricing of goods and services exchanged between their subsidiaries and associates in different countries. Elaborate Transfer Pricing regulations (Section 92 to 94) were introduced in the Income Tax Act by the Finance Act 2001 to prevent such tax avoidance by multinational companies. Transfer Pricing Officers (TPOs) were appointed specifically for this purpose.

Xi.3.k Direct anti-evasion measures

Direct anti-evasion measures have also been introduced including making laundering of black money a criminal offence; collection of third party information about transactions above a prescribed threshold made by their clients through AIR/CIB; and “Samman” to taxpayers a scheme introduced in 1998 to provide social recognition to honest taxpayers, recognising their important contribution to the national cause. The Economic Intelligence Council (EIC) at the centre and Regional Economic Intelligence Committees (REICs) were constituted at different locations as an apex forum of intelligence, enforcement and regulatory agencies. Apart from collecting data in respect of different tax entities and third party information on certain transactions, a data mining method to centrally manage data collected from internal and external sources was developed. The availability of information through usage of technology throws up more areas of investigation to prevent revenue leakage, increase collections and widen the tax base.

The Central Excise Commissionerates and Director General of Central Excise work to detect and prevent evasion of central excise duty and service tax. While the commissionerates with their extensive data base about units in their jurisdiction and presence in the field are the first line of defence against duty evasion, DGCEI specialises in collecting specific intelligence about evasion of substantial revenue.

Despite the measures noted above and other steps taken in this direction, the taxpayer base has not grown in line with the growth of the economy. The number has remained constant at 3.5 crore for several years. In order to analyse the reasons for this, the CBDT has commissioned the NIPFP (National Institute of Public Finance and Policy) to develop an analytical model to study the impact of an increase in per capita income on the total number of taxpayers coming within the taxation bracket. In FY2010-11, only 14.82 lakh new taxpayers were actually added against the target of 19.26 lakh new taxpayers, reflecting the challenges that remain in expanding the taxpayer base and, therefore, the need for persistent efforts in carrying out this task successfully.

XI.4 International best practices

Taxes are vital resources whose maximisation and mobilisation is of importance to governments to finance, among others, the development needs of the poor and under-privileged sections of
society and important sectors of the economy. This is possible through the expansion of the tax base and taxpayer base.

While tax administrations have adopted various ways to expand their tax base, the most common administrative and policy measures taken include withholding taxes or tax deducted at source (TDS); presumptive taxation; adoption of a single identification number, taxation of SMEs and wealthier citizens; increased tax enforcement, including more demands for disclosure and transparency; review and refinement of tax incentives/exemption/deductions; tighter transfer pricing regulations and oversight; and expanding the indirect tax net over more goods and services. Some of these measures are summarised in the following paragraphs while a detailed note is in Appendix XI.1.

Most countries have adopted a unique taxpayer’s identification number (TIN) which is allotted to existing and potential taxpayers. Appropriate legal provisions have been made to make its use mandatory in transactions with tax authorities for significant economic transactions that have tax implications. This forces potential taxpayers to come to the tax administration and register. Field surveys to detect unregistered taxpayers, as well as extensive publicity campaigns have often accompanied the drive to allocate TINs. The use of TINs has facilitated connecting taxpayers to their returns, payments and major taxable transactions with third parties.

Tax administrations in various countries have undertaken reviews of exemptions/incentives/deductions being given by them. After the review, some tax administrations, for example Korea, have withdrawn the deduction for future R&D. Singapore, on the other hand has decided to continue with the 50 per cent tax deduction on spending incurred on R&D activities conducted in Singapore for another 10 years. In Mauritius, allowances/deductions not linked with production of income like donations, tax holidays, and tax credits have been removed. In addition, complex systems of exemptions have been simplified. The discretionary power of the minister of finance to remit, exempt or refund tax or duty in respect of customs duties, excise duties, registration duties have been removed. By reforming its tax incentive regime, Mauritius has reportedly precluded high income earners from abusing various tax deductions, reliefs and donations to reduce their tax liability.

Many tax administrations are taking steps to expand the tax base comprising goods, services and other activities subject to indirect taxation. For example, China is aiming to broaden the tax base via the greater use of a VAT. China has merged VAT and Business Tax (BT), which has enabled input tax credit that was not available under the BT, to be made available under the VAT.

Taxpayer services provided by tax administrations are being continuously improved through the use of technology. An integrated tax office/one-stop-shop aiming to reduce the cost and burden of tax compliance is the new concept, and these are being set up. The integration of files has made it easier for the tax administrations match and cross-reference data.
The Canada Revenue Agency (CRA) uses centralised and automated methods for risk assessment. CRA uses a variety of means to assess tax compliance risk such as macro-level analysis, data mining, automated workload selections tool, and compliance measurement framework (CMF) besides others. The US-IRS uses a Discriminant Function (DIF) Workload Selection Model to score and select tax returns for potential audit. In France, the risk identification process is managed at the level of a local or specialised directorate in charge of audit activities. Selection of cases to be audited is made through different channels, all using a specific form that details the reasons why the taxpayer file is proposed for a possible audit.

Presumptive taxation involves use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer’s accounts. Various presumptive taxation methods are in use including reconstruction of income, percentage of gross receipts, asset based taxation, industry specific methods, methods based on outward signs of life style, etc. Argentina and Mexico have adopted the asset based taxation method. Ghana applies a minimum tax based on an individual’s profession or trade. France and Belgium use a contractual method based on an advance agreement between the taxpayer and tax administration to base the tax liability on estimated income instead of actual income. In Israel and France, extensive work has been done to establish prevailing profit rates in various business activities.

Simplifying the taxation system for SMEs has been accorded priority to facilitate registration of the hidden taxpayer and enhance voluntary compliance. This has been done, for example, in Malaysia, Australia, Singapore and Tanzania.

Measures have been adopted by various countries to enhance their enforcement efforts including aggressive tax audit, co-operation with other tax authorities on the exchange of information, and revamping tax disclosure requirements.

A number of OECD member countries provide rewards for information regarding taxpayer non-compliance. For example, CRA’s Offshore Tax Informant Programme (OTIP) allows the CRA to make financial awards to individuals who provide information related to major international tax compliance cases that leads to the collection of owed taxes. The United States Internal Revenue Service has a whistle-blower office that rewards individuals who come forward with information on major cases of tax evasion.

Many tax administrations are attempting to bring in a regime of taxing the rich, but are keeping an extremely high threshold limit. These include the US, UK, Europe and Australia. Appendix XI.1 has details on this.

Canada has launched the related party initiative (RPI) in 2004 to identify and examine HNWIs. The objectives of the RPI are to identify and respond to high risk compliance issues involving HNWIs and related economic entities. The UK’s HMRC uses cluster analysis to create segments according to asset size, and size of income from the assets, based on which it has started a pilot project to improve understanding of the needs of different HNWI customers and their behaviour.
to respond to them appropriately. With this objective, it has established a dedicated unit for servicing HNWIs.

**XI.5 Way forward**

Widening the taxpayer base is necessary to ensure growth of revenue for any government. As a proportion of the total population, India has a low taxpayer base of 3.3 per cent. Agricultural income is exempt from taxation in spite of large agricultural holdings; there are large scale exemptions and deductions in the form of tax preferences; and slackness in enforcement and lack of proper tax payer education are endemic.

A narrow tax base leads to a higher tax rate structure, an impulse to evade tax, and less equity. At present, the objective should be doubling the number of tax payers to 6-7 crore over a period of five years. It is a matter of concern that the department, which is otherwise aiming at widening the tax base, has not been able to retain the existing tax base of non-corporate taxpayers (in FY 2010-11). Considering the growth rate in the economy and the resultant spurt in both corporate and individual incomes, the number of taxpayers should have been much higher than it is. Of course, doubling the number of taxpayers would also entail commensurate staff and financial resources to administer them.

The departments have different mechanisms available to enhance the taxpayer base, which includes presumptive taxation, sharing of information with other tax departments, collection of third party information, surveys, and search and seizure. Automation also facilitates greater cross-linking (like linking tax returns with the PAN data base, linking TDS returns submitted by deductors on TDS deductions with the returns of the deductee, information about non-filers from e-TDS, etc). Major IT initiatives that can be leveraged to widen and deepen the tax base have also been taken by both the departments.

**XI.5.a Presumptive Taxation**

Businesses have grown over a period of time due to general growth of the economy besides other factors; at the same time, a large number of businesses and service providers, irrespective of their area of operations, earning substantial income are outside the tax net. One of the possible ways by which a large number of potential taxpayers can be brought into the tax net is to identify them through certain economic indicators and make it mandatory for them to file returns of income irrespective of the amount of income, by providing simple overall procedures and facilities for taxpayers to file and pay their taxes, minimising their compliance cost. For example, small businesses, farmers, and self-employed individuals, who may represent a large number of enterprises, lack proper books and accounting records to determine and self-assess their tax liabilities. Moreover, for the same reasons, it may be difficult and expensive for the tax administration to assess and collect taxes from these groups. Consequently, many small businesses in the informal economy simply elude the tax net and remain untaxed. For these groups, the tax administration could design, promote, and establish simple, optional presumptive tax schemes. If
used judiciously, presumptive taxation may broaden the tax base by increasing the number of taxpayers and their tax payments. Simplification of the tax structure could also play a role in reaching the “hidden taxpayers”. Hidden taxpayers refers to categories of persons, who, for diverse reasons, deliberately or unconsciously, do not register with the tax authorities and thus avoid payment of taxes. A flat rate of income tax with very limited deductions and separate rates with high use of TDS for non-wage income, or VAT with limited exemptions and zero rate categories can be used to bring hidden/potential taxpayers into the tax net. Even if the revenue per taxpayer is small, it may have spill over benefits in facilitating the movement of small taxpayers from the informal to the formal sector; they could also provide information to combat tax evasion.

Presumptive taxation for these new taxpayers cannot render them static. Taxpayers will need to graduate out of the presumptive system after a reasonable time. Such graduation can happen if they are encouraged to have records and embrace the formal sector rather than remain forever in the informal sector. To facilitate their movement to the formal sector, a presumptive taxation scheme needs to be backed by a taxpayer education programme (to bring taxpayers up to the point at which they can enter the regular system) and this should be an important goal of the scheme. This will also help tax authorities to retain them in the tax net. It may also be the case that some start-up firms as well as taxpayers may be “small” by their economic activity, but their business practices may be formal. Such formality of business practice should not bar them from subscribing to presumptive taxation as, for these taxpayers, reduction in compliance cost may be important and presumptive taxation may provide that opportunity. But under no circumstance should taxpayers be allowed to hide themselves forever in the comforting embrace of an unduly favourable presumptive taxation system.

Presumptive taxation is easy to administer and it is taxpayer friendly. It has been successfully implemented in many countries and is a source of hassle free revenue mobilisation. Wide publicity should be given to the provisions of presumptive taxation and a help desk should be maintained in income tax offices to assist taxpayers to file returns without difficulty (the return form for this should be not more than one page). This is possible only if there is an environment of mutual trust and the taxpayer is treated like a customer and an environment/culture is created for voluntary compliance as stated in Chapter II of the TARC’s report. The mind-set of tax officers has to be changed from treating taxpayers with mistrust to treating them with trust.

One problem with presumptive taxation can be how to keep out large and medium enterprises that try to look like small enterprises and hide themselves from the tax administration’s eyes. Just as it is important to ensure that small firms, when they become bigger, will graduate into the normal tax system, it is equally important to ensure that those who are in the normal system already – or who should be in that system – do not migrate into the simplified system and use the cover of smallness to shield themselves from taxation. One effective method to monitor small enterprises that opt for presumptive taxation would be to insist they file a declaration of their accounts in a simple format on an annual basis. Another method is to strictly enforce issuance of a sale/service
bill for each of the transactions, with a running serial number for a financial year, preferably electronically. This can be randomly checked by the department.

XI.5.b Strategies for taxing untapped resources

i. Unorganised sectors/hidden taxpayers

The strategies to promote and enforce the registration of hidden taxpayers include, first and foremost, increased taxpayer awareness and education for voluntary compliance, easier norms for determination of income liable for taxation and payment of taxes, including presumptive taxation, reducing the cost of compliance, an expanding net of taxes deducted at source (TDS accounts for over 38 per cent of gross revenue collection), facilitating the preparation and filing of returns of income in a cost effective manner, easier modes of tax payment and others. Once the process of registration of these taxpayers is completed, steps need to be undertaken to increase taxpayer confidence through trust (today over 98 per cent of returns filed are accepted in India), and responsive delivery systems.

Enforcement of registration by the reluctant taxpayer has to be done by non-intrusive strategies of 360 degree profiling, and data mining. This could help in issuing notices for initiation of registration and assessment proceedings, or even field action such as surveys and searches.

Economic structures in many developing countries are typically overwhelmed by the informal sector, which is expanding rapidly as large behemoths – the public sector units – get dismantled, leading to involuntary assimilation of large organised sector labour pools in the informal sector. And, within the unorganised sector, emerging business entities and individuals manage to avoid the full impact of the tax system by remaining outside the tax net as small and medium sized enterprises. They comprise the hidden taxpayers who take the form of unregistered merchants, often family-owned businesses, and professionals who predominantly transact in cash. They habitually tend or have difficulty in keeping books of accounts and records. They avoid or may not be familiar with banking or other financial institutions and, therefore, keep their own transactions under cover. There are increasing concerns in India that even medium and large businesses are hiding in the informal economy. These may include start-up firms, medium manufacturing and commercial firms that are capable of keeping accounts but for a range of reasons – to remain competitive or to minimise their tax burden – prefer to remain in the cash economy. High tax rates, inability to understand a complex tax system and procedures, and lack of confidence in government efficiency in the use of revenues are added reasons for low voluntary compliance.

These are the reasons why tax administrations should put in place innovative systems that encourage small and medium enterprises to register voluntarily. A unique identification number should be issued to each taxpayer on first registration (that is, PAN), which should be used as a common business identification number (CBIN) as suggested by the TARC in Chapter VI of its report.
ii. Small and medium-sized enterprises

Tax administrations around the world have started paying attention to the taxpayers from the group of small and medium-sized enterprises (SMEs). SMEs are often a dynamic sector of the economy and the key to overall economic growth. The Micro, Small and Medium Enterprise (MSME) sector in India contributes 8.7 per cent of GDP, 45 per cent of manufactured output, and 40 per cent of merchandise exports. According to the quick results of the All India census on MSMEs covering registered and unregistered segments for the reference year 2006-07 released by the Development Commissioner (MSME), registered MSMEs account for 1.56 million (6 per cent), while the unregistered account for 24.55 million (94 per cent), totalling 26.11 million enterprises. The MSME sector showed consistent growth of more than 11 per cent every year until FY2010-11. In FY2011-12 the growth rate was 19 per cent and in FY 2012-13 about 14 per cent.

The I-T Act provides for special legal provisions for some of the small businesses. One such provision is for the business of civil construction or supply of labour for civil construction work, having gross receipts from the business not exceeding Rs. 40 lakh. Another legal provision is for the business of plying, hiring or leasing trucks owned by a taxpayer owning not more than 10 trucks. Yet another is for the small retail sector, based on a percentage of the turnover. All the schemes are optional for taxpayers and presumptive in nature, and the taxable income is at a prescribed percentage basis. The income so estimated disallows business deductions that are admissible for other taxpayers.

Taxpayers’ distribution on the basis of tax returns filed, according to the CAG Report No. 15 of 2013, is given in Table 11.21.

Table 11.21: Distribution of taxpayers on the basis of tax return filed

<table>
<thead>
<tr>
<th>FY</th>
<th>Assessments with income below Rs.2 lakh</th>
<th>Assessments with income above Rs.2 lakh but below Rs.5 lakh</th>
<th>Assessments with income above Rs.5 lakh but below Rs.10 lakh</th>
<th>Assessments with income above Rs.10 lakh</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>287.90</td>
<td>31.38</td>
<td>10.09</td>
<td>2.18</td>
<td>331.65</td>
</tr>
<tr>
<td>2009-10</td>
<td>278.36</td>
<td>31.15</td>
<td>10.93</td>
<td>2.67</td>
<td>323.23</td>
</tr>
<tr>
<td>2010-11</td>
<td>283.72</td>
<td>35.64</td>
<td>14.58</td>
<td>3.11</td>
<td>337.17</td>
</tr>
<tr>
<td>2011-12</td>
<td>271.29</td>
<td>38.36</td>
<td>17.78</td>
<td>4.49</td>
<td>332.04</td>
</tr>
<tr>
<td>2012-13</td>
<td>267.68</td>
<td>60.26</td>
<td>21.23</td>
<td>6.57</td>
<td>357.61</td>
</tr>
</tbody>
</table>

Source: CAG Report No. 15 of 2013

220 In the European Union also, SMEs represent 99 per cent of all companies and there are more than 40 million SMEs in China, representing more than 99 per cent of total enterprises).

221 Economic Survey 2013-14
The same data for FY 2011-12, distributed according to the income range/slab (rather than value of assessments as in the previous Table) is given in Table 11.22.

Table 11.22: Number of returns filed on the basis of income range, FY 2011-12

<table>
<thead>
<tr>
<th>Income range ('000)</th>
<th>No. of returns</th>
<th>Total revenue collected (Rs. crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-50</td>
<td>3,009,628</td>
<td>0</td>
</tr>
<tr>
<td>50-100</td>
<td>4,439,040</td>
<td>969</td>
</tr>
<tr>
<td>100-300</td>
<td>2,502,247</td>
<td>4,301</td>
</tr>
<tr>
<td>300-500</td>
<td>78,632</td>
<td>687</td>
</tr>
<tr>
<td>500-1000</td>
<td>141,981</td>
<td>2,679</td>
</tr>
<tr>
<td>1000 -</td>
<td>33,170</td>
<td>3,906</td>
</tr>
</tbody>
</table>

Source: CBDT

It is difficult to come to a conclusion regarding the potential number of taxpayers from the above information, even when combined with data from the MSME Ministry. Data mining and matching from different sources remain crucial for analysis-based strategies to arrive at the correct tax base. Considering that potentially this is a significant taxpayer segment, special attention is required from the CBDT to address them.

Due to their small size and lean structures, SMEs often have to spend considerable time on activities such as filling out forms, applying for permits and licences, reporting business information, or notifying changes. These are particularly burdensome to smaller businesses and may even discourage potential entrepreneurs from starting a new business. The compliance burden created by the complexity of tax law and administration is of special concern to SMEs, in particular to the smallest enterprises, such as micro-enterprises. Therefore, it is imperative to identify or design measures that reduce the compliance burden, without undermining the quality or availability of the information needed to enforce compliance.

Within the group of SMEs, small businesses form a sub-group of particular concern to tax administrations. Although many compliant small businesses operate in the formal economy, they are nonetheless major participants in the cash economy. Compliance risks in this segment of the taxpayer population are different from those in the case of large (and medium-sized) enterprises and (wealthy) individual taxpayers. The characteristics of small business non-compliant behaviour include the absence of registration as a taxpayer; failure to file returns; absence of, or poor, payment records; underreporting of turnover and profit; and non-existent, or poor, book keeping. It must also be recognised that a complex tax structure, high tax burden, and high compliance costs are likely to be causes for a larger informal economy, to form and function, giving rise to non-
compliant taxpayer behaviour. On the flip side, unfair competition from non-compliant business puts a disproportionate tax burden on the formal sector and reduces growth in the formal economy. This tends to lead to low tax compliance in general. Research indicates that tax compliance in the formal sector is lower in countries with a large informal sector compared to countries with a smaller informal sector.\textsuperscript{222} The challenge is to improve compliance with tax obligations while, simultaneously, not use administrative instruments that discourage start-ups of new businesses, or inhibit their expansion.

A report of the OECD, Development Co-Operation Directorate (DCD-DAC),\textsuperscript{223} indicates that complex tax regulations and poor tax administration in many developing countries constitute serious barriers to the formalisation of small business. According to the report, informal enterprises are concerned about tax levels and complexity. They often do not understand how to comply with tax requirements; they fear the behaviour of tax officials; and they do not believe they will receive public services in return for tax payment. The report recommends avoiding retroactive taxation for businesses that formalise; simplifying tax administration especially since tax administration is more often cited by businesses as a bigger problem than tax rates; and sharing information on what taxes are used for, and how business benefits from public services.

To take one example, even the VAT, which is usually perceived as easy to administer by tax administrations, is seen as burdensome and costly by many small businesses. Setting a reasonably high VAT threshold and allowing a turnover based contribution – or compounding – for small businesses is an appropriate instrument to reduce compliance and administrative costs without reducing VAT revenue too much. Tax administration measures to improve SMEs’ VAT compliance, therefore, should include quick and easily accessible processes for registration and PAN issuance, and clear and easily available information on tax registration, filing and payment obligations and procedures. A turnover-based regime should be introduced for small taxpayers.

Once that happens, risk selection and audit activities targeted at this segment of taxpayers should take into account the specific characteristics of different groups of SMEs. ATO has developed data mining tools that have helped them in improving their understanding of the relationship between individuals, trusts, partnerships and companies within a group, and also their compliance behaviour. Once their compliance behaviour is understood, raising compliance is likely to again call for simplified returns, with simple profit and loss statement and simplified capital allowance, so that whichever SME is selected, their audit remains fair and transparent and not prone to disputes.

Coming to the issue of how small businesses move across to the medium range, a good presumptive system needs to be co-ordinated with the standard tax regime to avoid conflict of

\textsuperscript{222} Terkper, S.E., “Managing Small and Medium-Size Taxpayers in Developing Economies”, \textit{Tax Notes International}, January 13, 2003

\textsuperscript{223} OECD, 2012
rules, as well as obstacles for the move from one system to the other, in particular from the presumptive to the standard regime. Ideally, this should be based on thorough analysis of the expectations of the small taxpayers, as in the ATO model. Other characteristics needed include acceptance of the tax structure by stakeholders as stable; administrative simplicity for transition from small to medium; and inclusion of a tax payer education and information programme that actually reaches them. Frequency of payments, filing of returns, audits and scrutiny should not jump upwards and should be in tune with administration for small businesses in international jurisdictions. A good practice would be for specialised tax officers, always in a group, to visit start-up as well as regular small businesses in order to support them and communicate with them regarding the state of their trade, the status of their business, and their attitudes towards fulfilling their tax obligations.

The establishment of a call centre for resolution of basic queries is a responsive measure and would go a long way in deepening and widening the tax base. In fact, there have to be at least 8-10 of them established across India. This would be particularly helpful for the MSME sector, which does not have access to professional advice. Quick answers on compliance obligations and support in compliance fulfilment would increase tax registrations and payments. Information provision to business can be effectively carried through another arm, *i.e.*, close co-operation with chambers of commerce, local government and other government agencies.

**XI.5.c  Cash economy**

The cash economy is a major handicap in the Indian economic system. Large-scale transactions are understood to take place in cash, especially in land dealings. A non-intrusive verification system should be designed so that more cases of capital gains liability are detected. In the alternative, certain measures should be put in place to discourage cash transactions. For example, Circle Rates at which municipalities charge property tax are usually considerably below the market values for properties. Municipalities should be encouraged to bridge the gap since the reported value of a property deal tends to adhere to the Circle Rate rather than the much higher market value.

The problem of the underground economy is serious for tax administrations all over the world. In developing countries, in particular, the number of non-filers is very high. Non-filers are required to pay tax, but have never registered for tax, and consequently, have escaped paying their tax obligations altogether. They conduct their businesses or professions “below the radar” and go largely undetected. Tax administrations have a challenge to broaden the tax base by continually identifying non-filers and getting them to comply with tax laws, lessening the burden on those taxpayers who do comply voluntarily. This can only be accomplished through analysis-based segmentation of the taxpayer community, and efficient targeting of non-filers rather than good or habitual taxpayers. Taxpayer segmentation has been discussed in detail in Chapter XII of this report.
A concerted government wide effort to reduce the size of the cash economy can be done by increasing the digital footprint of transactions in the economy. The mandatory mention of PAN should be made more comprehensive and backed by robust information exchange between tax authorities and banks and other financial institutions as detailed in Chapter II of the TARC report. The adoption of PAN as a common business identifier, as recommended in Chapter VI of the TARC report, will go a long way in facilitating this practice.

There is a need to develop better understanding of the underground economy both in terms of its size and the economic and behavioural factors that motivate players in an economy. This is not only in the interest of the tax departments but of the government as a whole. Such a study does not exist for recent decades. Therefore, there is an urgent need to promote research in this area within the expanded analysis-oriented centre (KAIC) recommended in Chapter III of the TARC report.

There should be a provision for systematic migration from the cash economy to banking transactions/plastic economy. This has to be carried out in co-operation with the financial sector. The spread of stringent book keeping requirements will also leave audit trails that can be utilised by the audit section of the tax administration. However, the transition is admittedly challenging and will take time for appropriate implementation.

XI.5.d Retail sector

The Indian retail sector has witnessed an unprecedented growth over the last decade, driven by robust economic growth, rapid urbanisation and changing lifestyles and aspirations of the Indian retail consumer. It can be broadly classified into two categories, namely, organised and unorganised retail. Organised retail consists of organised traders/retailers, who are licensed for trading activities and registered to pay taxes to the government. Unorganised retail consists of unauthorised small shops, common conventional Kirana shops, and general stores, among other small retail outlets.

In the past few years, there has been tremendous growth in retail’s organised segment. Major domestic players have stepped into the retail arena with long-term plans to expand their business across cities, as well as other formats such as e-commerce and newly emerging areas of business. The retail market is expected to reach Rs.47 lakh crore by 2016-17, as it expands at a compounded annual growth rate of 15 per cent, according to a ‘Yes Bank-ASSOCHAM’ study conducted in 2014. The retail market (including organised and unorganised retail) was at Rs.23 lakh crore in 2011-12. According to the study, organised retail that comprised just 7 per cent of the overall retail market in 2011-12 is expected to grow at a compounded annual growth rate (CAGR) of 24 per cent and attain a 10.2 per cent share of the total retail sector by 2016-17. The unorganised sector has around 1.3 crore retail outlets that account for around 95-96 per cent of the total Indian retail sector.

High consumer spending over the years by the younger population (more than 65 per cent of the country is below 35 years) and a sharp rise in disposable incomes are driving the organised retail
sector’s growth. Even Tier I and Tier II cities and towns are witnessing a major shift in consumer preferences and lifestyles as a result of which they have emerged as attractive markets for retailers to expand their presence. Another segment is the emergence of online retail business, which has high potential for growth in the near future. An emerging trend in this segment is the virtual formats where customer orders are taken online through web portals and products are delivered at the door step the very same day or the following day. This trend has been catching up with most of large-sized retail chains that have their own websites.

Given that the growth of the retail sector is anticipated by the growth in the middle class, it may be worth looking at how the middle class has been projected to grow over the next decade. According to a research study conducted by McKinsey & Company, India’s average real household disposable income will grow from Rs.1,13,744 in 2005 to Rs.3,18,896 in 2025 at a CAGR of 5.3 per cent. This is significantly more rapid than the 3.6 per cent annual growth rate of the past 20 years and a much quicker income growth than in other major markets. As Indian incomes rise, apart from a substantial reduction in poverty, a sizeable and largely urban middle class will be created. In 2005, the Indian middle class comprised approximately 5 per cent of the population or 1.3 crore households. It is projected that the middle class will reach 41 per cent of the population or 12.8 crore households by 2025. It is estimated that almost two-thirds of India’s middle class will locate outside the top-tier urban areas and, instead, be in middle-tier or smaller cities.

There are an estimated 1.3 crore unorganised small trader outlets in the country, of which a large number are engaged in mostly cash transactions with per capita transactions of about Rs.2 lakhs per month. Unorganised retailers do not normally pay taxes and most of them are not even registered for VAT at the state level or income tax and service tax at the central level. There is a distinct aversion to paying taxes that can be traced to the widespread perception that the government offers nothing in return for the taxes that people pay which is linked to the seeming inability of government to ensure basic necessities such as water, power and safety. These matters have been discussed earlier as well as in the context of the impediments to creating a conducive environment and tax culture.

Perhaps, the use of ATM machines should be strongly encouraged by increasing the per day cash out flow of debit cards. This could encourage unorganised retailers to switch over to banking friendly channels from the cash economy as usage of debit cards has the inherent advantage of safety and security since it eliminates the risk of losing cash or misplacing it. Further, when in need of cash, one can access money at an ATM machine at any time. In many countries, the use of debit cards has become so widespread that their volume has largely replaced cheques and, even small cash transactions. Brazil is an eminent example among emerging economies.

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Using more of the banking network will certainly be useful to them for leveraging retail business in a more secure environment, particularly in Tier II and Tier III cities. In a broader perspective, such a shift would bring an institutional change in the style of conducting business. Using debit cards could also encourage retailers to enter the organised sector, leaving an audit trail of transactions undertaken by them, which could be progressively leveraged for widening the taxpayer base.

Further, the small retail sector could also be provided the facility to fast track applications for educational and housing loans once they are categorised as taxpayers.

**XI.5.e Agricultural income**

Agricultural income of non-agriculturists is being increasingly used as a conduit to avoid tax and for laundering funds, resulting in leakage to the tune of crores in revenues annually. A solution could be to tax large farmers. Against a tax free limit of Rs.5 lakh on agricultural income, farmers having a high agricultural income threshold, such as Rs.50 lakhs, could be taxed. This will keep small farmers out of the purview of taxation and yet close one escape route for black money. States could pass a resolution under Article 252 of the Constitution, authorising the Centre to impose tax on agricultural income. All taxes collected by the Centre, net of collection costs, could be assigned to the states. This will broaden the taxpayer base and help mobilise additional revenue without affecting any but a very miniscule proportion of the very large farmers whose annual income exceeds the threshold limit.

For this purpose, of course, an across-the-board political consensus needs to develop, and be followed by appropriate amendments, laws and collection procedures to ensure effective implementation of such an important change. But it will certainly bring about a much improved tax culture and performance. All stakeholders need to be on board, especially representative bodies of farmers, to determine the standard parameters of expenses and receipts on production in different areas for different crops on different types of land. To do this, the existing infrastructure and human resource base of the land revenue department could be utilised. The capacity of the latter should be strengthened with proper training and infrastructure, including automating record keeping and improving transparency, to reduce fraud and forgery.

Obviously, the TARC realises that this is a fundamental structural reform proposition. Yet, successive governments have shown a lack of political will to tax agricultural income because of the politically strong hold that the agricultural lobby has over governments.

**XI.5.f Services sector**

The services sector has been growing over the years, but has not been taxed to the optimum. In the services sector, retail and transport are the sub-sectors that account for a high percentage of GDP but their incomes are still significantly out of the income tax net for administrative reasons. This is largely due to lack of effective implementation, partly because the tax machinery lacks the
capacity to determine the actual income potential of individuals working in these sectors. To exploit the full potential of taxes in this sector, the tax administration needs to be fully equipped with data and understanding of the business processes to bring them in the tax net. In addition, a comprehensive review of exemptions is needed to deepen and widen the tax base. In service tax particularly, a study on the impact of the implementation of the negative list is urgently needed to develop a clear strategy to rationalise them.

 Besides the above, stock market brokers, jewellers, money changers, property dealers, doctors, architects and other professionals need to be focussed on to explore major individual entities in these sectors to tax them according to their potential tax ability. The overall objective should be to bring major business entities currently in the informal sector into the tax net. Standard parameters of each sector to determine business volumes should be arrived at through mutual consultation with stakeholders such as major business entities, their representative bodies, lawmakers, and chartered accountants. Once the parameters have been determined, individual business entities in these sectors should be identified by tax offices, informed, consulted and notified. Initially, this exercise could be done on a pilot basis in a few major cities with the rest of the cities to be taken up in the second phase after successful results in the initial phase.

 I-T department officers need to be properly trained and equipped before any of these exercises are initiated. Special training for officers to help them understand the business processes should be arranged so that they are able to work out business volumes, expenses, receipts and the profitability of the business sector being reviewed. These parameters should also be well documented and circulated so that the taxpayer has a fair idea about the parameters used to determine his tax liability. This will not only reduce the discretion of the tax administration but also increase the transparency of the taxation system.

 XI.5.g High net-worth individuals (HNWIs)

 HNWIs and their entities have seen greater focus on tax compliance by the tax administrations over the past few years. Taxpayers in this segment are not necessarily less compliant but the scale and complexity of their personal and business tax arrangements need to be reviewed more effectively to examine their tax affairs. Many tax administrations view HNWIs as a separate segment of the taxpayer population that requires a tailored approach to compliance. They term them “complex” individuals if their incomes come from multiple and global sources.

 The Wall Street Journal reported in 2013 that there are about 125,000 millionaires in India. On the other side of the wealth spectrum, reflecting the high degree of inequality in India, 95 per cent of the country has assets below $10,000. The existence of this shocking disparity has so far done little to shake the administration to move towards making HNWIs pay their rightful tax share to the exchequer. It is obvious that successive governments have been unable to achieve progress except perhaps in small, occasional instances. Thus, in March 2013, as part of the budget, the then Finance Minister proposed a 10 per cent surcharge that would be applied to people with annual income of at least Rs.10 million (about $ 176,000). However, as informed by the Finance Minister to the
Parliament, this would apply only to about 43000 individuals in the whole country despite the fact that the number of millionaires is believed to be at least 3 times that.

In India, there is no formal recognition of HNWIs as a category of taxpayers. But the taxpayers are poorly defined higher income category in the sense that they are all pooled at a taxable income above Rs.10 lakh and taxed at the higher rate of 30 per cent, and besides a surcharge of 10 percent. The obverse side of this is that such cases tend to be subject to scrutiny if they are picked up for audit on the basis of criteria-based risk assessment. Although there are more such potential taxpayers in reality, those filing tax returns are only about 43,000 as implied by the Finance Minister’s statement.

This category of taxpayers normally gets substantial dividend income. Currently, dividend income is tax-free in the hands of the investor as the company distributing dividend pays dividend distribution tax at the rate of 15 per cent. Hence, such HNWIs are taxed at a lower overall effective marginal rate than those having little or no dividend income. Many HNWIs use HUFs to spread their income and fall under the threshold limit to save the tax. HUFs are also known to launder money or receive money as gifts from relatives, especially from abroad. HUF cases can also be selected for audit. The need to focus on expanding this category of taxpayer base, therefore, is crucial at this point.

The HMRC adopted the standard statistical tool, cluster analysis, to create segments according to size and income yields of asset groups. The result of such cluster analysis has been shown in Diagram 11.1.

**Diagram 11.1: Cluster Analysis - Age vs. Asset Income percentage**

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Source: CATA conference, presentation by HMRC
The size of each circle in the Diagram is proportional to the number of individuals in that cluster. The analysis also showed that the use of tax avoidance schemes by HNWI clusters is on the rise as shown in Diagram 11.2.

**Diagram 11.2: Tax avoidance schemes by HNWI clusters**

Source: CATA conference, presentation by HMRC

Some of the strategies adopted by the HNWIs and their compliance are reflected in Diagram 11.3.

**Diagram 11.3: HNWIs clusters and compliance**

Source: CATA conference, presentation by HMRC
It is imperative for India to adopt similar measures as analysed in Chapter XII on compliance/risk management.

Managing the affairs of a defined population of HNWIs within a single operational unit has enabled HMRC to track their behaviours over time and examine the way they have responded to various changes in the tax landscape. It has also provided the opportunity to look at different characteristics within this diverse group to tailor their operations to better handle the tax risks that are presented. It is learnt that with these analyses, HMRC succeeded in increasing its tax yield from this segment by 21 per cent in one year in 2012.

Australia’s approach towards HNWIs is to achieve practical certainty and reduce on-going compliance costs, increase collaboration with other tax jurisdictions for exchange of information, and manage individual taxpayer compliance according to the level of tax risk he represents using a risk differentiation framework to categorise levels of risk. The ATO has specific funding for compliance strategies focusing on wealthy individuals and profit shifting arrangements. Some factors that attract the attention of the ATO in relation to the use of trusts and other investment vehicles include arrangements where trusts or their beneficiaries have received substantial income but are not registered, or have not lodged tax returns or activity statements.

Similarly, as already mentioned, India should focus on HNWIs. The wealth tax base can be increased by comprehensively including intangible financial assets in the base while raising the threshold and decreasing the rate of wealth tax. This would be a significant improvement over the current collection of approximately Rs.800 crore from wealth tax, which is almost negligible.

Administratively, there is need for a separate cell for HNWIs to understand taxpayers’ needs and behaviours to respond to them appropriately, helping them to get their affairs right and pursuing those who bend or break the rules. Such an HNWI unit would provide a number of benefits in terms of improving capabilities within the administration in relation to HNWI tax affairs and their links with connected entities. This will also help compliance by gaining a better understanding of the behavioural drivers of those HNWIs and ultimately widen and deepen the taxpayer base. In Section III.5.a of its report, the TARC had recommended setting up of a compliance verification vertical. This vertical can have separate cells for HNWIs.

**XI.5.h Special tax treatments (exemptions/incentives/deductions)/ Tax expenditure**

Special tax treatments in the form of targeted tax reliefs to correct market failures, contribute to re-distributing income, favour a particular interest group, reduce tax compliance cost and save on administrative costs lead to loss of government revenues. This may force government to keep tax rates high, which in turn can lead to additional efficiency losses, affect income re-distribution and add to administrative and compliance costs for the non-benefited groups.
Table 11.23: Tax Expenditure

<table>
<thead>
<tr>
<th>FY</th>
<th>Total Tax expenditure</th>
<th>Tax Expenditure as per cent of GDP</th>
<th>Tax Expenditure as per cent of DT</th>
<th>Tax Expenditure as per cent of GTR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006-07</td>
<td>49,800</td>
<td>1.35</td>
<td>30.14</td>
<td>13.6</td>
</tr>
<tr>
<td>2007-08</td>
<td>77,177</td>
<td>1.8</td>
<td>33.53</td>
<td>16.3</td>
</tr>
<tr>
<td>2008-09</td>
<td>1,00,256</td>
<td>2.1</td>
<td>32.11</td>
<td>16.9</td>
</tr>
<tr>
<td>2009-10</td>
<td>1,04,471</td>
<td>1.86</td>
<td>31.29</td>
<td>17.26</td>
</tr>
<tr>
<td>2010-11</td>
<td>1,18,023</td>
<td>1.82</td>
<td>31.26</td>
<td>18.9</td>
</tr>
<tr>
<td>2011-12</td>
<td>94,738</td>
<td>1.22</td>
<td>21.2</td>
<td>11.94</td>
</tr>
<tr>
<td>2012-13</td>
<td>1,01,140</td>
<td>1.13</td>
<td>20.47</td>
<td>11.38</td>
</tr>
</tbody>
</table>

Source: CAG Report No. 15 of 2013 (Direct Taxes)

Graph 11.17: Tax expenditure

(Refer Table 11.23.)

Specific economic parameters like the tax-GDP ratio, the growth of specific sectors, and the growth of households should be identified to increase the tax payer base. The selected economic parameters should be periodically verified, improved and modified. Some of the parameters may require total overhaul based on social and other changes. However, at no point of time should schemes based on specific economic parameters be dropped midway without a critical evaluation of the effectiveness of the parameters selected and possible modification to suit revenue needs. For example, the 1/6 scheme (mentioned earlier) which was in vogue in the early part of 2000, was given up abruptly. No study was conducted to find out the reasons for it not fulfilling the requisite objectives, or possible modifications/changes that could have been made to effectively implement the scheme.
One lesson is that exemptions/deductions based on area and industry should be minimised, if not done away with. It is ironic that all tax experts across the world are of the same opinion, yet governments continue with them propelled, mainly by big industry interests that bankroll the political process. One, therefore, cannot expect an accepted and agreed upon correct policy to be implemented in the foreseeable future. However, start up industry can be mandated to pay tax at a lower rate for a specific period of time and a sunset clause introduced to ensure a review of the benefit arising from lower rate of tax, expansion of industry/area etc. For other industry groups, every attempt should be made to reduce tax preferences even if the likelihood of success is expected to remain low.

In the case of excise duties, there are several exemptions categorised under different heads, *viz.*, value based exemptions for small scale manufacturers, exemptions under various export promotion schemes, exemptions relating to goods manufactured in specified areas, exemptions for job work, exemptions to goods for captive consumption, exemptions to goods manufactured in government factories and supplies to the defence sector, exemptions to technical, educational and research institutes, exemptions to goods produced without the use of power and for units in rural areas, and exemptions to certain goods and industries. Of these, a review of value-based exemptions for small-scale industries (popularly known as SSI excise exemption) may be an effective measure to widen the central excise taxpayer base.

The SSI exemption was introduced in the year 1986 to promote the growth of small-scale industries; this was later extended to non-SSI units as well. At the same time, a credit scheme (then MODVAT and now CENVAT) was introduced to remove the cascading effect of taxation on goods. The scheme has been in vogue all these years and to some extent, it has also achieved the purpose of removing the cascading effect of tax. With an IT-enabled environment gaining focus and attention across the country (at the end of manufacturers, service providers and traders), even small-scale manufacturers should not find it difficult to operate under the CENVAT credit mechanism. Hence, there is need to review whether the exemption from excise should be shelved or continued with lower value limits of say Rs.10 lakh to bring it in line with the one prescribed for small service providers. With GST likely to come into force in the near future, it may be time to withdraw or prune this exemption so that small-scale units work under a duty paying regime duly, availing of the benefits of the credit scheme for inputs, capital goods and input services. A review on the lines suggested may also end the practice of many small units operating under their own new satellite units with a view to continue availing of the small-scale exemption year after year.

As far as service tax is concerned, the government introduced a few amendments to bring a limited number of changes in the service tax law in the 2014 Finance Bill to ensure stability and continuity of the new service tax regime (the regime of a negative list of services), to widen the tax base and enhance compliance. While this measure should lead to a widening of the taxpayer base under service tax, a review is needed to assess its efficacy since industry has complained that economic activity that are not typically services in international practice are termed as service for tax
purposes in India and the same economic activity is being taxed twice, at the central level and then also at the state level.

The present law lists out specified services for levy (declared services) with a number of exemptions for certain specified services and service providers. The scope of reverse charge\(^{225}\) for payment of service tax has also been enlarged to bring into its fold a number of services, one such service being “goods transport operators service”. This alone takes out of the service tax net a sizable number of taxpayers. If the reverse charge mechanism for this service is withdrawn, it may bring a sizable number of potential taxpayers under the service tax as well as income tax net.

Today, to determine whether a particular service is leviable to tax or not, the provider of service has to apply/interpret the definition of service under the law read with the list of exemptions. In case of difficulty, one can refer to the service tax guide released by the Service Tax Department soon after the new regime was introduced. However, it is felt in the service industry that the service tax guide is not comprehensive as it does not bring total clarity with regard to the levy under the new law. The service industry is looking for clarity on coverage under various categories of services by way of illustrations. This would facilitate widening of the base under service tax.

### XI.5.i Risk analysis

Development of sophisticated systems for risk analysis and selection of cases for audit and investigation is another tool to improve the enforcement capacity of the revenue administration. These systems, which have been implemented in Chile, Colombia and Hungary, use information from different sources to zero in on cases where the risk of fraud is high. These cases are then picked for detailed investigation and audit and physical inspection (in customs). Adopting a risk analysis based approach to curbing tax evasion and smuggling has many advantages. First, since the selected cases, prima facie, have some suspicious characteristics, it is more likely to find actual tax evasion in these cases, than if cases are picked up at random. Thus, the productivity of enforcement activities in terms of gathering additional revenue and penalising evasion increases. Consequently, it also enhances the deterrent effect of such actions in the minds of the normal taxpayers. Second, risk analysis allows the revenue administration to be more selective in scrutinising cases. The percentage of cases selected for examination is usually between 1 to 10 per cent of the total number of cases. This leads to more intense scrutiny and better use of investigation, inspection and audit skills, that are invariably in short supply in most revenue administrations. Third, the reduction in the number of cases facing tax administration interventions implies that most of the other cases are accepted through an automatic review process. There, therefore, is no need for any interaction between tax officials and taxpayers. On the one hand, this reduces opportunities for corruption. On the other, it reduces the overall compliance costs to taxpayers. In the customs area, acceptance of most of the customs declarations means that goods can be cleared without physical examination, saving traders considerable time and cost. Given international

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\(^{225}\) Reverse charge is a mechanism in which the tax, instead of being collected at the hands of the service provider, as is the usual case, is collected at the hands of the recipient of service.
experience, risk analysis should be made more robust and continuously improved in India. The framework for risk management has been discussed at length in Chapter XII of this report.

XI.5.j Tax deduction at source (TDS)

Current practices in TDS have been reviewed earlier in this chapter. Here we are looking at how to take it forward in the light of best global practices. TDS is an effective and efficient mechanism for widening and deepening the tax base. It leaves behind an audit trail that acts as a deterrent to tax evasion and in the collection of tax as soon as a transaction takes place. More than 90 per cent of tax revenue accrues by way of TDS and advance tax. It is also a non-intrusive method of expanding the base, minimises discretion, and fosters better tax compliance. Hence, the coverage of TDS/TCS\(^{226}\) should be expanded to cover more and more transactions, especially those that involve large amounts of cash but remain outside the tax net. This would require legislative amendment. Further, this needs to be supplemented by intrusive methods like search, survey etc.

Even now, the information being collected on deducting tax at source (with-holding tax on various transactions including property transactions, filing of TDS returns) is not being analysed or effectively used. The TDS returns are not monitored to ensure that the deductees file their I-T returns or returns that are filed by deductees and deductors are complete in all respects. It may so happen that many individual taxpayers whose liability is far in excess of TDS avoid filing their I-T returns. It is one thing to have TDS but it is more important to see if the final returns by the deductees are filed since the taxpayer base may not necessarily increase by mere introduction of TDS unless correct filing of I-T returns by deductees and deductors is ensured.

TDS may be extended to areas such as commission paid to distributors and sub-distributors by firms, companies and other legal partners, amount paid in respect of value addition by manufacturers, lease rent or rent on machinery and plants that is debited to the accounts of a concern, market fees paid during purchase and sale of agriculture produce and debited in the books of a concern, royalty paid on account of publication, incentives in kind or cash paid on account of extra sales or bringing extra business, payments made on account of repair of machinery and plants, payments on account of franchises, payments in the form of gifts taxable as income in the hands of recipients etc.

XI.5.k Survey, search and seizure

Broadening and widening the tax base is a strategic objective for a tax administration. It is evident that potential taxpayers, in particular small businesses, escape the tax net. The growth of potential taxpayers under all taxes, namely, corporate, non-corporate, service tax, central excise and customs has been phenomenal. Complicated tax systems, high tax rates and complex procedures create high

\(^{226}\) TCS (Tax collection at source) is income tax collected by seller from payer on sale of certain specified items, such as alcoholic liquor, tendu leaves, timber obtained under a forest lease, scrap, specified minerals, etc, as provided for in Section 206C of the I-T Act, 1961.
compliance costs, and encourage small taxpayers, who are largely outside the tax net, to hide themselves from the eyes of tax officials.

To widen the tax base, one focus has to be on those who are not filing returns, i.e., non-filers and stop filers. Non-invasive surveys and information and a technology-based tax collection system, which is non-intrusive, should be used to identify non-filers and stop filers. This can be done effectively by concentrating on clusters of business units, especially in developed cities and new emerging cities and sectors known for the use of undocumented/cash transactions. Real estate and the SME sector are particularly relevant in this regard. This would require that information in the books of the tax administration be continuously updated by collecting information from diverse sources/data bases, both internal and external, and surveys identifying the premises of potential taxpayers. The information thus gathered should be integrated with the existing data base and non-filers/stop filers identified. Once identified they should be asked to comply through the issue of letters online. This heightens the perception that the tax administration is aware of defaulters and would pursue them, and ensures that a significant percentage of defaulters comply. Again, it helps deepen and widen the tax base.

The concept of non-invasive survey should be implemented on a large scale without laying unnecessary emphasis on collection of taxes. It should take the form of soft enforcement with risk-based supervision. Action needs to be taken jointly by the direct and indirect tax administrations for this purpose. A combined survey effort (by the Centre and states) should also be thought of with reference to the National Population Register (NPR) data base available at the state level that gives details of household types with characteristics such as name, address, age, etc. which could be useful for both the departments. Details regarding registration of doctors could be taken from the Medical Council of India and compared with the department’s database to find the extent of non-filers/stop filers. AADHAR information can be used to locate the potential taxpayer at his current address, which the tax department may not have.

If income cannot be captured, then expenditure has to be looked into. People who are spending over a certain amount or have an opulent life style need to be identified and, whether they are paying taxes or not should be ascertained. If not, they should be brought into the tax system. The UK’s HMRC uses an available software to zero in on such behavioural indicators. The Indian tax administration should develop such software. And, it should not be assumed that the informal sector is all poor; there are the rich hidden under that umbrella.

Surveys could also be based on growth trends and sectoral and industrial trends in each of the metros and Tier II cities, where large scale development is taking place at present. This should be done initially on a pilot basis and, thereafter, based on an objective valuation, extended to other areas. In operationalising this, it should be ensured that the actions do not result in any harassment or customer dissatisfaction. The responsibility of senior officers in ensuring this is of great importance.
Search and seizure operations are mechanisms used in cases where credible information about tax evasion is in the possession of the tax department. Evidence gathered through such operations, which is not possible to gather otherwise, generally leads to unearthing of undisclosed transactions/incomes, which ultimately translates into deepening the tax base. Such evidence/information also leads to the identification of new taxpayers and stop filers, resulting in widening the tax base. Further, the operations also help detect failure to deduct tax at source (TDS) by persons responsible for doing so, failure by deductors to pay the TDS to the government’s account and failure to furnish returns and statements by those who are statutorily obliged to do so. This leaves an audit trail, which can be leveraged to widen the tax base. An objective evaluation to ascertain the actual revenue yield or outcome of search operations should also be made.

Search and seizure operations should be limited to cases where hard core tax evasion is suspected. To ensure this, economic intelligence should be better developed and exchanged and used effectively. Structured sharing of important, and often sensitive, information is frequently needed to achieve better co-ordinated searches. An effective mechanism of collecting information from various sources, data matching, integration and use needs to be put in place, as has been discussed in Chapter IX of the TARC report. Besides strengthening enforcement, data exchange fortifies the exercise and success of searches, and sends out a strong signal to evaders that multiple departments are aware of their illegal practices.

However, information exchange for all tax authorities as on date does not exist or exists in isolation. The scope of exchange of information should be extended to all information systems of all direct and indirect tax laws governed and implemented by the central as well as state governments and integrated. There should be a common platform and single data base, integration of technology to enable systems to talk to each other, integration of all data bases to form a common warehouse and an intelligence tool for developing analytics, as has been suggested in Chapter IX of the TARC report.

Implementing effective data-matching procedures can be a daunting challenge for even the most sophisticated tax administration. In India, such data matching has not been possible so far. Implementing automatic matching algorithms that are able to cope with massive amounts of data should be considered to tap various heterogeneous databases across administrations (tax authorities) and financial entities (banks, insurance companies) using an efficient taxpayer identification scheme. Industry associations can also be good sources of data that could be useful in putting together a comprehensive data set.

Encouragement and assistance to taxpayers in complying with tax laws cannot be expected to automatically lead to higher tax collections, unless taxpayers perceive the risk of being caught and the penalty for non-compliance as being high. The aim of strengthening enforcement is to heighten risk perception and demonstrate the tax administration’s capacity to detect and punish evasion. The enforcement mechanism should take its own course by imposing penalty and interest and initiating prosecution as and when required.
The line between tax evasion and tax avoidance is getting thinner. A tax avoidance scheme is generally understood to be one where “steps having no commercial purpose apart from the avoidance of a tax are inserted in a composite transaction made up of a pre-ordained series of transactions.”\textsuperscript{227} Tax laws in many countries like Singapore, Australia, New Zealand, UK, Malaysia, etc., now have anti-avoidance provisions. Similar provisions should be adopted in India, although this should be done with great care by tax officers trained to implement anti-avoidance laws with sensitivity.

**XI.5.1 Tax amnesty**

Governments have frequently turned to tax amnesties as part of their fiscal strategy. An amnesty typically allows individuals or firms to pay previously unpaid taxes without being subject to some or all of the financial and criminal penalties that could be imposed on them. Many taxpayers who do not comply with tax laws may be unaware of their tax obligations, and changing tax laws magnify the problem. Tax amnesty gives such taxpayers a chance to voluntarily comply. The benefits of tax amnesty include bringing evaders to the route of honesty and new taxpayers entering the system, leading to improved voluntary compliance. Tax amnesty provides information about the taxpayers and their activities, which can be used to expand and widen the base.

There is a contrary viewpoint that prevails, which contends that tax amnesty schemes encourage taxpayers not to file their return and pay due taxes within the stipulated time. Taxpayers keep waiting for such schemes to be announced and take advantage of these schemes to build their capital. Amnesties also cause inequity among taxpayers, and there is no proof that they improve taxpayer behaviour among evaders. They should, therefore, not be encouraged through amnesties.

However, innocent mistakes made by the taxpayer should be differentiated and given a treatment that enables them to correct errors without their being drawn into disputes or harassed, as is common in India.

**XI.5.m Research and analysis**

Analysis is very important for any tax administration as it not only provides valuable inputs to policy making but is also crucial to assess the success of existing policies and procedures. A lot of emphasis is laid on extensive research and analysis in various areas of taxation by most modern tax administrations. In India, we do not have a comprehensive and ongoing process for tax research and analysis. Even though the Tax Research Unit (TRU) of the CBEC and Tax Policy and Legislation (TPL) division of the CBDT do carry out bits of analysis for making policy changes, it is far from adequate and many policy changes are still introduced by the two Boards without sufficient analysis, leading to unintended consequences. There is, therefore, an immediate need to

set up an institutional mechanism for carrying out research and analysis by the two Boards in various areas of tax administration. This is why in Chapter III of the TARC’s report, a very large and comprehensive centre, the Knowledge Analysis and Intelligence Centre (KAIC), has been recommended. The TARC recommends that sanitised macro data on taxpayers, returns filed, tax collected, etc., should be made available in the public domain, so that research bodies are able to analyse them and provide their findings to the tax department from time-to-time. This will help in developing research input for decision making.

XI.5.n Spreading awareness through education

Spreading awareness through education has proved very effective in broadening the taxpayer base. The general feeling among taxpayers, especially the self-employed, professional, business community in semi-urban and rural areas, is to avoid filing I-T returns because they fear they will be harassed by the tax administration once they are in the tax net. This misconception has to be removed through extensive taxpayer education programmes discussed in Chapter II of the TARC report. They could be organised through the Confederation of Indian Industry (CII) and other chambers with the help of the I-T Department.

The tax administration must clearly explain the importance and fairness of broadening the tax base, and continuously convey messages to potential and actual taxpayers and the general public on the negative implications of tax evasion, increasing the capacity of the tax administration to combat tax evasion and bring informal sectors into the tax net.

The importance of paying the right amount of tax for the development of the nation and acting as responsible citizens need to be taught to students/younger generation. They are the future of the nation. This could be done through the undergraduate college curriculum, (discussed in detail in Chapter XII), interactive sessions in colleges, etc. It may be mentioned that a programme has already been initiated by the CBDT to liaise with the Education Department; the initiative includes the introduction of the fundamentals of taxation in NCERT books for school children. This needs to be carried forward as a compulsory course for undergraduate students of all streams to make them aware of the relevance of taxation in a country’s development, the benefits of taxation, the citizen’s role in the country’s development through payment of taxes, their duties and their rights as citizens and what the role of the tax administration is in furthering this/helping them to achieve their objective. The thrust should be on ‘catching them young’ and to make them aware of their tax responsibilities as a citizen.

If one knows the basic rules, people feel comfortable in being compliant, and fears about the income tax department may fade. In fact, lack of compliance arises from the fear of the unknown. It is necessary to frequently organise meaningful and well-designed taxpayer education and assistance programmes. This should be coupled with making available departmental publications in Hindi, English and local languages to taxpayers.
XI.5.o Creation of tax culture and conducive environment

It is an admitted fact that the tax culture is lacking in India. Despite considerable efforts to widen the tax base, the number of taxpayers is about half the number who should pay tax if they adhere to the law. Although the rates have been lowered over the years, the country still lacks the desired tax culture that exists in developed nations. It is time perhaps that tax is not considered a burden but a price for public services, if not for civilisation itself.

The education and publicity programme should go hand in hand with creating a tax culture and environment that maximises voluntary tax compliance. This requires tax rules and regulations that are sensitive to economic and commercial conditions and that are system-oriented and do not cater to individual interests. Generating an environment and tax organisational ethos that encourages maximum voluntary compliance is the direction in which Indian tax administration should move.

To develop a tax culture, revenues collected should be wisely spent and taxpayers should be able to see how their tax money has been spent. This will encourage them to pay willingly and may be happily. Tied to this is the need to curb corruption and tax evasion. Every rupee collected that is misapplied reduces monies that would otherwise be available to the government for developmental purposes. Corruption serves as a disincentive to payment of taxes. The fight against corruption must be continuous and sustained. The taxpayer should be treated as king. If there is no taxpayer, there is no assessment and no tax revenue and hence no growth. In India, however, taxpayers feel that they are being treated harshly and punitive provisions in tax laws are applied ruthlessly against them. Hence, a large proportion of people consider it prudent to keep a distance from the tax department and the number of non-filers of tax returns is increasing. Many taxpayers become defiant, demotivated and disillusioned because of wrong notions held by tax collectors about their powers, the desire to pass on their part of work to taxpayers, indifference towards them and an attitude that assesses are out to manipulate figures and evade taxes. Such notions strike at the root of a healthy tax culture. A proper tax culture can develop only when taxpayers and tax collectors discharge their obligations equally well. The principle of mutual trust and accountability should be followed. All taxpayers should be responsible and accountable on all tax issues, including transparency, to the government. The government on its part should also be responsible and accountable to citizens on all issues related to taxation.

Tax professionals can also play a role in this. Apart from advising their clients on the present tax scenario, which is more liberal than in earlier decades, tax professionals can play a vital role in educating taxpayers on why they need to pay the right amount of tax; the need to declare their income, pay income tax and furnish income tax return within the prescribed time; the penalties associated with default or delay in fulfilling one's obligations and the actions that the authorities could take against tax evasion and other serious lapses including prosecution.

From the view point of ‘taxes’, it is not only the tax system and actual tax practice that form part of a country’s ‘tax culture’, but also the relationship between the tax authorities and taxpayers. How explicit and precise the tax law is and consequently, how violations are treated will also have
a bearing on the development of a tax culture. In nutshell, tax culture is the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution.

XI.5.p Political will, corruption

One of the major conditions for tax compliance is a conducive political environment. Taxpayers comply readily with tax laws when they have the assurance that the tax administration is for them and their perceived interests and well-being are protected. The contrary is the case when they feel politically oppressed or victimised. This is why voluntary compliance is always easy under a favourable political climate.

However, opportunities for corruption are pervasive in tax collection; hence, a comprehensive anti-corruption strategy including effective internal audit is necessary. But this cannot happen without support from the top policy making levels. The existence of huge tax evasion signifies the absence of such support.

XI.5.q Relations with taxpayers

A major challenge tax authorities face is in being responsive to the individual circumstances of taxpayers, while at the same time being conforming to the demands of the system. Responsiveness translates to accessible, dependable and timely information service as well as the fair and timely treatment of requests and appeals. This can be achieved by constructing systems and procedures that are aimed more towards the needs of the taxpayers than those of the tax administration. Examples of this would be facilitating links with taxpayers through single points of contact to ensure that services are available when and where needed. Efforts to develop enhanced electronic means of communication between taxpayers and the tax authority should include electronic submission of returns, electronic tax payments and on-line access to tax account balances.

A good tax authority consults with taxpayers and other stakeholders on changes to, and the development of, significant policies and procedures. It ensures that compliance costs are kept to the minimum to achieve compliance with tax laws. Tax authorities should also co-operate with other regulatory bodies to design appropriate approaches to lessen compliance costs with due regard to the interests of all levels of government.

Consistency is improved by having policies and procedures that are transparent and that conform to domestic tax laws and international tax treaties and norms. Consistency also implies ensuring that the rights and obligations of taxpayers, complaint procedures, and redressal mechanisms are outlined and communicated through guides, forms, and public information and education programmes.

The TARC has recommended treating the taxpayer as a customer and to serve him better. Complaints about the present tax system, viz., complex structure, low transparency, delay in issue of refunds, high compliance cost, lack of attention to taxpayer needs, lack of respect from officials,
tax leakage, corruption, etc., all need to be addressed to provide friendly service and greater compliance. This will serve to increase the number of taxpayers.

A mechanism for stakeholder consultation to improve voluntary compliance by removing procedural obstacles and improving relations with taxpayers was introduced in July 2013\(^{228}\) in the form of a Tax Forum for exchange of views between industry groups and government on tax related issues or tax related disputes. The need for such a forum was felt necessary in view of the number of representations received by government from chambers of commerce or industry associations. The issues either concerned a particular industry as a whole or a large section of that industry. The forum provided an opportunity to government officials to hear the arguments of industry groups, analyse their point of view and place them before the government for its consideration. The forum was chaired by the Adviser (Minister of State) to the Union Finance Minister and supported by officers of the Central Board of Direct Taxes (CBDT) and the Central Board of Excise and Customs (CBEC).

The Tax Forum held 18 meetings on Wednesdays during August-September 2013. It discussed issues related to direct as well as indirect tax, concerning an industry group or sector and did not entertain representation of individual taxpayers. In order to have structured and meaningful discussions, a format was devised for receiving memoranda from industry groups to clearly highlight the tax issue or tax dispute sought to be discussed. The memoranda received from industry groups in the given format were circulated to the CBDT and CBEC for examination and analysis. Every Tuesday, the issues that were to be taken up during the next day’s meeting were discussed internally. On Wednesday, the forum met with the industry group, heard their views and explained the government’s position on the issues. On the basis of discussions during the meetings and subsequent analysis, representations were divided into three categories: (a) those for which there was no basis for further movement; (b) those for which further information from industry was requested; and (c) those where the two Boards were required to examine the obstacle under question facing the industry. Formats were devised for each of the categories and issues discussed during the Wednesday meetings were populated in any one out of the three formats and sent to the two Boards for further examination and comments. The process was completed before the following Tuesday, which was the day for the preliminary meeting for the next Wednesday meeting. This process continued from August 7, 2013 to September 26, 2013.

In light of the discussions held by the Tax Forum with the industry groups, issues that fell in category (c) were further analysed by the CBDT and CBEC. These issues, thereafter, were discussed with the Finance Minister, who took a final decision. Wherever possible, specific time lines for taking necessary action were also indicated to the two Boards. The decisions were conveyed to the public by issuing press releases.\(^{229}\)

\(^{228}\) Government of India Press Release dated 18.07.2013

\(^{229}\) Government of India, Press Release dated December 17, 2013
During the said two-month period, the Tax Forum covered matters relating to the information technology sector, manufacturing sector, infrastructure sector, the services sector including financial services, insurance sector including reinsurance, the export sector and issues in international taxation. The forum identified 29 issues in direct taxes and 47 issues in indirect taxes where the two Boards were required to remove particular obstacles facing industry and issue clarifications or amend procedures.230

Several long standing issues faced by taxpayers, both in direct and indirect taxes, were taken up, analysed and resolved through these meetings. Many circulars and notifications to clarify issues discussed during the forum meetings were issued by the CBDT and CBEC. Unfortunately, there has been a slowdown of the process.

The Tax Forum consultations coupled with focussed analysis brings a tax related issue or dispute at a preliminary stage to the notice of government and help resolve these before it snowballs into a major problem.

While some of the cases discussed during the forum meetings were purely administrative, requiring the issue of instructions to field formations to carry out already existing instructions, others involved carrying out analysis to issue clarifications to resolve existing disputes and preventing avoidable litigation. Table 11.24 provides a few examples of the kind of analysis carried out by the forum and the two Boards to resolve the issues involved.

**Table 11.24: Examples of analysis carried out by the Tax Forum**

<table>
<thead>
<tr>
<th>Issue raised before the Forum</th>
<th>Chair’s analysis of the issue</th>
<th>Outcome of discussions with the Finance Minister based on Chair’s analysis and views of CBDT/CBEC</th>
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<tbody>
<tr>
<td><strong>Safe Harbour</strong></td>
<td>Before finalising the safe harbour guidelines, a draft should be shared with the industry to avoid any unintended hardship to the taxpayers.</td>
<td>CBDT posted the draft safe harbour rules on the departmental website indicating the proposed safe harbour percentages for various eligible international transactions and called for comments of all stakeholders. The comments were analysed by the CBDT and the final notification on safe harbour was issued after considering the comments of stakeholders.</td>
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## Issue raised before the Forum

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<tr>
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<tr>
<td><strong>Deductions for exports of onsite services</strong></td>
<td>Deduction should be allowed if there was nexus of onsite services with the eligible unit in India and such nexus (a business or performance relationship) could only be established through proxies. NASSCOM should come up with a list of proxies that could be considered for establishing the nexus of onsite services with the eligible unit in India. CBDT will examine the list and, thereafter, come out with a circular for guidance of AOs enumerating factors that would establish the nexus of onsite services to eligible export unit for allowing the deduction.</td>
<td>NASSCOM suggested the list of proxies to the CBDT and these were circulated to field formations for comments by May 15, 2014. This issue should possibly be resolved by now.</td>
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<tr>
<td><strong>Software product taxation</strong></td>
<td>Industry informed that for software distribution the margins are low ranging between 2-3 per cent. However, the sale proceeds are subject to TDS at the rate of 10 per cent under section 194J. The CBDT circular for removing the cascading effect by having TDS only at the first dealer level is not being implemented in the field as it is not possible to establish the nexus between tax-deducted purchases with further sales as there are no unique identification numbers for software products. The CBDT should carry out necessary analysis to ascertain the profit margins in software distribution. Lowering of</td>
<td>The CBDT responded that the matter was being examined from the point of view of legislative change since the issue of instruction for a particular industry may not be feasible. However, Instruction No.1/2014 for disposal of applications for lower deduction of tax in a time bound manner was issued on January 1, 2014.</td>
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<td>Treating Indian manufacturing companies as Permanent Establishment (PE) of parent and group companies.</td>
<td>TDS rate, however, would require legislative change. Therefore, it was recommended that the CBDT, in the meanwhile, should issue instructions directing AOs to issue a certificate for lower deduction of tax in such cases in a time bound manner.</td>
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<td>Provisions of Section 14A of the Income Tax Act, 1961 read with Rule 8D of the Income Tax Rules</td>
<td>Instances were cited where tax authorities were treating the Indian manufacturing companies as PE of parent group companies when the parent provided experienced expatriates for carrying out the business of the Indian company or seconded some employees to India. Such a treatment led to taxation on supply of raw materials and finished goods from outside India. Although the issues of whether the foreign company had a PE or not depended largely on the facts and circumstances of the case, in certain cases, part of the profit could be attributable to the unit in India. However, to provide certainty to taxpayers and avoid litigation, the CBDT could analyse this issue and come out with a Guidance Note for AOs. The Guidance Note should also clarify that the mere existence of a subsidiary in India or mere sending of employees to India would not constitute a PE of the parent company.</td>
<td>The determination of PE is an exercise depending on the facts of a particular case. General guidelines already exist in the OECD and UN Model Commentaries. Therefore, industry was asked to prepare a draft circular on this issue for consideration by the CBDT.</td>
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<td>computation of disallowance under Section 14A based on investments, income from which is exempt from taxation. This may result in situations where disallowance would happen even if there is no exempt income or the quantum of disallowance may exceed the exempt income. It was also represented that the deeming provision of administrative expenditure at the rate of 0.5 per cent of the average investments resulted in ad hoc and excessive disallowance. It was, therefore, requested that Rule 8D be rationalised for the calculation of disallowance of expenditure under section 14A of the Act. After analysing the issue, it was felt that disallowance under Section 14A, read with Rule 8D (1), was in respect of expenditure incurred in relation to income that does not form part of the total income in a previous year. This should include situations in which the assessee had made investments that gave rise to exempt income but there was no exempt income in that previous year. The CBDT may issue suitable clarification on Section 14A explaining that disallowance can be made in a situation when no exempt income has resulted in a previous year but the assessee had made investments that would give rise to exempt income. However, there was some merit in industry’s argument on the quantum of situation when the entire expenditure gets disallowed due to an asset giving rise to exempt income. For example, if there is agricultural land worth 100 crore, and expenditure in P&amp;L account is 50 lakh, the entire expenditure will be disallowed. Besides how other countries disallow such expenditure had to be analysed.</td>
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<td>Taxation of consortium arrangements in turnkey/EPC infrastructure contracts as Association of Persons (AOPs)</td>
<td>disallowance under clause (iii) of Rule 8D(2) since the basis of calculating the disallowance in investment in assets gives rise to exempt income.</td>
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<td>Taxability under Minimum Alternative Tax (MAT) u/s 115JB on share of income of a member from an AOP</td>
<td>Industry represented that some recent rulings of the Authority for Advance Rulings (AAR) holding that consortium arrangements for execution of infrastructure projects result in the creation of Association of Persons, were being applied by revenue authorities to all projects for taxing MNC contractors as AOPs. To obtain clarity it was agreed that industry should approach the CBDT with specific business models that usually apply. The CBDT would then analyse these models and clarify whether and how such contracts would result in taxation of a consortium as AOPs, or whether they would be taxed separately.</td>
<td>The specific business models from industry were awaited. Turnkey projects were to be assessed as an AOP unless industry came up with a business model to prove the contrary.</td>
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<tr>
<td>Applicability of Minimum alternate Tax to Foreign Companies</td>
<td>When a consortium was taxed as an AOP on its total income, the share of income of a member of the AOP would again be subjected to tax under Section 115JB of the Act leading to double taxation of the same income. The issue should be flagged and necessary changes to avoid double taxation in Section 115JB should be considered for the next Union Budget.</td>
<td>Income should not be taxed again in the hands of the members of AOP. As it required amendment to the I-T Act, it was to be corrected during the budgetary exercise of 2014-15, though it was not.</td>
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<td><strong>Service tax in respect of services provided by reinsurance agents</strong></td>
<td>Industry raised the issue of liability to service tax on brokerage paid by foreign reinsurers to Indian reinsurance agents for placement of reinsurance business with them. The business is organised in such a way that the reinsurance premium, including brokerage, for reinsurance is paid to the broker. This premium, net of brokerage, is passed on by the broker to the reinsurer. It was explained that service tax was paid on the composite amount, including reinsurance premium and brokerage, paid to the broker as well as separately charged on the brokerage, which resulted in double taxation.</td>
<td>Department will seek inputs from the insurance industry to ascertain whether there is double taxation of the brokerage paid to reinsurance agents, and issue a circular, if necessary, for mitigation of double taxation, if any.</td>
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<td><strong>Valuation of goods sold at a price below the cost of production</strong></td>
<td>The Hon’ble Supreme Court had, in a recent decision in the case of CCE, Mumbai vs. Fiat India (P) Ltd., held that where products are sold at considerable losses for an unduly long period of time for the purpose</td>
<td>The modality of implementation of the decision of the Hon’ble Supreme Court is under consideration of a committee of Chief</td>
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<td>Liability of payment on removal of capital goods after use</td>
<td>of market penetration, the transaction value cannot be accepted for the purpose of levy of excise duty. Pursuant to this decision, field authorities were asking assessees to furnish cost data of various products for past years. The issue was analysed and it was agreed that the decision of the Hon’ble Supreme Court was applicable where facts and circumstances were the same as in the Fiat case. A clarification along this line may be issued for field officers.</td>
<td>Commissioners. The circular was, thereafter, issued on January 15, 2014, after seeking comments of CBDT/CBEC.</td>
</tr>
<tr>
<td>Distribution of CENVAT Credit by</td>
<td>The amendment in CENVAT Credit Rules, 2004, w.e.f. April 1, 2012, to provide for liability for payment on removal of capital goods, whether as capital goods (on the basis of depreciation at the rate of 2.5 per cent per quarter), or as waste and scrap, whichever was higher, was causing hardship to assessees as the amended rules assumed a shelf life of 10 years for capital goods that often tended to have a shorter shelf life. Industry suggested that the reversal of input tax credit should be based on the transaction value of the scrap or waste. The CBEC may come out with an amendment to take the transaction value as the base, keeping in view the rationale for the 2012 amendment.</td>
<td>An amendment has been carried out vide Notification No. 12/2013-CE(NT) dated September 27, 2013, allowing reversal of credit on transaction value basis if capital goods are cleared as waste and scrap. An amendment has been carried out vide Notification No. 12/2013-CE(NT) dated September 27, 2013, allowing reversal of credit on transaction value basis if capital goods are cleared as waste and scrap.</td>
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<td>The industry represented that the amendment in Rule 7 of the CENVAT Credit Rules in 2012 was to have been placed in</td>
<td>A draft amendment in the rule to mitigate the problem was to have been placed in</td>
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<td><strong>Input Service Distributor</strong></td>
<td>imposing additional conditions in relation to the distribution of credit led to practical difficulties and errors, which in turn, would result in undue disputes and litigation with the Department. They suggested that CENVAT Credit Rules 2004 should be amended appropriately to allow distribution of eligible input credit of service tax by input service distributors to any unit of an entity as long as the unit to which credit is getting distributed is manufacturing dutiable goods or providing taxable output services.</td>
<td>the public domain by December 17, 2013, seeking comments of stakeholders within 10 days. The amendment was finalised by December 31, 2013 and, Notification No. 5/2014 was issued.</td>
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<tr>
<td><strong>Applicability of service tax on financial dealings (cash calls and reimbursements/allocations of overhead costs) between unincorporated joint ventures (UJV)/Associations of Person (AOP) and their members</strong></td>
<td>The issue is whether transactions between the UJV and its members that are purely in the nature of funding arrangements/capital contribution or recovery from its members of proportionate expenses incurred by UJV should be subject to service tax. Service tax should be charged on that component only if there is an element of commission retained by the lead operator. Otherwise, the operator is merely a conduit without any value added at his level, and no service tax should be charged.</td>
<td>It should be analysed as to why a UJV was being formed if there was no service involved. In pure financial dealings such as cash calls and reimbursements, there may not be a service component but for others, there may be. This is fact dependent and it will be difficult to issue a general guideline in this matter.</td>
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<tr>
<td><strong>Service tax on capital grants to Project Support Fund and revenue share paid to the sponsoring authority</strong></td>
<td>In order to support the development of an unviable project (for example in a backward area), the sponsoring authority (say NHAI) pays into a fund called the Project Support Fund. This was not towards provision of any service and should not be chargeable to service tax. Similarly, according to the terms of</td>
<td>There should not be any service tax on Project Support Fund or viability gap funding. Suitable clarification should be issued on this aspect. The issue of revenue share should be further analysed</td>
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<tr>
<td><strong>Cascading of Service Tax for Brand Owners when manufacture is by job-workers</strong></td>
<td>the concession agreement in respect of infrastructure projects, the concessionaire is required to pay negative grants/revenue share to the sponsoring authority, which was also not towards the provision of any service. The twin issues should be analysed after inputs from the field and suitable clarification issued regarding chargeability of service tax on the Project Support Fund and Negative Grants.</td>
<td>for issue of a suitable clarification.</td>
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<td>In the case of Brand Owners who employ job-workers exclusively for manufacture of goods, the benefit of CENVAT credit pertaining to raw materials and capital goods is available to the assessee irrespective of whether manufacture is in-house or at job worker premises. However, the benefit of service tax credit is available only if the manufacture is at the assessee’s own unit. This happens because payments for taxable input services are generally effected by the Brand Owner instead of the job-worker. Therefore, the benefit of service tax credit is not available. The Brand Owner cannot avail the credit since he is not the manufacturer and the manufacturer, i.e., the job-worker, cannot avail the credit since he does not pay for the taxable input service. This being an anomaly leading to differential treatment for tax credit for input services as against for raw materials and capital goods inputs, the CBEC may examine the feasibility of a mechanism for</td>
<td>It may be difficult to issue a clarification in the matter.</td>
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<td>Deemed Credit on non-excisable steel scrap</td>
<td>Industry informed that until 1987, deemed credit was available for iron and steel products but was later withdrawn, perhaps because of some misuse. No steel scrap can be available in the market without the basic material having being earlier subjected to excise duty and it was requested that deemed credit may be allowed on scrap being generated out of non-excisable units such as in the cycle and sewing machine industry, SSI units and units located in tax free zones on the presumption that the steel used by them is already duty paid. Given the smallness of the industry units, CBEC may consider providing abatement in the form of deemed credit. To prevent misuse, deemed credit could be allowed only on scrap coming out of a registered unit.</td>
<td>The mechanism for deemed credit should be simple. Industry had suggested 20 per cent cash payment, which appeared to be low. An appropriate rate should be agreed with the industry after adequate analysis and thereafter it may be implemented on trial basis for six months.</td>
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<tr>
<td>Valuation rules for interrelated/interconnected units</td>
<td>The furnace industry stated that interrelated/interconnected units were being asked to pay excise duty on cost of production + 10 per cent, thereby resulting in assessable value being much higher than the market value. It was argued that this industry does not have a 10 per cent rate of return and the high assessable value resulted in unutilised CENVAT credit in the books of their downstream units.</td>
<td>The matter may be appropriately analysed to ascertain whether the claim of accumulation of credit was correct. If found correct, it needs to be suitably addressed.</td>
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### Chapter XI

The next Union Budget. In this way, while administrative issues as well as administrative matters should be
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The above table shows that the Tax Forum process was very useful in resolving many long-standing tax disputes and obstacles faced by the industry in a quick and focussed manner. The fair and transparent process adopted by the forum to resolve tax disputes was highly appreciated by industry. The independent status of the forum, chaired by the Adviser to the then Finance Minister, gave it the desired credibility and neutrality. This was reflected by the flood of requests received

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<tr>
<td>Availing CENVAT credit in case of reimbursement of motor/health claims</td>
<td>CBEC may examine the rationale for adding 10 per cent to the cost of production in case of interrelated units and carry out appropriate analysis to calibrate the percentage to be added to cost of production depending upon the value addition in different sectors.</td>
<td>The issue has merit and needs to be further analysed, particularly in cases where the insurance company has actually paid the claim inclusive of service tax.</td>
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<tr>
<td>The treatment for availing of credit by insurance companies was inconsistent in the case of reimbursement of motor/health claims because of two modes for settlement of claims. While CENVAT credit was being allowed to service tax paid on payments of claims through ‘cashless facility’ between the insurance company and service providers, the same was not being allowed when amounts were directly settled by the insured with garages/hospitals and later reimbursed to the insured by the insurance companies. An examination of international practices in this regard reveals that Australia, New Zealand, Singapore and South Africa levy VAT on insurers on their value added, i.e., the difference between the premium received and the claim paid. CBEC may analyse the issue and come out with a clarification.</td>
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The recommendations on administrative matters made by the body should be taken up immediately within a time frame, such recom

sent to the two Boards for consideration and comments within a specific time frame, say a

The recommendations on policy issues received throughout the year should normally get due i

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The treatment for availing of credit by insurance companies was inconsistent in the case of reimbursement of motor/health claims because of two modes for settlement of claims. While CENVAT credit was being allowed to service tax paid on payments of claims through ‘cashless facility’ between the insurance company and service providers, the same was not being allowed when amounts were directly settled by the insured with garages/hospitals and later reimbursed to the insured by the insurance companies. An examination of international practices in this regard reveals that Australia, New Zealand, Singapore and South Africa levy VAT on insurers on their value added, i.e., the difference between the premium received and the claim paid. CBEC may analyse the issue and come out with a clarification.

The issue has merit and needs to be further analysed, particularly in cases where the insurance company has actually paid the claim inclusive of service tax.
from industry groups for meetings with the forum. Many requests could not be taken up by the forum and the list of such requests was forwarded to the two Boards. It is hoped that the issues represented therein would have been analysed and resolved by the two Boards. At least, a body such as the Tax Forum should be immediately revived and the process of problem solving should be re-instated as a support mechanism for enhanced voluntary compliance through improved relations with tax payers.

The forum process highlights the need and importance of analysis, particularly in matters related to tax issues and disputes. The TARC, therefore, recommends the constitution of a permanent body for analysis of tax related issues and tax related disputes along the lines of the Tax Forum. The permanent body should, as in the case of Tax Forum, take up issues related to industry sectors and not consider individual cases of taxpayers. This body, like the Tax Forum, should be chaired by an independent person and may have representatives from the TPL and TRU divisions of the two Boards. Later, when the Boards are restructured and the Governing Council and Tax Council are constituted, this permanent body for analysis of tax issues could be internalised in such councils.

As opposed to the Tax Forum, which considered only administrative issues, the permanent body for analysis of tax issues should consider administrative as well as policy matters. Recommendations of this permanent body on policy as well as administrative matters should be sent to the two Boards for consideration and comments within a specific time frame, say a maximum of three months. In case the response of the Boards is not received within the specified time frame, such recommendation may be placed before the Finance Minister for consideration.

The recommendations on administrative matters made by the body should be taken up immediately for resolution through the issue of requisite clarifications, circulars, changes in procedures, etc. On the other hand, recommendations on policy issues received throughout the year should normally be clubbed to be incorporated in the next Union Budget. In this way, while administrative issues would be tackled and resolved on a continuous basis, the policy issues will also be simultaneously taken up and analysed by the respective policy wings throughout the year. This will avoid the last minute flood of suggestions for policy changes at the time of the budget, many of which do not get due importance due to paucity of time. The body may also recommend mid-year amendment on an issue causing significant obstacles to economic activity that cannot be postponed until the Union Budget is presented and where urgent intervention of government is required for amendment in law.

**XI.6 Summing up**

Broadening and widening of the tax base and taxpayer base is a strategic objective for tax administrations. The growth of potential tax payers under all taxes has been phenomenal and there is a huge gap between the potential and existing tax and taxpayer base. Major contributors to the low tax base are the large scale cash economy comprising mainly the unorganised sector, high net worth individuals, and small businesses. An important factor that influences attitude towards tax payment is the perception that the tax system is complicated and not taxpayer friendly. The other
factors are the multitude of tax exemptions and incentives, slack enforcement and a poor tax climate characterised by absence of trust between the administration and the taxpayer, inadequate customer focus leading to weak awareness of compliance requirements and a negative tax culture.

To address this, the TARC has identified various measures like simplification of laws and procedures; extension of the scope of presumptive taxation and tax deduction at source; creation of a separate cell for HNWIs in the compliance vertical; use of cluster analysis; carrying out surveys based on growth trends, lifestyles, expenditure, etc.; structured sharing of information and matching; data mining, developing analytics amongst others. This will require the tax administration to create and sustain a much higher multi-disciplinary analytical and technological capability that should be leveraged by co-operative and joint working by the direct and indirect tax administration.

These also need to be accompanied by the creation of a conducive environment for voluntary compliance, mutual trust and improved organisational ethos in tax administration. Needless to say, strong political will is a must for these measures to result in positive outcomes.

XI.7 Recommendations

i) Number of taxpayers

a) There has been a gradual increase in the number of non-corporate taxpayers for the categories Rs.2 lakh-Rs.5 lakh and Rs.5 lakh-Rs.10 lakh over the period FY2007-12 but only a moderate fluctuation in the category below Rs.2 lakh over the same period. The department should ascertain the reasons by analysing the data it is collecting and use the results to enhance the expansion of tax payer base. (Section XI.2.g)

b) There is a gap in the number of corporate tax payers registered with the I-T department vis-à-vis the number of working companies registered with the Registrar of Companies (ROC), even though all of them are legally required to file returns mandatorily. The department should pursue this lead to identify corporates that are registered but have not filed returns. (Section XI.2.g)

c) Only 33 per cent of registered persons under service tax filed returns in FY2012-13 and the number fell short of the previous year’s figure by approximately 1 lakh. The CBEC needs to have this investigated and follow up with appropriate analysis for corrective action. It is well known that the unanticipated introduction of the “negative list” in service tax has caused intense ire among taxpayers. Is it this that has had an impact on the number of filers of service tax returns? A quick yet comprehensive survey is of the essence. (Section XI.2.g)

d) More than 50 per cent of registered central excise taxpayers are not filing returns. Hence, a mechanism needs to be put in place to ensure the filing of returns by all registered taxpayers. The CBEC should investigate and analyse why the percentage of returns filed is so low.
The tax base is not commensurate with the growth in both corporate and individual incomes in recent years that reflect the growth in the economy. An effective mechanism for collecting information from varied sources should be put in place to identify potential taxpayers and bring them into the tax net, broadening the tax base. (Section XI.2.g)

f) The number of tax payers should be considerably more than it is at present. (Section XI.2.g)

g) The number of income taxpayers should be doubled, from slightly more than 3 crore to 6 crore in three years, which would entail commensurate staff and financial resources to administer them. (Section XI.2.g)

h) The CBDT should comprehensively identify reasons for the widening gap between PAN card holders and actual number of taxpayers as also between number of entities to whom TAN has been allotted via-a-vis number of deductors filing TDS returns. The result obtained should be used to enhance the taxpayer base. (Section XI.2.g)

i) The compliance system should be made simple and more user friendly to encourage voluntary compliance, thereby broadening the tax base. (Section XI.2.g)

**ii) Collection, dissemination and effective use**

j) There is at present no structured mechanism for matching PAN with non-PAN data. More data based investigation is required to develop such a mechanism as this would contribute to deepening and widening of the tax base. (Section XI.3.a)

**iii) Tax deducted at source (TDS)**

k) TDS leaves an audit trail that acts as a deterrent to tax evasion and in early collection of tax as soon as a transaction takes place. It is a non-intrusive method of expanding the base. Regular monitoring of the tax deduction transactions should be made and compared with the tax return data to identify whether deductees file tax returns. (Section XI.5.j)

l) TDS deductors must file the TDS returns on time, each quarter and must include the details of name of the deductees, their PAN and amount of transaction. (Section XI.5.j)

m) TDS coverage should be expanded to capture more and more transactions, especially those that involve large amounts of cash but remain outside the tax net. (Section XI.5.j)

n) The taxpayer base may not necessarily increase merely by introduction of TDS unless deductees and deductors file correct returns. To ensure that correct returns are filed, TDS needs to be supplemented by enhanced enforcement methods. (Section XI.5.j)
iv) **Fringe benefit tax (FBT)**

- Reintroducing FBT would be an effective measure to widen the direct tax base, while doing so no distinction, as was being made earlier, be kept for the levy. This is a good temporary administrative measure for enhancing tax collection. This is a good temporary administrative measure for enhancing tax collection, until rising income tax collection makes it unnecessary. (Section XI.3.j)

v) **Banking cash transaction tax (BCTT)**

- There is no instrument at present that captures details of cash withdrawals from bank accounts, other than savings accounts. The availability of such information would help the I-T department widen its information base on the use of black money since excessive cash withdrawal can help it understand the extent of the cash economy. Hence, Rule 114E of the I-T Act should be suitably revised to include in its ambit cash withdrawals exceeding specified amounts in a day from bank accounts other than savings accounts. Alternatively, BCTT should be reinstated as an effective administrative measure. (Section XI.3.g)

vi) **Presumptive taxation**

- There is still a large number of individuals in businesses, trade, services and professions, (especially in the unorganised informal sector and sectors where large scale transactions take place in cash) who are outside the tax net. Therefore, the presumptive profit estimation scheme should be reviewed based on appropriate analysis and its scope enlarged. (Section XI.3.i)

- Many small businesses in the informal economy elude the tax net and remain untaxed. For these groups, the tax administration should design, promote, and establish simple, optional presumptive tax schemes, including those based on turnover or a compounding (turnover) basis, in service tax below a threshold. (Section XI.5.b)

- Since there is some scope for presumptive taxation in the I-T Act, which is applicable to only some business sectors with a turnover below a threshold limit, data mining remains crucial for analysis based strategies to examine if its scope should be expanded. (Section XI.5.b)

- The presumptive taxation scheme should be backed by taxpayer education programmes to bring taxpayers up to the point at which they can enter the regular tax system. This should be an important goal of the scheme. (Section XI.5.b)

- In the ultimate analysis, under no circumstance should a taxpayer be allowed to hide for his entire productive life as a non-filer or in the comforting embrace of an unduly favourable presumptive taxation system. Progressive assimilation should be not only through education, but also through increased risk perception regarding the likelihood of penalties being imposed. (Section XI.5.a)
v) It is equally important to ensure that large and medium enterprises which are in the normal system or should be there should not be allowed to migrate into the simplified system to avoid paying tax. (Section XI.5.a)

w) An effective method to monitor small enterprises that opt for presumptive taxation would be to insist on their filing declaration of their accounts annually and it should be made mandatory for them to issue sales/service bill for each transaction, with a serial number in a financial year. (Section XI.5.a)

vii) Small and medium-sized enterprises (SMEs)

x) High tax rates, the inability to understand a complex tax system and procedures, and lack of confidence in government efficiency in the use of revenues are added reasons for low voluntary compliance. Therefore, tax administration measures to improve SMEs tax compliance should include

- quick and easy processes for registration and PAN issuance
- clear and easily available information on tax registration, filing and payment obligations and procedures, and a turnover based regime
- targeted risk selection and audit activities taking into account the specific characteristics of different groups of SMEs
- once compliance behaviour is understood, raising compliance is likely to again call for simplified returns, with simple profit and loss statement and simplified capital allowance so that whichever SME is selected, their audit remains fair and transparent and not prone to disputes
- setting up of at least 8 call centres for responding to, and resolving basic queries and
- visit by specialised officers in a group for SME support. (Section XI.5.b)

viii) Retail sector

y) Unorganised retailers often have a tendency not to pay taxes and most are not even registered for VAT at the state level or income tax and service tax at the central level. There is a distinct aversion to paying taxes. A conducive environment and tax culture should be created to encourage them to pay their tax dues voluntarily. (Section XI.5.d)

z) By encouraging small traders to use debit cards more extensively, by not only explaining to them their benefit but also increasing the per day cash withdrawal limit from ATM machines, they could be attracted to enter the organised sector. That would leave an audit trail of transactions undertaken by them, which could be leveraged for widening the taxpayer base. (Section XI.5.d)
aa) The small retail traders could be encouraged to enter the banking network by providing the facility of fast tracking applications for educational and housing loans once he is categorised as a tax payer. (Section XI.5.d)

ix) Agriculture income

bb) Large farmers should be brought into the tax net. Against a tax free limit of Rs.5 lakhs on agricultural income, farmers having income above much higher threshold income, such as Rs. 50 lakh, could be taxed. This will broaden the taxpayer base. (Section XI.5.e)

dx) Cash economy

cc) The cash economy is a major problem in the Indian economic system as large scale transactions reportedly take place in cash, especially in land dealings and the construction sector. A non-intrusive verification system should be designed so that more cases of capital gains liability are detected. (Section XI.5.c)

dd) Certain measures should be put in place to discourage cash transactions. For example, municipalities should be encouraged to bridge the gap between the circle rate that is used by them for property valuation for tax imposition, and the market value of properties (even allowing for a lower property tax rate), and increase the digital footprint of transactions. Mandatory mention of PAN should be made more prevalent, backed by robust information exchange between tax authorities and banks and other financial institutions (as detailed in Chapter IX of the TARC report) and the adoption of a common business identification number (CBIN). Indeed, the PAN should be used as a CBIN as recommended in Chapter VI of the TARC report. (Section XI.5.c)

ee) There is a need to develop better assessment of the underground economy both in terms of its size and the economic and behavioural factors that motivate the players in that economy. There is no recent study on the issue. Therefore, there is an urgent need to promote research in this area within the expanded, analysis-oriented Knowledge, Analysis and Intelligence Centre (KAIC) as recommended in Chapter III of the TARC report. That would provide much needed insight into the functioning of the black economy and how to harness it with appropriate revenue yielding administrative measures. (Section XI.5.b)

xi) Services sector

ff) The services sector has been growing over the years but has not been taxed in an optimal manner due to the tax administration’s incapacity to determine the actual potential of individuals working in these sectors, as well as over estimation and obvious errors in estimation in some sectors. The tax administration needs to be fully equipped with data and understanding of the business processes to be able to work out the correct business volumes, expenses, receipts and profitability of the business sector being reviewed in conjunction with information gathered from, and consultations with, chambers of industry and commerce. These parameters should also be well documented and circulated so that the taxpayer has a fair idea about
parameters used to determine his tax liability. This will curtail the discretion of the tax administration and increase the transparency of implementation of tax laws in question. (Section XI.5.j)

**xii) High net worth individuals (HNWI)**

gg) Wealth tax base can be increased by including intangible financial assets in the base while considerably raising the threshold and decreasing the wealth tax rate. (Section XI.5.g)

hh) Following international practices, the CBDT should also exclusively focus on HNWIs. Administratively there is need for a separate cell for HNWIs with a view to improving the understanding of different customer needs and behaviours in order to respond to them appropriately, assisting them to get their affairs right and pursuing those who bend or break the rules. (Section XI.5.g)

**xiii) Special tax treatments (exemptions/incentives/deductions)/Tax expenditure**

ii) There should be a comprehensive review of exemptions. Both the Boards should consider measures to phase out unwarranted tax exemptions that continue in the form of various tax preferences. (Section XI.2.e)

jj) The CBEC should endeavour to analyse the outcomes of central excise exemptions and make the analysis available to the public. (Section XI.2.e)

kk) For service tax, the CBEC should consider ways to estimate revenue foregone and do a gap analysis. (Section XI.2.e)

ll) Specific economic parameters like growth rates of specific sectors, and growth of businesses and households should be identified and analysed for increasing the taxpayer base. The economic parameters, once selected, should be periodically verified, improved and modified. Schemes based on specific economic parameters should never be dropped midway without a critical evaluation of the effectiveness of the parameters selected and possible modification to suit revenue needs. Broad parameters should be narrowed down into more specific ones as experience in parameter analytics is gathered and consolidated. (Section XI.5.h)

mm) Exemptions/deductions based on area and industry should be minimised, if not done away with. If at all, investment incentives could receive a tax preference since they directly affect growth; even such incentives should be for a specific period of time and a sunset clause should be introduced to ensure a review of the benefit arising from a lower rate of tax or development of an industry/area. For all other categories, including SSIs, every attempt should be made to reduce tax preferences even if the likelihood of success in curbing the incentives may be expected to remain low. (Section XI.5.h)

nn) The “reverse charge” mechanism for the service causes many tax payer complaints. Its reform may bring a sizable number of potential taxpayers under the service tax net. (Section XI.5.h)
oo) There needs to be greater clarity on the coverage under various categories of services by way of illustrations. This should not only be customer focused, but should facilitate widening of the base under service tax. (Section XI.5.h)

pp) A comprehensive review of exemptions is needed to deepen and widen the tax base. In service tax particularly, an urgent study is needed on the impact of the implementation of the negative list to help develop a clear roadmap towards rationalising it by reducing the taxpayer distress that it has caused, and is continuing to cause. (Section XI.5.h)

xiv) Survey, search and seizure

qq) Surveys and technology based information and intelligence systems should be used to identify potential taxpayers. Action needs to be taken jointly by the direct and indirect tax administrations in an integrated and co-ordinated manner to get better results. Databases of different agencies like the Medical Council of India and AADHAAR should be used to locate non-filers and stop filers. (Section XI.5.k)

rr) Surveys should be based on growth trend in sectors and industries especially clusters of business units known for use of undocumented and cash transactions; expenditure and opulent life style etc. Tax administration should develop/use software to zero in on such behavioural indicators. (Section XI.5.k)

ss) A combined survey effort with the states should also be considered with reference to the National Population Registry database available at the state level. (Section XI.5.k)

tt) Search and seizure mechanisms should be used in a co-ordinated manner in limited cases. To achieve better results information should be shared in a structured and integrated manner as discussed in detail in Chapter IX of the TARC report. (Section XI.5.k)

uu) Enforcement should be strengthened to heighten the perception of the risk of being caught and of penalty for non-compliance being high. (Section XI.5.k)

vv) Anti-avoidance provisions should be incorporated in tax laws to be implemented with great care and sensitivity. (Section XI.5.k)

xv) Risk analysis

ww) Given international experience, risk analysis should be made more robust and continuously improved as detailed in Chapter XII of this report. (Section XI.5.i)

xvi) Tax amnesty

xx) Taxpayers keep waiting for amnesty schemes to be announced and take advantage of these schemes to build their capital. Amnesty schemes also cause inequity among taxpayers, and there is no proof that they improve taxpayer behaviour among evaders. They, therefore, should not be encouraged through amnesties. (Section XI.5.i)
**xxvii) Research and analysis**

yy) There is immediate need to set up an institutional mechanism to carry out research and analysis by the two Boards in various areas of tax administration. Thus, the setting up of KAIC is the most crucial at this point in time as a combined and consolidated instrument to analyse direct and indirect taxes. (Section XI.5.m)

zz) The TARC recommends that sanitised macro data on taxpayers, returns filed, tax collected, etc., should be made available in the public domain, so that research bodies are able to analyse them and provide their findings to the tax department from time-to-time. This will help in developing research input for decision making.

**xviii) Creation of tax culture and conducive environment**

aaa) Generating an environment and tax organisational ethos that encourages maximum voluntary compliance is the direction in which the two Boards should move. (Section XI.5.o)

**xix) Tax Forum**

bbb) A permanent body should be set to analyse procedural issues and solve them quickly, on an on-going basis. Analysis should consider administrative as well as policy obstacles. The recommendations of this permanent body on policy and administrative procedures should be sent to the Boards for consideration and comments within a specific time frame, say a maximum of 2-3 months. In case the response of the Boards is not received within the specified time frame, such recommendations may be placed directly before the Finance Minister for consideration. The operation of such a Tax Forum was extremely successful in the previous government, although it has not continued thereafter. Considering the extent of customer satisfaction it generated, it needs to be revived urgently. (Section XI.5.q)
CHAPTER XII

COMPLIANCE MANAGEMENT
Chapter XII

Compliance Management

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Chapter XII
Compliance Management

XII.1 Introduction

Tax compliance can be defined as the ‘degree to which a taxpayer complies (or fails to comply) with the tax rules’ of his country. The term compliance covers a range of activities that are favourable to the tax administration of a country. Compliance by taxpayers implies compliance with all statutory obligations specified in tax law, including registration, maintaining required records, timely filing of returns (filing compliance), reporting tax returns correctly and accurately (reporting compliance) and paying taxes correctly and on time (payment compliance).

Tax administrations have a fundamental role and a vested interest in ensuring that taxpayers understand their obligations under different tax laws. For their part, taxpayers have an important role to play in meeting their obligations because in many situations, it is only the taxpayers who are in a position to know their obligations under the law. While the exact obligations placed on a taxpayer vary depending on the type of tax involved (such as income tax, customs duty etc.) and the segment they fall in (large, medium, small, individual taxpayers), some broad categories of obligations are likely to exist for almost all taxpayers, irrespective of these criteria. ‘Compliance’ is essentially related to the extent to which a taxpayer meets these obligations. If taxpayers fail to meet any of these obligations, they could be considered non-compliant. Non-compliance is a result of the actions of taxpayers themselves, caused by ignorance, carelessness or deliberate action (evasion) or inaction (non-filing), or due to inherent weaknesses in the tax administration.

Historically, these failures or instances of non-compliance were addressed primarily in terms of enforcement through an audit-based or investigation-based approach. While audit remains a fundamental and necessary approach to addressing non-compliance, there has been wide recognition that factors that influence compliance among taxpayers are unlikely to be addressed successfully by a single action strategy based solely on verification and enforcement actions. It is equally important to realise that there are different degrees of non-compliance and that all tax administrations possess a finite level of resources, which are invariably short of what is required to ensure full compliance from all taxpayers.

Impelled by the recognition of such factors, all good tax administrations have made the transition from the traditional administrative and enforcement dominated approach to a more sophisticated and holistic compliance management philosophy that lies at the heart of their reform. It also enables them manage their tasks in ways that sustain the confidence of the people in the tax administration and demonstrates that the system is operating correctly.
The major strands of tax system reform across the world, as noted in Chapters II, III, VI and VII of the Tax Administration Reform Commission (TARC) Report, are (a) revamp of their governance (b) adoption of the principle of self-assessment coupled with a strong emphasis on promotion of voluntary compliance, (c) a sharp enhancement of customer focus, (d) organisational restructuring along functional lines (e) streamlining of processes and (f) high investment in information and communication technology (ICT), and research and analysis. All of these are essential ingredients of a holistic and effective compliance management framework.

Compliance management is by no means a straightforward proposition. Intertwined with resource allocation decisions are issues of deciding priorities for compliance strategies, a robust assessment of the major risks involved, the taxpayers these risks relate to and how these risks should be treated to achieve the best possible outcome. The answers to these questions are complicated by the rapidly changing business environment, the diversity of taxpayers’ compliance behaviours, the factors that underpin such behaviour, the complexity of many taxpayers’ tax affairs and numerous other influences. Compliance management strategies need to provide a graduated response to compliance behaviour – making it easy for those who want to comply and applying credible enforcement to those who do not.

It is important, therefore, for tax administrations to design a structured and systematic process for deciding what is important in a compliance management context and how major compliance risks will be identified and addressed. Tax administrations should design their compliance management framework in a way that assists senior officials in answering these questions in a comprehensive and justifiable way. In formal terms, compliance management is a structured process for the systematic identification, assessment, ranking and treatment of tax compliance risks (for example, failure to register, failure to properly report tax liabilities and pay the taxes due on time, etc).

Compliance management involves the optimal use and application of appropriate tools and strategies to address different types of non-compliance keeping in mind the limited resources in the hands of tax administrations. Tax administrations must have at their disposal the tools to permit them to impose sanctions upon taxpayers for non-compliant behaviour. Taxpayers respond better to compliance efforts if they perceive that they have received procedural justice. In other words, they respond better when they perceive that they have been treated fairly by the tax administration and can accept that the tax administration has the power to take the course of action that it has. Applying the model of compliance is consistently and appropriately represents a significant step towards demonstrating procedural justice and, in turn, building community confidence. While softer measures should be applied to address taxpayers who are voluntarily willing to comply (willing to do the right thing and those who try but are not always successful due to factors such as complex laws, insufficient access to tax agents, etc.), slightly stricter measures such as reminders and alerts should be applied to those who do not want to comply but would, if the tax administration is attentive towards them. The threat or fear of enforcement action by the tax administration should be enough to encourage this category of taxpayers. Tax administration should apply their enforcement actions and efforts towards those taxpayers who are entirely
unwilling to comply, such as habitual tax evaders. Compliance is most likely to be optimal when
tax administrations pursue a citizen-inclusive approach to compliance through policies that
courage dialogue and persuasion, combined with an effective mix of incentives and sanctions.

The idea of voluntary compliance is allied to a self-assessment tax system, like the one prevalent
in India. It means that the tax administration does not compute the liabilities of taxpayers in the
first instance. Instead, taxpayers have to determine their own liabilities, file returns reflecting those
liabilities on the proper forms and settle the liabilities by specific dates. However, even in a tax
system that relies largely on voluntary compliance, the tax authorities are not naive in any way.
When required, they use their sovereign power to ensure tax compliance and enforce tax laws
through audits, penalties, interest charges and a number of other collection tools.

XII.2 Current status

In Chapters III and IV of the TARC report, the current structures and the basic processes adopted
by the Central Board of Direct Taxes (CBDT) and Central Board of Excise and Customs (CBEC)
were described. As noted there, the organisational structures are currently predominantly
geographical and there is absence of adequate functional specialisation. The human resource (HR)
policies adopted by the two Boards – the CBDT and CBEC – are also generalist in their orientation
and are not geared to advancing the cause of greater specialisation in key areas, competency
building and professionalism in tax administrators.

Although the promotion of voluntary compliance is the stated goal of both the direct and indirect
tax administrations, there is a basic absence of trust in the taxpayer, inadequate emphasis on the
creation of a taxpayer friendly culture and providing comprehensive and reliable guidance on
compliance to taxpayers. The tax administration is, by and large, perceived to be unfriendly
towards the taxpayer. While the Vision and strategy documents of both the Boards espouse lofty
ideals, the actual taxpayer experience is at wide variance with these ideals and shows a gulf
between what is professed and actual practice.

The present state can be attributed largely to the general revenue maximising strategy prevalent in
the two Boards, coupled with the near total absence of customer focus. In this respect, the Indian
tax administration seems to be placing itself at a large distance from international best practices.

The other key aspect that differentiates the Indian tax administration from its best international
peers is the absence of an evolved, comprehensive and clearly articulated compliance risk
management framework that is aimed at maximising voluntary compliance and minimising the tax
gap. We will deal with some of these issues in the next section.

The next section contains a quick review of four important limbs of compliance management that
are particularly important in the Indian context, namely, customer focus, compliance verification,
dispute management and compliance risk management.
XII.2.a Customer focus

i) Making understanding of compliance easy

As mentioned in Section VII.3 of Chapter VII of the TARC Report, both the CBDT and CBEC have information portals that put out information about laws, regulations, downloadable taxpayer information booklets etc. However, the questions that need to be asked are if they are user friendly, if the information can be accessed quickly and comfortably, and if there is a reliable content management process in place to ensure that the websites are updated in a manner that would allow the users to rely on them completely. The answers to these questions would reveal the scope that exists to enrich the websites continuously to improve customer experience.

Apart from the Authority for Advance Rulings (AAR)\textsuperscript{231} to provide binding rulings on certain income tax issues or issues under indirect tax laws arising out of a transaction/proposed transaction, the only other mechanism to provide a degree of certainty to taxpayers are the clarificatory circulars issued by the two Boards on contentious issues. Currently, there is a high degree of uncertainty in the application of tax laws as the interpretation is largely left to the assessing officers in the field, with little guidance being provided, and they may make differing interpretations. As the TARC noted in Section V.4.b of Chapter V of the TARC Report, there is very little proactive use of the statutory provisions (Section 37B of the Central Excise Act, 1944 for Central Excise and Service Tax, Section 151A of the Customs Act, 1962 for Customs and Section 119 of the Income Tax Act, 1961) that enable the two Boards to issue clarifications that bind the tax officers, in order to ensure consistency and nip avoidable disputes in the bud. This is illustrated by the data in Table 12.1 below, derived from the circulars published on the official websites.\textsuperscript{232} Circulars are issued by the two Boards from time to time to inform taxpayers and citizens about changes in laws and procedures, and to issue clarifications on legal provisions. However, there is a time lag in the issue of these circulars. The language used in these circulars is often complicated and full of legal jargon and the absence of explanatory notes makes it difficult for taxpayers to understand the circulars. At times, the circulars also tend to reproduce \textit{verbatim} the provisions of law leaving the question of interpretation open.

\begin{table}[h]
\centering
\begin{tabular}{|c|c|c|c|c|c|c|c|c|}
\hline
\textbf{Year} & \textbf{Income Tax} & \textbf{Central Excise} & \textbf{Customs} & \textbf{Service Tax} & \textbf{Customs} & \textbf{Central Excise} & \textbf{Income Tax} & \textbf{Customs} & \textbf{Central Excise} & \textbf{Service Tax} \\
\hline
2014 & & & & & & & & & & \\
\hline
2013 & & & & & & & & & & \\
\hline
2012 & & & & & & & & & & \\
\hline
2011 & & & & & & & & & & \\
\hline
2010 & & & & & & & & & & \\
\hline
2009 & & & & & & & & & & \\
\hline
2008 & & & & & & & & & & \\
\hline
2007 & & & & & & & & & & \\
\hline
2006 & & & & & & & & & & \\
\hline
\end{tabular}
\caption{Circulars/Instructions/Order/Office Memoranda}
\end{table}

\footnote{AAR’s ruling is in the nature of a private ruling insofar as the ruling is applicable to the applicant taxpayer and is binding only on the facts of each ruling.}

\footnote{The data in the table include only those circulars, etc., that specifically invoke the respective provisions of the three Acts cited here. Hence, the actual number of clarificatory circulars could be a little higher than the numbers reflected in the table.}
Table 12.1: Circulars/instructions/orders/office memoranda issued from 2006 to 2014 in income tax, central excise, service tax and customs

<table>
<thead>
<tr>
<th>Number of Circulars/Instructions /Order/Office Memoranda</th>
<th>Income tax</th>
<th>Central excise</th>
<th>Customs</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>Nil</td>
<td>1</td>
<td>Nil</td>
</tr>
<tr>
<td>2007</td>
<td>2</td>
<td>1</td>
<td>Nil</td>
</tr>
<tr>
<td>2008</td>
<td>1</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>2009</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>2010</td>
<td>2</td>
<td>Nil</td>
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<td>1</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>2014</td>
<td>4</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Source: www.incometaxindia.gov.in and www.cbec.gov.in

As already mentioned in Appendix II.1 of Chapter II of the TARC Report, both the Boards bring out informative and topical advertisements in newspapers, television, radio, outdoor advertisements and SMS to coincide with deadlines for payment of taxes or filing of returns. Both the Boards’ websites are available in both English and Hindi. They also provide forms that can be downloaded together with instructions. The CBDT has made available tutorials on filing income-tax returns and tax deduction at source (TDS) statements, taxpayer information booklets and pamphlets on its website.

The CBEC’s Automation of Central Excise and Service Tax (ACES) website provides videos on learning management systems. E-learning videos are available on central excise and service tax including topics such as registration, returns, refunds, dispute resolution, provisional assessments, claims, intimations, permissions, etc. The CBDT’s five call centres and CBEC’s e-helpline facility also find mention in Appendix II.1 of Chapter II of the TARC Report. The main objective of the e-helpline is to provide help to taxpayers on issues relating to procedural delays and in addressing system related problems, including in the ACES and the Indian Customs EDI System (ICES). This has been discussed in Chapter VII.1.a of Chapter VII of the TARC Report. For taxpayers who might require help, the Directorate of Systems (DoS) has entered into Memoranda of Understanding (MOUs) with the Institute of Chartered Accountants, the Institute of Cost and Works Accountants and the Institute of Company Secretaries. Under the MOUs, members of the three institutes, who meet the standards specified by DoS and who are vetted by the Institutes, can set up certified facilitation centres (CFCs) to help taxpayers digitise paper returns and e-file them.
in ACES for a small fee. Over 1100 such CFCs have been set up across the country. This has been discussed in Section VII.1.a of Chapter VII of the TARC Report.

ii) Outreach and education

Outreach and education programmes such as the Tax Return Preparer (TRP) Scheme, taxpayer conferences and lounges at international trade fairs, children’s education programmes through visit to schools, Aayakar Seva Kendras (ASKs) asset up for single-point service delivery in each Income Tax (I-T) Department building have been discussed in detail in Appendix II.1 of Chapter II of the TARC Report. Similarly, the CBEC has set up facilitation centres in field offices. It had also taken initiatives to set up help desks in the premises of industry associations. This, however, was marked with hardly any success in terms of its utility to the taxpayers, as the machinery usually failed to meet their requirements for clarification and guidance.

iii) Co-ordination with partners and stakeholders

The stakeholder consultation on both direct and indirect taxes front is through advisory committees – separate central tax advisory committees and the regional tax advisory committees at the level of regional chief commissioners. The central committees formed for stakeholder consultations were formed for tax policy inputs, but the committees largely focus on administrative issues, and meet only occasionally. Apart from this, the regional committees at many places are found to be either not constituted or not functional. The CBDT also holds conferences from time to time with various trade associations. Similarly, the CBEC has trade facilitation committees functioning at both the commissioner and chief commissioner level. A tax forum was constituted by the Finance Ministry in 2013 to look into tax-related issues/disputes and served as a platform to hear the views of industry groups and associations. This has been treated in detail in Chapter XI of the TARC Report through a description of how the process was conducted since it has been quite successful and should be continued. Consultation with stakeholders as well as the tax forum has been discussed in detail in Section II.6.b of Chapter II of the TARC Report.

XII.2.b Provisions for voluntary compliance

An enabling legal framework for voluntary compliance has already been built into in all three indirect taxes statutes. Under Section 11A of the Central Excise Act, 1944, an opportunity is provided to a person chargeable with duty to pay duty that may have been short-levied or erroneously refunded along with the due interest, either on his own or by the central excise officer’s ascertainment before the issue of a notice. The person who has paid the duty along with interest can thereafter inform the proper officer of such payment in writing. Upon receipt of such information, the officer will not serve any notice in respect of the duty or interest so paid or levy any penalty on the same. Exceptions to the above mechanism for voluntary compliance find mention in Section 11A(4) and (5) where, in cases of fraud, collusion, etc., for which the details relating to the transaction are available in the specified record, the amount of penalty is reduced to 50 per cent of the duty leviable as opposed to 100 per cent in cases where the transactions are
completely unrecorded. Further, in Section 11A(6), if such duty and interest is paid before the
issue of notice, the penalty is reduced to 1 per cent of such duty per month from the due date, not
exceeding a maximum of 25 per cent. Section 73 and 78 of the Finance Act, 1994, relating to
service tax provide a similar mechanism for voluntary compliance with graded incentives. Section
28 of the Customs Act, 1962, also contains similar provisions for voluntary compliance with duty
reduction up to 25 per cent. General exceptions as mentioned above, however, are not available in
the Customs Act, 1962.

Similar provisions do not exist in the Income Tax Act, 1961. Section 139(5), however, gives the
taxpayer an opportunity to file a revised return stating the correct particulars if he discovers any
omission or any wrong statement in his return. The taxpayer can file this revised return any
time before the expiry of 1 year from the end of the relevant assessment year or before the
completion of assessment (whichever is earlier). Revision is allowed only if the mistake was
unintentional and cannot be claimed by a person who has filed fraudulent returns. There is also no
restriction on the number of times the return can be revised if it is done within the prescribed time
limit.

XII.2.c Compliance measurement

Currently, there are no formalised mechanisms that the CBDT or CBEC have adopted for
compliance measurement.

XII.2.d Taxpayer segmentation

Segmentation is only done on the basis of turnover. Although most evolved tax administrations
have utilised taxpayer segmentation based on different criteria to develop customised approaches
to meet the needs of each group, such taxpayer segmentation has not been done yet in either of the
two Boards. As discussed in Section II.5.c of Chapter II of the TARC Report, in line with best
practices, four large taxpayer units (LTUs) were set up to administer both direct as well as indirect
taxes. The progress of LTUs, however, has been far from satisfactory, as not many large taxpayers
have joined these LTUs. Besides, as noted in Section III.1 of Chapter III of the TARC Report,
LTUs have also not brought about the desired integration of even the common functions of the two
departments as they continue to function in separate silos within the LTUs.

As regards other taxpayers, other than the small-scale industry (SSI) sector on the indirect taxes
side, there is hardly any segmentation by size at present. On the direct taxes front, a degree of
segmentation exists based on the type of tax such as personal income tax (PIT), corporation tax,
trusts, etc. There are elements of segmentation in terms of functions such as international taxation
and transfer pricing cases in direct taxes. But, overall, the current Indian practice is rudimentary
in comparison with best international practices in the area of customer segmentation.
XII.2.e Compliance verification (Audit)

Audit is the primary tool used by tax administrations to verify compliance. The CBEC distinguishes the processes for review and correction of returns as well as risk-based scrutiny of returns from audit. The CBDT, on the other hand, relies primarily on the Computer Aided Selection System (CASS) based on a scrutiny of returns filed by taxpayers. The main difference between the two is that while in indirect taxes, audit refers to the verification that happens in the taxpayer’s business premises, there is no similar process on the direct taxes side and the scrutiny in done by the assessing officers in their offices. If any verification is to be done, surveys are conducted. But that is not the same process as audit in the CBEC. For the purposes of this report, the term audit refers to all processes conducted for the verification of compliance.

Audit in direct taxes

The present risk-based approach of identifying taxpayers, called CASS, is quantitative and is automated. Quantitative filters are run on the electronic database of tax returns to generate a list of scrutiny cases. Of late, inputs are being called from field officers either for ex-ante choice of the filter or ex-post appraisal of the efficacy of the choice of filters used for selecting scrutiny cases. The CASS normally picks up returns of income that have a high refund (say, Rs. 5 lakh and above), cases that have high introduction of capital, etc. The I-T Department also collects a large amount of information on taxpayers from third parties such as banks, property registry offices, insurance companies, through the mandatory Annual Information Return (AIR). These data also are used to match taxpayer’s data for audit purposes.

CASS provides for a centralised rule-based mechanism for selecting cases for scrutiny. Rules and parameters are reviewed and fine-tuned every year on the basis of suggestions received from field formations and reviews by a cross-functional committee. An analysis is also made of the addition in cases selected under CASS in previous years. Such analysis is done issue wise, form wise and location wise. Manual discretionary selection has been disallowed from 2013.

Despite such progress on objective and information-based audit selection, there have been complaints about the effectiveness and efficacy of CASS. Taxpayers complain that the same taxpayer, for some odd reason, is selected again and again. It has also been reported that the CASS parameters do not distinguish cases of re-investment in instruments like mutual funds, fixed deposits, etc., from fresh investment. The reason for selection could be as simple as the taxpayer having renewed an old fixed deposit in a bank, and the computer picks up that investment as a new one; or, it could be that somebody undertook a foreign trip and the computer picked up that data point as expenditure not commensurate with income, even though that expenditure was subsequently reimbursed by his/her employer. For these reasons, sometimes the assessing officers are less reverent about the CASS selected cases as the cases are often not the deserving ones. On the other hand, a large number of taxpayers, such as senior citizens including retired tax officers, executives, etc., have had to face the ignominy of needless and unjustified scrutiny repeatedly. Once again, this reflects insensitivity towards the taxpayer, coupled with a complete lack of
accountability in the functioning of systems, procedures and officers, including those at the top. This kind of harassment of taxpayers is unique to the Indian tax administration.

The CASS parameters, therefore, need to be reworked to recognise such cases of reinvestment so that a taxpayer is not unnecessarily harassed by the picking of the same case repeatedly and to avoid frittering away the resources of the tax administration.

Currently, there is no reliable risk analysis in the area of transfer pricing (TP), although the CBDT has recently made uploading of Form 3 CEB, which will enable proper risk analysis, mandatory. At present, there is mandatory scrutiny of cases involving international transaction above Rs.15 crore. The outcome is that India has by far more TP dispute cases as compared to other countries. Besides, because of the large workload generated by the mandatory selection, potentially riskier cases could be escaping the department’s attention.

Since CASS requires automated running of filters on an electronic database, any taxpayer who had filed a paper return and whose return has not been uploaded to the electronic database may escape the audit selection process. However, with increased e-filing, this risk would appear to have diminished considerably.

As can be seen from Table 12.2, huge tax demand is generated in the process of scrutiny of assessment, which does not result in any corresponding revenue gain. Only in a small number of cases does the department get favourable decisions from the ITAT.

Table 12.2: Disputed demand and collectible amount (corporate income tax and personal income tax)

<table>
<thead>
<tr>
<th>Financials</th>
<th>FY 2011-12</th>
<th>FY 2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Outstanding Demand</td>
<td>478,863</td>
<td>580,326</td>
</tr>
<tr>
<td>Net Collectible Demand</td>
<td>20,804</td>
<td>19,326</td>
</tr>
</tbody>
</table>

Source: Ministry of Finance (Budget Division), Annual Report 2013-14

In general, the scrutiny process followed in direct tax cases cannot be called an audit in the true sense of the term. The officers are keen to ensure that positions taken on various issues in earlier years are followed and that there is no possibility of adverse observations following revenue audit and inspection by senior authorities. In important areas such as corporate cases, international taxation and transfer pricing, the workload of an officer is huge due to which the time available for a case is very limited. Consequently, officers do not get sufficient time to examine facts, undertake proper comparative data analysis, identify tax evasion/avoidance, if any, and take the matter to a logical conclusion. They do not get time to visit premises of taxpayers, nor is there a
process to collect facts even if they doubt the veracity of facts submitted by taxpayers. The assessments undertaken are table-bound. There is no time, aptitude or encouragement from the system to go to the premises of taxpayers to verify facts.

The I-T Department is in the process of issuing request for proposals (RFPs) for its data warehouse project named ‘Project Insight’, which is intended to significantly enhance its non-intrusive compliance management as well as analytical capabilities.

They have also recently established a Directorate of Risk Management. However, it is in a nascent state at present. Its charter of responsibilities is yet to be defined and it is yet to be properly staffed.

Audit in indirect taxes

Central Excise and Service tax

It has to be recognised that there is a vast difference in the number of taxpayers handled by the CBDT and CBEC. Hence, there are bound to be differences in approach and performance. However, the implementation of GST will lead to a multi-fold increase in the taxpayer base to be handled by CBEC and these differences are likely to diminish. Internationally, the approach to compliance verification in both direct and indirect taxes has substantially converged and there is need for that trend to be reflected in India too.

The verification processes in the CBEC include the processes of preliminary scrutiny of returns (review and correction in ACES) and detailed risk-based scrutiny of returns, which are carried out by range officers in the field and audit of taxpayers that is carried out by officers of the audit wing.

There is a fairly robust process of audit in central excise and service tax terms EA 2000. The process entails risk-based audit selection, desk-based review and development of audit plan, execution of the plan, and subsequent evaluation and monitoring. As discussed below, however, it suffers from some drawbacks.

Currently, audit selection in the CBEC for central excise and service tax is a combination of mandatory audits and audit selected on the basis of certain risk parameters. All units paying revenue of more than Rs.3 crore are to be mandatorily audited every year. For other units, selection is to be made based on the rupee risk ratio, which broadly takes into account the relationship between the availing of input tax credit and duty payment through a personal ledger account (PLA). However, this risk assessment is quite simplistic, based on a single criterion, i.e., duty payment, as it does not take into account the differences between various different sectors of industry and different types of products. Risk factors are not identified on the basis of detailed analysis.

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233 EA 2000 refers to the re-engineered audit process introduced in central excise and service tax developed in the course of a project on capacity building in collaboration with Canadian Revenue Agency and Canadian International Development Agency.
As prescribed in the departmental manuals, the selection is required to be based on risk parameters – R1 (national level) and R2 (local level) – which are to be computed relying on data harnessed from ACES. There, however, is reported to be insufficient data to compute R1 and there are problems in accessing data to even compute R2. Hence, the selection is largely based on local parameters. Apart from this, even though mandatory units vary from 10 to 1000 in different commissionerates, the manpower available for audits remains more or less the same. The prescribed frequency of audits in central excise and service tax is given in Tables 12.3 and 12.4.

**Table 12.3: Frequency of audits in central excise**

<table>
<thead>
<tr>
<th>Category</th>
<th>Quantum of annual total duty payment (Cash+ CENVAT Credit)</th>
<th>Frequency of Audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Units paying more than Rs.3 crore</td>
<td>Every year</td>
</tr>
<tr>
<td>B</td>
<td>Units paying between Rs.1 crore and Rs.3 crore</td>
<td>Once every two years</td>
</tr>
<tr>
<td>C</td>
<td>Units paying between Rs.50 lakh and Rs.1 crore</td>
<td>Once every five years</td>
</tr>
<tr>
<td>D</td>
<td>Units paying below Rs.50 lakh</td>
<td>10 per cent of the units every year</td>
</tr>
</tbody>
</table>

**Table 12.4: Frequency of audits in service tax**

<table>
<thead>
<tr>
<th>Category</th>
<th>Quantum of annual total duty payment (Cash+ CENVAT Credit)</th>
<th>Frequency of Audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Units paying more than Rs.3 crore</td>
<td>Every year</td>
</tr>
<tr>
<td>B</td>
<td>Units paying between Rs.1 crore and Rs.3 crore</td>
<td>Once every two years</td>
</tr>
<tr>
<td>C</td>
<td>Units paying between Rs.25 lakh and Rs.1 crore</td>
<td>Once every five years</td>
</tr>
<tr>
<td>D</td>
<td>Units paying below Rs.25 lakh</td>
<td>2 per cent of the units every year</td>
</tr>
</tbody>
</table>

Incidentally, in a recent performance review of the CBEC in his compliance audit report 17 of 2013, the Comptroller and Auditor General (CAG) noted that that there had been a shortfall in the coverage of audit in respect of Category A and B units in both central excise and service tax in FY2011-12 with the shortfall in service tax being as high as 50 per cent. On the department’s comment that the shortfall was due to staff shortage, the report observes that the department can still make a difference through better risk management and careful planning of audit – a comment with which the TARC whole heartedly agrees. The report also noted that in excise, the coverage of category C and D was more than that specified in the norms. The TARC, however, was informed by the DG (Audit), CBEC, that the selection norms were being revised to include a wider range of parameters, risk scores derived from analysis of data and to factor in the availability of manpower.
The EA 2000 process for audit in central excise and service tax also requires that the audit parties are required to discuss the audit findings with the auditee, before finalisation of their reports. This is a good practice representing a modern element of customer focus.

DG (Audit) also undertakes quantitative and qualitative evaluation of the performance of audits by the commissionerates. The quantitative evaluation is through the Annual Performance Index in which quarterly and annual grading is done of the commissionerates based on various parameters such as audit detections/recoveries, productivity per audit, adherence to audit processes such as preparation of assessee master files, desk review, audit plan, verification, working papers, etc. Quantitative evaluation is done through quality assurance reviews (QARs) of the internal audit branches of the commissionerates in which 25 files are randomly selected for scrutiny and reviewed to ascertain the quality of the audit process in terms of due diligence and adherence to the audit procedure. On the basis of this review, commissionerates are graded as excellent, very good, good, average and below average. QARs are conducted to assess the quality of audits conducted by the service tax commissionerates as well as composite commissionerates administering both central excise and service tax. Commissionerates are graded into these categories on the basis of their conformity to the audit process. A Computer Assisted Audit Programme (CAAP) is also being implemented by the DG (Audit).

**Customs**

Based on the parameters set in it, the risk management system (RMS) identifies some bills of entry for detailed scrutiny after clearance of goods called post-clearance compliance verification (PCCV). It is also referred to as post-clearance audit. It is basically a transaction-based check and does not provide an opportunity to verify or scrutinise the correctness of declaration vis-à-vis the books of accounts and other documents over a period of time. The on-site post-clearance audit (OSPCA) was introduced in October 2011 to provide for a record-based audit at the premises of the importer/exporter.

The rationale behind the introduction of post-clearance audit in customs was to shift from physical controls to fiscal controls, reduce unnecessary pre-clearance intervention by customs in order to provide for faster clearance at the borders and increase the efficiency of the clearance process to reduce transactions costs for the trade. It was intended to align Indian customs with best international practices. However, as the TARC noted in Section VIII.4.e of Chapter VIII of its report, the situation on the ground has in fact regressed and not improved, with post-clearance audit pendency constantly increasing on the one hand, and the levels of pre-clearance interventions also increasing rather than decreasing. This is quite disappointing given the optimism with which the RMS was put in place in 2005.

**Reorganisation of audit**

One positive development that has taken place is the reorganisation of audit along functional lines and its separation from other functions. After the cadre restructuring, implemented in
October 2014, the audit function will be performed by separate audit commissionerates, numbering 45, including two exclusive LTU audit commissionerates. The establishment of a single function audit commissionerate is expected to bring greater depth of knowledge, cohesion, uniformity and specialisation in the sphere of audit.

The administrative structure of the audit commissionerates would now have uniformity across jurisdictions while ensuring effective reach to the taxpayer. Their headquarters will have separate sections for planning and co-ordination, risk management and quality assurance, one for personnel, administration and vigilance, and finally a section for technical/legal work and follow up. There will be functionally oriented circles covering the geographical jurisdiction of each executive commissionerate for the actual conduct of audit. Further, officers in audit have been legally empowered under three indirect tax statutes and have been granted co-terminus jurisdiction to ensure integrated audits in the context of exclusive commissionerates for central excise, service tax and OSPCA.

Two exclusive Audit Commissionerates have been created for the first time for LTUs:

- The Delhi LTU Audit Commissionerate has jurisdiction over assessees of the Delhi, Kolkata and Bangalore LTUs. Subordinate offices are in Kolkata and Bangalore
- The Mumbai LTU Audit Commissionerate has jurisdiction over assessees of the Mumbai and Chennai LTUs. The subordinate office is in Chennai.

It is not clear if the audit set up will be located in the LTU offices. If not, the purpose of customer focus is likely to be lost.

XII.2.f Enforcement

Enforcement activities are spearheaded by the DGs (Investigation) in the CBDT, by the Director General of Revenue Intelligence (DGRI) for customs and the Directorate General of Central Excise Intelligence (DGCEI) for central excise and service tax. The DGs (Investigation) are functionally separated from the field assessment and collection organisations in the case of income tax. In the CBEC, on the other hand, barring some preventive commissionerates in customs, enforcement activities are looked after by preventive and intelligence units in custom houses and the excise and service tax commissionerates. It is these units that handle the prosecution of offenders as well, barring those cases that are prosecuted by DGRI and DGCEI.

While these units report a large number of possible tax frauds, and indeed, in absolute terms the figures for detections might appear large, it needs to be remembered that the overall success rate f

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234 An audit commissionerate is headed by a Commissioner supported by two Additional/ Joint Commissioners, 10 AC/DCs, 50-80 Superintendents and 60-120 Inspectors. It will perform all functions relating to audit, up to and including the issue of demand notices arising from audits, the decision on such demands being taken in the executive commissionerates.
the departments in disputes is quite low as shown in Tables 5.4 and 5.11 in Chapter V of the TARC’s Report. These statistics also include a number of cases booked by the enforcement wings in the two Boards and as such can be said to reflect on the quality of those cases. The question that needs to engage the attention of the Boards is whether enforcement activities are able to create a credible deterrence against deliberate non-compliance. In the absence of any research by the two Boards on this aspect, it is difficult to arrive at a reliable answer. However, popular perception appears to be that there is an absence of fear in fraudulent business.

A recent CAG performance audit\(^2\) of the administration of penalty and prosecutions in the I-T department found inconsistent application of penalties. With regard to prosecutions, its findings were:

a) There were mismatches at every stage of selection, initiation, pursuance and disposal of cases as also at every level of monitoring and co-ordination. The CBDT has not ensured posting of appropriate officers to handle prosecution cases.

b) There were wide discrepancies in data on pending/disposed cases, calling into question the authenticity and reliability of prosecution data.

c) Physical verification of prosecution records, which could have streamlined record maintenance, *had also not been carried out since FY 2008*.

d) There were substantial delays in launching prosecution cases ranging from 5 to 48 years.

e) In respect of prosecution against the corporate sector, the CAG found that cases were being launched and pursued even where companies had already been liquidated or have been declared sick by the Board for Industrial and Financial Reconstruction (BIFR).

f) The CBDT is pursuing cases under repealed sections of the I-T Act, dead assesses, etc., resulting in wastage of resources. The CAG found that even after 11 years of the Supreme Court judgment and after 5 years of opinion from the Ministry of Law, 76 cases were still being pursued, frittering away valuable time and resources of the Income Tax Department (ITD).

g) The CBDT’s co-ordination and pursuance of cases in the courts was grossly inadequate as revealed by non-attendance/non-representation in court proceedings. The enforcement of the CBDT’s policy and procedures on prosecution counsels has not been effective. The CAG found that no prosecution counsel had been appointed at various stations, which has affected the pursuance of cases.

h) Poor record maintenance and delay in the production of evidence has led to the acquittal of assessee The cases purported to have been pending at the jurisdictional high court, as

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\(^2\) CAG’s Performance Audit Report No.18 of 2013.
evidenced from ITD’s records, had already reached finality and the courts had disposed of the cases.

i) Compounding of offences as a mechanism of alternate dispute resolution was not exercised to reduce litigation and realise due revenue. The CBDT’s litigation mechanism was not in consonance with the spirit of the National Litigation Policy, resulting in the clogging of the judicial machinery as also wastage of valuable departmental resources.

j) The application and pursuance of prosecution against individual assessees and low money value cases diluted the deterrent effect against systematically organised entities. The Central Economic Intelligence Bureau (CEIB) established for gathering, collation and dissemination of information among tax gathering agencies like the CBDT, CBEC, etc., has not worked in co-ordinated manner to arrest tax evasion.

The situation in the CBEC is not palpably different.

**XII.3  International best practices**

Tax administrations across the world are required to maximise the overall level of compliance with tax laws despite a resource constraint. This entails the development of a compliance management framework to ensure allocation of resources geared towards the achievement of the best possible outcomes in terms of raising the levels of compliance. Directly related to this is the critical issue of deciding the specific actions to be undertaken and how to prioritise these actions. Their strategies are centred on the promotion of voluntary compliance by effecting substantial improvement in the key dimensions of taxpayer services, compliance verification and enforcement. Their efforts are supported by significant investments in ICT.

**XII.3.a    Customer focus**

i) Reform and simplify tax law

Most tax administrations have taken a number of steps to identify simplification options that have resulted in the reduction of the compliance burden on taxpayers. These include improved drafting of laws, and establishing permanent bodies that have simplifying forms, processes and procedures as their main work. The simplification is achieved by publishing guidance for taxpayers from time to time, which enhances compliance by providing detailed substantive and procedural rules, introducing toolkits that provide guidance on areas of frequent error seen in returns and setting out the steps that can be taken by taxpayers or agents to reduce those errors, introducing pre-filled tax returns aided by technology, issuing rulings, etc.

ii) Fair treatment

To ensure that the level of taxpayer confidence is retained in the tax administration, a “service and client/customer” approach has been adopted by tax administrations that encourage trust rather than
a “cops and robbers” approach based on sanctions. Furthermore, tax administrations conduct extensive surveys of taxpayers to identify areas where improvement is needed so that those areas can be worked upon to alleviate taxpayer burden and enhance public confidence in the integrity of the tax system, appointed taxpayers’ Ombudsman that operate independently from the tax administrations and report on their working and incentivised compliance by honest and truthful taxpayers by rewarding them. Apart from this, in an effort to appear fair in their practices, a number of tax administrations have decided to significantly reduce the level of red tape so that human interface can be reduced and business can be conducted smoothly online.

iii) Communication

Tax administrations are now seen to be interacting with taxpayers keeping in mind the preferences of taxpayers. In addition to identifying and adapting to taxpayer needs, tax administrations now clearly communicate with taxpayers to reduce their compliance burden and as a result, reduce their own workload.

- **ICT Enabled communication**

By making greater use of new technology, tax administrations have become more agile and service-friendly through self-service and electronic-service taxpayer options available on their websites and on mobile devices, such as e-filing, online registrations, checking the status of refunds, webinars given by experienced tax officers to help taxpayers, tax professionals, organisations, businesses and government officials to gain clarity on a particular topic. Moreover, tax administrations have now moved beyond traditional channels of communication by making tax applications available on the mobile phones of taxpayers.

- **Non-ICT enabled communication**

Everything a tax administration does can resonate with taxpayers’ attitude about paying taxes. Therefore, even non-ICT-based communication deployed by tax administrations now consciously incorporates normative appeals in all actions such as mass media campaigns, letters sent by the tax administrations, seminars and in moments of personal contact.

iv) Outreach and education

Taxpayer behaviour needs to be influenced in different ways depending on the context. It is always good to foster a social and personal attitude in favour of tax compliance. If there is no positive attitude in favour of compliance, deterrence can work in the short run. In the long run, a high level of voluntary compliance can only be achieved by establishing an attitude in favour of compliance. Education and outreach programmes can help in achieving voluntary compliance by adopting a hybrid approach to encourage tax compliance, entailing both persuasive appeals and deterrent messages. A hybrid approach has been seen to be adopted by tax administrations wherein aside from some motivating effect, the tax administrations advertise and spread awareness about the
consequences of avoiding tax liabilities via public information seminars, conducting classes in educational institutions on taxes and introducing supplementary textbooks for this purpose, sponsoring high-school essay contests on tax topics, media campaigns, etc.

v) Co-ordinations with partners and stakeholders

Tax administrations constantly engage with different types of intermediaries by way of regular meetings to consult with tax practitioners, educational programme organisers, testing agencies, accreditation agencies, etc.

XII.3.b Compliance measurement

The monitoring and measurement of compliance is fundamental to assessing the effectiveness of a tax administration’s operations. Advanced tax administrations therefore, undertake systematic compliance measurement. Compliance by taxpayers is also measured in terms of whether such compliance is achieved voluntarily (voluntary compliance) or corrected by verification/enforcement actions carried out by the revenue body (enforced compliance). In a tax administration context, this distinction is highly relevant as ‘enforced compliance’ has a cost, and very often, a significant one. In line with their overriding goal and mission, all revenue bodies should aim to improve the overall level of ‘voluntary’ compliance and by definition, rely less on ‘enforced’ compliance. Other terms often used in a tax ‘compliance’ or ‘non-compliance’ context are ‘tax evasion’ and ‘tax avoidance’ or ‘unacceptable tax minimisation arrangements’. Most evolved tax administrations use the tax gap to measure compliance. Compliance measurement has been dealt with in detail in Appendix XII.1.

XII.3.c Voluntary disclosure programmes

Several countries currently have voluntary disclosure programmes (VDPs). Such programmes provide an opportunity to facilitate compliance in a timely and cost effective manner, saving costly and contentious audits, litigation and criminal proceedings. These VDPs provide sufficient incentives for those engaged in non-compliance to come forward in a timely and self-initiated manner in exchange for reduced liability and punishment. While some tax administrations have organised their VDPs in an ongoing manner, and hence made it a permanent feature of the tax administrations, others introduce it from time to time for a limited period only.

XII.3.d Segmentation

Most tax administrations segment the taxpayer population into sub-populations of taxpayers with similar characteristics and behaviours. This facilitates more precise identification and categorisation of compliance risk, which, in turn, leads to a richer understanding of the true compliance risks and ultimately assists in the specification and delivery of risk treatments.

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Differentiation in this way has enabled these tax administrations design compliance strategies better suited to these segments. Tax administrations have segmented the taxpayer base keeping in mind different perspectives such as segmentation by size, industry and nature of taxes and behaviour of taxpayers.

XII.3.e Compliance verification (Audits)

The basis for most modern tax administrations’ effective audit strategies is reliable risk identification and workload selection. Improvement in capabilities and processes in these areas have been found to bring about considerable effectiveness gains by reducing the number of unproductive audits. Apart from this, with modern compliance risk management strategies, more emphasis is placed on identifying and responding to aggregate risks as opposed to individual cases. In this regard, tax administrations have designed new risk management procedures to achieve more optimal allocation of audit resources.

XII.3.f Deterrence

Using robust intelligence risk assessment aided by ICT, best practicing tax administrations ensure a sharpening of their focus on fraud, prevention and detection. They are also cognizant of the direct and indirect effects of enforcement actions on overall compliance and use these to shape their communication strategies with taxpayers.

A more detailed discussion on global best practices is in Appendix XII.1.

XII.4 Way forward

XII.4.a Governance

It will not be unfair to say generally that when taxpayers walk into a tax office in India, they cannot but feel a sense of trepidation, if not foreboding. It is not a prospect they look forward to even when in their estimation, they have followed the law. If they wish to get an issue resolved or clarified, even an ordinary one, it is not to the tax department that they turn to, for they have little hope of getting a decisive and reliable answer. They rely on intermediaries like chartered accountants (CAs) or consultants. If they have to appear before a tax officer, they will look among their acquaintances to see if there is someone who can “put in a word” to the officer, believing that they are unlikely to get a fair hearing otherwise. This perception may not be always well founded, but it cannot be denied that it is prevalent. On the other hand, there exists a wide perception that a large number of well-to-do individuals in society are cheating on taxes without any fear of being caught and punished. Thus, ordinary law abiding taxpayers tend to view the tax administration – both direct and indirect – with a mixture of fear and lack of confidence and trust, while violators seem to have no fear of the administration.

If voluntary compliance is to be maximised, this picture must change and this change must take place radically and quickly. What this entails is a fundamental change in the tax governance in the
country, as already emphasised by the TARC, and from the present lack of trust and mutual suspicion to one marked by mutual trust and confidence. Taxpayers must develop the confidence that the administration is helpful towards the compliant while it deals strictly and effectively with those who are deliberately non-compliant. This will certainly enhance voluntary compliance, a point emphasised in the context of expanding the taxpayer base in Chapter XI of the TARC Report. This requires a fundamental change in the belief and attitudes prevalent in the tax administration.

To begin with, the two Boards need to seek honest answers to some simple questions. They need to ask themselves whether the revenue coming in is because of the administration or despite it. And if so, how much of it is because of the administration’s efforts? Answers to these questions will illuminate their path to reform. This is an opportunity for them to use the TARC’s suggestions as a mirror to themselves.

The two Boards cannot hope to achieve the objective of maximising voluntary compliance without the co-operation of the community of taxpayers. The widely prevalent impression of a hostile tax environment in the country cannot be erased unless they address the root causes that have led to this impression, namely an unfriendly and unresponsive administration, a very high degree of uncertainty and unpredictability in tax matters due to inconsistent understanding and interpretation, and a huge amount of disputes and litigation.

At the root of this would appear to lie the excessive emphasis on tax maximising behaviour, spurred by overwhelming obsession with revenue targets to the exclusion of the quality of revenue collection. It would be idle to talk about creating a climate conducive to voluntary compliance without first purging the pathology of issuing and confirming inflated tax demands and unjustifiable persistence in litigation that imposes heavy costs on the taxpayers. In fact, by letting many issues be decided by courts even when it is within their powers to clarify and settle them, the two Boards seem to have not only abdicated their responsibility but also ceded areas of tax policy to courts and allowed the growth of uncertainty. This has also sometimes led to increasing the gap between the original policy intent behind a particular legislation and its final interpretation.

The almost total obsession with meeting unrealistic revenue targets has led the tax administration to ignore more important and vital aspects of compliance management and resulted in a deplorable fall in the quality of the administration, driving taxpayers to frustration, exasperation and anger towards the administration. This can be ignored by the administration only to the country’s peril. It is essential, therefore, that a wholesome set of goals that are focused on minimising the tax gap are set up and cohesive strategies and programmes designed to achieve those goals in place of the present compulsive obsession with revenue maximisation by any means.

It needs acknowledgement, however, that a part of this problem is exogenous to the two Boards, in as much as they lack a decisive say in the formulation of the revenue targets that are imposed on them. However, they themselves have not come up with a more rational and reliable alternative methodology for making projections of revenue. The TARC will deal with this aspect when it submits its report on the aspects of forecasting, analysing and monitoring revenue targets.
Effective compliance management by enhancing voluntary compliance, therefore, necessitates nothing short of a complete rebooting of the tax administration. A reformed tax administration system, built on values, trust, enabling processes and with a robust enforcement mechanism, should show continuous improvement in compliance. A high performing tax administration will achieve the following outcomes:

- Increase in revenue and reduction of tax gap
- Enhancement of the tax base and taxpayer base
- Increase in voluntary compliance
- Reduction in compliance cost as well as cost of tax administration
- Increase in customer satisfaction

The TARC has, in several previous chapters, made a large number of recommendations touching upon vital aspects of tax governance. Broadly, they relate to:

- Increased customer focus
- Improved governance
- Improved people management
- Effective dispute management and resolution
- Streamlining of processes
- Enhanced exploitation of ICT and greater use of data analytics using a wide range of internal and external data

Importantly, the TARC noted the absence of co-ordination and information exchange not only between the two Boards but also between the different wings within each department and how it was impacting adversely the task of compliance management. As noted by the TARC, most tax administrations have moved towards unification and India remains an outlier in this respect. Accordingly, an approach to selective convergence, leading to eventual integration, for sound compliance management was recommended and the discussion in this chapter needs to be appreciated in that context.

All those recommendations have a direct bearing on effective compliance management and are not being repeated in this chapter except where a greater detailing or emphasis is required. This chapter focuses on certain key aspects of compliance management that need immediate improvement, viz., effective compliance risk management, excellent customer focus, robust compliance verification and enforcement.
It needs to be said at the outset that transformational changes in any organisation require careful attention to what are often described (somewhat misleadingly, as they are invariably the hardest to grapple with) as “soft” aspects of management, which are people (or staff) related issues such as those of leadership, culture and attitudes. For the reasons that the TARC has highlighted in Chapter IV of its report, it appears that they have not received sufficient importance in the two Boards. Changes that are clearly desirable cannot come about unless there is a fundamental change in the attitudes and culture that are prevalent and unless they are driven by a strong and committed leadership. Another crucial aspect is accountability, without which there is little willingness to change in a static bureaucracy.

The move towards compliance management requires the tax administration to recognise and accept a re-defined role and that role is one of a regulator rather than that of purely an enforcer. Thus, enforcement becomes a tool that is applied intelligently, selectively and only when it is needed and the administration’s role as an enabler of compliance becomes more salient. It, thus, needs to see its role as that of enabling, monitoring and managing compliance and not merely of enforcing of laws. This is a necessary consequence of the principle of voluntary compliance and self-assessment in which the responsibility for compliance is shared between the taxpayer and the tax administration.

A fundamental change is thus required in the foundational beliefs, attitudes and culture prevalent in the administration. The administration needs to embrace trust as the foundational principle rather than suspicion and distrust. As is evident, self-assessment and voluntary compliance is not merely a moral, but a practical imperative given the huge growth in the complexity as well as workload volumes in a modern tax system that makes it well-nigh impossible for the tax administration to cope with challenges through a purely enforcement oriented approach. Therefore, its compliance philosophy needs to be built on the principle of trust, combined with careful monitoring and management of compliance risks.

Enablement of the taxpayer inevitably requires enablement of the employees too, for one cannot expect ill-trained and ill-motivated employees to deliver high quality customer service or deal with complex compliance issues with competence and in a manner that sustains public confidence in the administration. Equally, one cannot realistically expect employees to behave fairly and on the basis of trust in the taxpayer if the internal systems of the organisations are founded on suspicion and distrust towards the employees. Hence, the principle of trust needs to be embedded in both the internal and external dimensions of the organisation.

The principle of self-assessment has been enshrined in the legislation for direct as well as indirect taxes administered by the two Boards. Similarly, their Vision and Mission statements explicitly set out the promotion of voluntary compliance among their important goals and emphasise aspects such as making compliance easy, enforcing tax laws with fairness, and delivering quality taxpayer services of specified standards.
However, as already noted by the TARC, there is a wide gap between what is professed in these documents and the actual experience of the taxpayers. As evidenced by the large number of disputes, the present relationship between the taxpayer and the tax administrations is marked by distrust. It is adversarial and disputatious, as evidenced by the data given in Chapter V of the TARC’s Report relating to the pendency of disputes at various appellate levels in both the administrations. Furthermore, these numbers are seen to be mounting with every passing year and disputes are repeated year after year even after decisions by the appellate authorities. Despite protestations to the contrary, the tendency of both departments to drag matters into appeals needlessly continues unabated, creating the impression of an intractably litigious administration. The upshot is that while on the whole the majority of decisions by the departmental authorities show a marked revenue bias, in many of those exceptional cases where fair and competent orders are passed, the higher authorities in the administration show a propensity to file appeals to the Tribunals, High Courts and even Supreme Court. Apart from costs of such litigation, such questioning of their orders demotivates those officers at the junior who act fairly and objectively, reinforcing the tendency towards arbitrary anti-taxpayer orders. Courts have in many cases passed strictures on judicial indiscipline and needless appeals on the part of revenue. In many cases, they have directed their orders to be sent to the Boards and the Ministry of Finance. The instances mentioned in Box 12.1 are but a few examples of an unrelieved stream of such arbitrary and capricious orders and appeals. However, such adverse comments from judicial bodies and frequent public criticism seems to have had little impact on this tendency as, to the TARC’s knowledge, no one has ever been held accountable for such glaring lapses – again sharply underlining the complete absence of accountability at all levels. This is reflective of either incompetence or an attitude of disregard for judicial discipline, as observed by CESTAT in the case cited in Box 12.1. In either case, it vitiates the business climate – generating avoidable uncertainty and costs for the taxpayer – and shows the administration in a poor light. While such an attitude pervades it, it is hard to see how any taxpayer can feel any sense of respect or affiliation towards the administration, let alone be motivated towards voluntary compliance. It is time that both Boards took decisive steps to arrest this decline and avoid the opprobrium of strictures from judicial authorities. Mere issue of instructions will not do. They must own up the responsibility for the performance of their officers and enforce accountability on their officers. They can do so by first desisting filing of appeals against well-reasoned and sound orders passed by their officers simply because they are pro taxpayers and by taking notice of capricious orders, irrespective of revenue consequence and disciplining the errant officers – even by meting out punishment where required.
Box 12.1: Some examples of needless litigation

1. In the case of _Commissioner Income Tax-6, Mumbai vs Maersk Global Service Centre (I) Pvt. Ltd (TS-260-HC-2014 (BOM)-TP)_ , the revenue was in appeal before the Bombay High Court, questioning the orders both of the Commissioner (Appeals) and the Income Tax Appellate Tribunal. The burden of the revenue’s song was that, in view of the infirmities of the Assessing Officer’s (AO’s) order, the Commissioner ought to have remanded the case back to him for a fresh consideration. Finding that the Commissioner had considered all aspects, including those alleged to have been ignored by the AO (in other words, the Commissioner himself corrected the omission of the AO by undertaking the exercise that the AO had omitted to do) and passed a reasoned order, the Tribunal had negated the appeal and upheld the Commissioner’s order. While dismissing the appeal, the High Court said:

“To our mind, the order of the Tribunal is not vitiated by any serious legal infirmity nor is it perverse, rather it is unfortunate that a detailed and properly reasoned order of the First Appellate Authority and the Second Appellate Authority is being challenged and that too on such grounds by the revenue. We would highly appreciate the parties not discrediting the Tribunal or the First Appellate Authority in this manner. The complaints about unfair treatment or breach of principles of natural justice ought to be backed and supported by some material which would demonstrate serious prejudice and loss. A technical objection of nature will not carry the case of either parties (sic) any further. It would mean that a speaking order or the record is disputed or challenged by oral complaints across the bar before this Court. Nothing is going to be achieved by such an approach and in the least by the revenue. In these circumstances and finding that the present appeals are brought by the revenue on frivolous complaint of breach of principles of natural justice, we are constrained to dismiss them with costs. That is because we are also wasting precious judicial time by hearing such appeals and perusing the record.”

2. In _M/s RGL Converters Vs Commissioner of Central Excise Delhi-I (2014-TIOL-2305-CESTAT-DEL)_ , while upholding the taxpayer’s appeal, the CESTAT felt compelled to award costs to the appellant and direct a copy of their order to be sent to the CBEC and Secretary (Revenue). This was a case involving failure of judicial discipline on the part of original and appellate officers of the department in not following a judicial precedent binding on them and the consternation of the Tribunal is clearly reflected in the following observations:

“10. It is axiomatic that judgments of this Tribunal have precedential authority and are binding in all quasi-judicial authorities (Primary or Appellate), administering the provisions of the Act, 1944. If an adjudicating authority is unaware of this basic principle, the authority must be inferred to be inadequately equipped to deliver the quasi-judicial functions entrusted to his case. If the authority is aware of the hierarchical judicial discipline (of precedents) but chooses to transgress the discipline, the conduct amounts to judicial misconduct, liable in appropriate cases for disciplinary action……

12. Nevertheless, the primary and the lower appellate Authorities in this case, despite adhering to the judgment of this Tribunal and without concluding that the judgment had suffered either a temporal or plenary eclipse (on account of suspension or reversal of its ratio by any higher judicial authority), have chosen to ignore judicial discipline and have recorded conclusions diametrically contrary to the judgment of this Tribunal. This is either illustrative of gross incompetence or clear irresponsible conduct and a serious transgression of quasi-judicial norms by the primary and the lower Appellate Authorities, in this case. Such perverse orders further clog the appellate docket of this Tribunal, already burdened with a huge pendency, apart from accentuating the faith deficit of the citizen/assesse, in departmental adjudication……

15. In the circumstances and since the Authorities below have adjudicated against the assessee, despite and clearly contrary to the binding precedent and thereby subjected the assessee to an avoidable litigative trauma and the accompanying expenditure, we allow the appeal with costs of Rs.10,000/- payable by Revenue to the appellant- assessee within one month from the date of receipt of this order.
What is clear is that the administrations are functioning without accountability. It is difficult to conceive where the accountability lies — whether at the level of the officer who is found to be negligent, the chief commissioner or chief commissioner, who ignore the actions of the officer or the Board itself. Even if it is assumed that the officer or the Board is correct, a deviation from the clarifications, the situation is likely to persist. Unless measures are put into place to enforce adherence to the Board’s guidance, there is no way to ensure that the Board has any real impact on the assessing officers.

As noted in the previous section as also in Chapter V of the TARC Report, a large number of disputes arise because of the failure of the two Boards to issue clarifications in a proactive and timely manner. What is worse is that sometimes assessing officers to the clarifications issued by the Boards and action is taken to discourage the AO to follow the Board’s instructions. A recent report appearing in one of the tax websites (see Box 12.2) illustrates of the problem.

Box 12.1 – Cont.

16. We direct that copies of this order be communicated to the Central Board of Excise and Customs and to the Secretary (Revenue), Ministry of Finance, Government of India, for information.”

3. Yet another example is furnished by the ITAT order in the case of ITO – 9(1)(4) vs. M/s Growel Energy Co. Ltd (ITA No. 338/Mum/2011). This was a departmental appeal filed against an order of Commissioner (Appeals) in which he had upheld the party’s appeal against the AO’s assessment. The Tribunal found the appeal ill-considered, ill-prepared and baseless and dismissed it, with costs awarded to the assessee while making some stinging remarks on the AO who preferred it and the Commissioner who authorised it. To quote:

“At the outset, it may be mentioned that the Income Tax Officer, who is the appellant herein, as well as the Commissioner of Income Tax, who has authorized the AO to prefer an appeal, did not apply their mind in the correct perspective and in a very lacklustre and routine manner filed the appeal which, in turn resulted in wastage of time which would be highlighted at appropriate places…..”

“A plain look at the findings of the CIT (A) clearly indicates that the AO was desperate to make an addition under Section 40(a)(ia) of the Act thereafter under Section 69C of the Act by stretching the language of the section to an extent where no person with a reasonable understanding of law would not have applied Section 69C in the said context. However, he chooses to file a further appeal and seeks permission of the Commissioner, who has immediately granted permission. At this juncture it may be noticed that the power is vested with the Commissioner of Income Tax and not with the AO because the Legislature, in its wisdom, thought that a superior/senior officer can take a more balanced decision so as to avoid filing frivolous appeal in a routine manner. However, even the Commissioner has not given his reasons as to why he has authorized the AO to file an appeal on this issue.”

Noticing a basic error in the grounds of appeal on account of casualness in drafting, which led to an opposite meaning from the grounds of appeal being conveyed, the Tribunal observed:

“….. Neither the learned DR cared to look at the grounds, nor the AO intended to change the ground of appeal. Even if it is assumed that the AO seeks to challenge the order passed by the CIT (A) on this issue, even before us no material, whatsoever, was placed to show as to under which provision of law addition can be made...”

“Having heard the learned DR and the learned counsel for the assessee in this regard, we are of the firm view that the AO has raised a soul-less ground which deserves to be dismissed in-limine. We could have saved a lot of time had the Commissioner not given his authorization on such frivolous issues. On the contrary, it is incumbent upon the Commissioner, as a supervisory authority, to admonish the AO for making an addition without basic understanding of legal position...”

“Having regard to the circumstances of the case, we are of the firm view that the order passed by the learned CIT(A) does not call for any interference. We hold accordingly...”

“As we have already mentioned, on account of improper action on the part of the Commissioner of Income Tax, as well as the AO, the assessee had to engage a counsel and incur substantial expenditure to defend its case. Therefore, we award a token cost of Rs. 5000 upon the Commissioner of Income Tax who has given the authorization and cost of Rs. 10,000 upon the AO who has filed this appeal.

The said payment should be made to the assessee within one month from the date of receipt of this order. Registry is also directed to mark a copy to the Chairman CBDT so that in future the Income Tax Commissioners who are responsible for filing appeals before the Tribunal, would take proper care to scrutinise the issues before authorising the AO to file appeals before the Tribunal. With these observations, the appeal filed by the Revenue is treated as dismissed with costs.”
As noted in the previous section as also in Section V.4.b of Chapter V of the TARC Report, a large number of disputes arise because of the failure of the two Boards to issue clarifications in a pro-active and timely manner. What is worse is that sometimes litigation is persisted in by the departments despite a clarification by the Board and in a number of cases, officers in the field fail to follow the Board’s instructions. A recent report appearing in one of the tax websites is illustrative of the problem (see Box 12.2). Unless measures are put into place to enforce adherence by field officers to the clarifications issued by the Boards and action is taken to discourage deviation from the clarifications, the situation is likely to persist. Senior officers in the field such as chief commissioners and commissioners need to discontinue such conduct on part of the assessing officers. It is difficult to conceive where the accountability lies, leave alone action taken – whether at the level of the officer who ignores the Board’s guidance, or at the level of the commissioner or chief commissioner, who ignore the actions of the officer or the Board itself. What is clear is that the administrations are functioning without accountability.

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Box.12.2: CBEC in Circular No. 495/61/99-CX.3 dated 22.11.1999 clarified:

It has been brought to the notice of the Board that field formations are demanding duty on the compound preparation arising during the course of manufacture of Agarbathi classifying them under heading 3302.90 of the Central Excise Tariff as odoriferous compound.

2. The matter has been examined in the Board. The Agarbathi manufacturing process involves simple mixing of a few aromatic chemicals with a base oil in a container in liquid form which is mixed directly with the dough or applied on Agarbathi in the required proportion and such dough, mixed with the aromatic compound; is used for rolling of Agarbathi. The Agarbathi manufacturers normally carry out the whole process in a continuous manner in the course of manufacture of Agarbathi.

3. Moreover, each brand of Agarbathi has a different fragrance which is on account of the different formulation used by the manufacturers which is specific to that particular brand. Preparation of such odoriferous compound, substances applied on the Agarbathi varies from one Agarbathi manufacturer to another. Such preparations are not sold by them in the market so as to keep their respective trade secrets. As the constituents, their proportions and formula of preparation are kept as secret, such compounds cannot be considered to be marketable in the commercial parlance.

4. Accordingly, it is clarified that the odoriferous compound or Agarbathi dough mixed with odoriferous substances, not being capable of being bought and sold in the market in the normal course of trade, is not an excisable product and no duty is therefore, leviable on such compound arising during the course of manufacture of Agarbathi.

Following this Circular, Karnataka Soaps and Detergents Ltd, who were paying duty on stock transfer of certain odoriferous compounds to their own unit, stopped payment of duty with effect from April 2000. This was accepted by the Department for some time, but in November 2005 some wise officers felt that Board was wrong and so issued Show Cause Notices to the assessee - Karnataka Soaps. As usual the Adjudicating Authorities confirmed the demand with Odoriferous penalties (sic).

The Tribunal observed - 2011-TIOL-520-CESTAT-BANG, "In our considered view, the board has taken a view which is applicable to the entire length and breadth of India and it cannot be so easily brushed away by the departmental officers ....... In our considered view, the Board Circular will apply in its full force to the case in hand before us at least to the agarbathi perfumery compounds wherein revenue has not produced any evidence of they being bought and sold."

The love of litigation took the Revenue to the Supreme Court, where the case is pending.

**Fifteen Years after the Circular was issued:** New wisdom dawned in the dark corridors of power and the Board has now clarified:

It has been reported that some manufacturers of such odoriferous compounds have claimed non-excisability on the ground that such compounds are a trade secret, not sold in the market and hence not excisable. This is despite the fact that such compounds have shelf life and are capable of being marketed as a distinct identifiable commodity.

It may be noted that Section 2(d) of the Central Excise Act, 1944 has been amended in 2008 to insert a deeming fiction regarding marketability. Specific cases have been detected, where intermediate masala mix has been found to be actually bought and sold. It is therefore clarified that Board's Circular No. 495/61/1999-CX.3 dated 22.11.1999 is applicable only to such intermediate compound or odoriferous compounds as are not capable of being bought and sold. In cases where on the basis of evidence it is established that such intermediate compounds are capable of being marketed, the same will be excisable, irrespective of whether the compound is actually marketed or not. Why did the Board wait for fifteen years to clarify this position and why did the Board take the matter to the Supreme Court when an assessee had followed its own circular?

How much money are they going to get from the Agarbathi (perfumed incense stick) manufacturers as excise duty on the secret odoriferous compounds? Even if it is excisable and dutiable, shouldn't it be exempted - and what is the cost of litigation?
Another aspect is that there appears to be no uniform practice of citing the statutory provisions (Section 119 of the Income Tax Act, Section 37B of the Central Excise Act and Section 151A of the Customs Act) while issuing clarifications. This is perhaps why the number of such clarifications appears so small – although it may actually be higher. The TARC is unable to understand the reason for this. When these provisions have been specifically enacted to enable the Boards to issue binding clarifications, there is no reason why they should not be specifically invoked. Citing the relevant authority will help ensure that no doubt is left in the minds either of the taxpayer or the concerned officers that officers are required to abide by such guidance.

The fact that this is not given due importance only reflects the general indifference to the importance of ensuring certainty in taxation for the taxpayers. Governance needs to be founded on the principle that the administration is responsible for the actions of its officers and, as far as the taxpayer is concerned, the decisions taken by individual tax officers are the decisions of the tax administration. The taxpayer is entitled to expect that all officers will consistently follow the position taken by the administration, irrespective of their individual views. The traditional obsession with the “primacy of the assessing officer” in the administration’s ethos must yield to its responsibility to ensure the consistent interpretation of law across the country.

To alter the situation, the Boards will have to infuse life in their Vision and Mission statements to create a value-based administration. This means strong internal governance supported by an effective performance management framework, which the TARC has discussed in detail in Section IV.3.d of Chapter IV of its Report. As indicated there, this requires the development of performance measures and indicators that bring about coherence between organisational goals and individual behaviour and incentivisation and encouragement of the right behaviour. Specifically, the TARC had given an illustration in relation to the dispute management function of how this could be achieved in Table 4.1 in Chapter IV. A similar approach needs to be adopted for the other key functions.

One of the instruments the TARC had recommended in Section IV.4.a of Chapter IV was the adoption of a code of ethics, which could supplement the Conduct Rules governing the conduct of civil servants. Such a code can give concrete shape to values such as professionalism, objectivity, courtesy and helpfulness and be actionable where deviance is noticed. It should contain a detailed delineation of the standards of behaviour and conduct that would be the touchstone for assessing the conduct and performance of officers. Suppression of rude behaviour would not be possible, for instance, unless this is actively discouraged and delinquent officers face consequences in terms of such conduct being reflected in their performance assessments (after a due opportunity to improve) and, in deserving cases, suitably punished. Similarly, elimination of unwarranted revenue maximising decisions, etc., will not be possible, for instance, unless officers are penalised for incorrect decisions even where they are pro-revenue. Per contra, the fear against fair but pro-taxpayer decisions needs to be eradicated. Such actions are possible when the organisation commits itself to an explicit code of values and the leadership demonstrates that commitment through their own conduct consistently.
A culture of openness and trust towards to taxpayer can only be created when the leadership of the organisation, cultivates the same culture inside the organisation. The bureaucratic culture in India is rigidly hierarchical and authoritarian and most of the leadership typically adopts a highly directive, rather than enabling, approach towards juniors. There exists a great distance between the senior leadership and the front level executives and staff, among whom morale is quite low. And these are the officers and staff who most often face the taxpayer, who often becomes a victim of their frustration. The onus, therefore, is on the leadership in both the Boards to replace this culture with one that is more transparent, open and marked by a greater sense of equality and respect irrespective of individuals’ ranks. The grooming of leaders for such change must begin at the earliest stage in the career of the IRS officers and the training academies and this should be an important component of the syllabi of probationers. The same also holds good in respect of the training for other categories of staff delivered through the Regional Training Institutes. Besides, it should be mandatory for the officers to undergo a course in ethics periodically, say once every three or four years. National Academy of Direct Taxes (NADT) and National Academy of Customs, Excise and Narcotics (NACEN) must give the highest priority to shape leadership and inculcate the code of ethics in this manner. This should be done through structured leadership programmes, designed with the help of national and international institutions of repute.

XII.4.b Compliance risk management framework

As was noted in the earlier section, advanced tax administrations have embraced cohesive and well-articulated compliance management strategies for coping with the complex challenges they face. Recognising the limits of a purely enforcement led approach and the fact that the taxpayer community is not a homogenous mass, these strategies are based on a careful analysis of risks, compliance behaviour and the deployment of an appropriate mix of interventions calculated to achieve organisational goals and priorities.

It has to be said that while elements of such management are present in the Indian tax administration, what is missing is a coherent and clearly articulated framework that weaves the different aspects of the departments’ functioning together into a well-directed movement towards the goal of compliance maximisation and enables an assessment of overall performance against goalposts. As noted above, while the vision, mission and strategy documents of the two Boards espouse lofty ideals, there is little evidence that these ideals and values are shared across the organisation. Indeed, the evidence, as reflected in the attitudes and behaviour of officials at different levels, is to the contrary. In many cases, the approach of even senior officers is in conflict with stated values.

The first requirement for achieving the goal of promoting voluntary compliance, therefore, is to build an organisation wide consensus on what the role of the tax administration is in the modern context, communicate and internalise this understanding and put in place measures that encourage desired attitudes and behaviour and discourage deviations from these. This, of course, is easier said than done and is bound to be a long and arduous process. But both the Boards must embark
this journey if they are to raise themselves in peoples’ esteem and enhance their legitimacy in the eyes of the stakeholders. Therefore, it is essential the vision and strategy are developed into long-term strategic plans and medium and short-term operational plans that translate them into programmes and projects that facilitate the achievement of organisational goals. The Boards’ leadership owes it themselves and later generations to do so and leave a positive legacy for their successors.

It is a well-developed and structured compliance risk management process that enables a tax administration to achieve the most optimal application of scarce organisational resources for effectively attaining its organisational goals. In Section III.3 of Chapter III, the TARC has already noted the absence of a strategic risk management framework in the two Boards and outlined such a framework while recommending the functional vertical of Strategic Planning and Risk Management. Further, noting the commonality of risks and challenges faced by the two Boards, the TARC has also recommended that they should evolve a common risk management framework.

Currently, the risk management in the Boards is highly transactional, quite rudimentary and limited to specific areas of operations, namely selection of cases for scrutiny and audits. Examples are CASS in CBDT and the RMS in customs. The approach to audit selection in the CBEC would appear to be even more backward. From a strategic perspective, what represents a compliance risk must be determined in the light of a tax administration’s broader objectives and coherence brought about between the larger goals of the organisation and the functioning of its different wings in a concerted manner that facilitates a smooth movement towards the goals. This is the object of an organisation-wide risk management framework.

As depicted in Diagram 12.1, risk management is a step-wise cyclical process comprising the identification of risks, their evaluation and prioritisation, the determination of appropriate risk treatment strategies, implementation of such strategies through suitable actions and finally an evaluation of the effectiveness of such actions. Such evaluation is to be used continuously as feedback to effect improvements in risk management. To be successful, the entire process must be based on sound measurement and carried out in an objective and scientific manner.
Diagram 12.1: Compliance risk management diagnostic model

Source: OECD

Identifying Risks

The aim of compliance risk identification is to identify the specific compliance risks that a tax administration must confront as comprehensively as possible, minimising the possibility of overlooking risks and facilitating subsequent in-depth analysis. As depicted in Diagram 12.2, risks fall on a continuum ranging from the strategic to tactical dimensions and the level at which they need to be addressed determines the level of knowledge, rigour of evidence and analysis and the sophistication needed to address them effectively. It is obvious that any risk to the future viability of a tax administration will affect its capacity to manage and improve compliance with tax laws. Compliance risk management, therefore, must begin at the Board level by identifying strategic risks. These are risks that threaten the vision or strategic objectives of the tax administration. They arise from the environment in which the tax administration functions. For example, the rapid expansion, increased sophistication and globalisation of the Indian economy mean that the country is exposed to large systemic risks. Typically, these would be market wide risks that affect tax administration. Similarly, policy decisions such as SEZs, areas based exemptions, etc., also have an impact on the tax administration’s risks. The treatment of such risks requires strategic interventions, such as changes in legislation, investments in technology, creation of new competencies and reallocation of resources etc., which are relatively long-term measures. The identification of such strategic risks requires an ongoing scan of the changing global environment and its impact on the tax environment. This level of analysis would lead to identification of significant risks in relation to specific industries and taxpayer segments. Aggregated analysis of such industries and segments will help identification of the typology of such risks and selection of treatment strategies, which can form the basis of work plans in different functional verticals. For example, if focused compliance verification is determined to be an appropriate and cost effective
response to the risks perceived in a particular segment or industry, it would get included in the priorities of the compliance verification function. Similarly, for some other industry, where enforcement is considered the appropriate response, it would get into the priorities of the enforcement vertical.

Diagram 12.2: Compliance risk management diagnostic model

Source: OECD

Assessing and prioritising risks

Having identified the risks, the next step in the risk management process is to assess and prioritise them. Central to this process is a sound framework within which the identified compliance risks can be comparatively assessed in a repeatable manner. The purpose of this step is to separate the major risks (that need to be treated specifically) from the minor ones and make a comparative evaluation of the risks in terms of their probability or likelihood, dimension and impact. This requires consideration of the source of the specific risk identified, an assessment of how likely it is that the risk event will occur and what will be its potential impact or consequences for the organisation should it occur. It relies upon the use of data and information to substantiate the consequences that are likely to be incurred if the risk occurs and/or remains unaddressed.

Probability or likelihood is the chance of the risk occurring and is expressed in terms of degrees of probability. While this is in large measure a judgment call, for the purpose of common understanding in a structured risk analysis, the measures need to be expressed in either qualitative or quantitative terms as illustrated by Table 12.5.
Table 12.5: Compliance risk likelihood matrix

<table>
<thead>
<tr>
<th>Rating</th>
<th>Likelihood Description</th>
<th>Subjective definitions</th>
<th>Objective definitions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Rare</td>
<td>‘May occur only in exceptional circumstances’</td>
<td>‘Likely to occur once in 25 years’</td>
</tr>
<tr>
<td>2</td>
<td>Unlikely</td>
<td>‘Could occur at some time’</td>
<td>‘Likely to occur once in 10 years’</td>
</tr>
<tr>
<td>3</td>
<td>Moderately likely</td>
<td>‘Might occur at some time’</td>
<td>‘Likely to occur once in the next three years’</td>
</tr>
<tr>
<td>4</td>
<td>Likely</td>
<td>‘Will probably occur in most circumstances’</td>
<td>‘Likely to occur more than once in the next three years’</td>
</tr>
<tr>
<td>5</td>
<td>Almost Certain</td>
<td>‘Is expected to occur in most circumstances’</td>
<td>‘Likely to occur this year or at frequent intervals’</td>
</tr>
</tbody>
</table>

Assessment of impact relates to the consequence that the risk event would have on the achievement of the objectives of the tax administration. Included in it is also the assessment of dimension of the risk i.e. whether it affects the whole or specific parts of the organisation, whether it is limited to specific geographical areas, specific sectors of the economy etc.

Like in the case of probability assessment, impact assessment too is a judgment call and needs to be expressed in the form of either qualitative or quantitative measurement or both. Thus, impact could be measured on a scale ranging from low to severe, with a clear definition for each degree provided to ensure a common understanding. This could be defined also in terms of a scale of numbers ranging from say 10 for the most severe risk to 1 for low risk. The important factor is that it should be relevant to the intended objective under consideration, thus facilitating a comparative assessment of otherwise disparate risks, in a manner that is repeatable.

The relative rating of risks is a product of the combination of the assessed probabilities and impact on the mandate and business objectives of the tax administration, such as physical and economic security, the likely cost to revenue in the short-term and the long-term, the potential impact on other government programmes and the risk to the reputation of the tax administration and community confidence in it. The administration has to weigh these factors in choosing its response to risk. For example, a high impact risk with a medium probability of occurrence, a likelihood of a terrorist attack, could take precedence over a high probability risk of revenue loss. Thus, the end product should be a summary of prioritised compliance risks to be subjected to specific risk treatment actions, in accordance with some standardised criteria. The end result of the risk identification and assessment process is typically an ordered programme of proposed activity aligned to corporate planning and funding cycles.
Having thus evaluated the risk, the next step would be to choose the appropriate risk treatment and this requires a deep understanding of compliance behaviour.

**Analysing compliance behaviour**

Confidence that any action taken will be successful grows from a clear understanding of what is motivating the non-compliant behaviour identified. Therefore, analysing the taxpayers’ behaviour is important. Diagram 12.3 depicts the compliance philosophy that the Boards need to embrace.

**Diagram 12.3: Compliance philosophy**

As can be seen from the diagram, taxpayer behaviours are spread across the compliance spectrum ranging from highly compliant to highly non-compliant.

At the extreme left lies the segment of taxpayers who exhibit both high commitment and capacity to comply. These would be individuals and businesses that believe in doing the right thing and take concrete steps to ensure they maintain compliance. They would include firms with a strong record in corporate governance and ethics, those employing reliable professionals to ensure maintenance of compliance and ensuring adequate diligence to maintain systems that are configured to ensure compliance.

In the next quadrant would lie that segment of taxpayers comprising taxpayers who are basically law abiding in attitude but who may lack the capacity, either by reason of limited resources or limited knowledge of law, for full compliance. They are termed triers because they do make the effort to comply but may fall short of full compliance owing to their limited capacity.
Fence sitters are those who have no basic commitment to compliance but would like to avoid the risk of consequences if, in their perception, there is a high probability of their non-compliance being detected.

Offenders are those who would appear to be habitual offenders who may not be amenable to persuasion and who make tax evasion their business strategy.

**Determining the risk-treatment strategies**

Compliance programmes need to provide a graduated response to compliance behaviour, making it easy for those who want to comply and applying credible enforcement to those who do not. If the risk has been appropriately stated, and if the driver of the non-compliant behaviour for the selected target group has been clearly identified, then the next step is to select or develop an appropriate treatment strategy to address the behaviour.

An important aspect in the development of a compliance programme is that it should be well balanced. It should include a good mix of both proactive and reactive strategies as well as strategies that cover all aspects of compliance management from education through to prosecution. Finally, because non-compliance can arise as a consequence of many different drivers and manifest itself in the form of different behaviours, a good compliance response will often be a suitable mix of strategies rather than a single approach.

If taxpayers do not understand what their obligations are, any intervention to enforce compliance will be perceived as unfair. Thus, the first step in considering how to address a specific non-compliant behaviour is to review whether or not the appropriate steps have been taken to make obligations clear – meaning transparent, easy to understand, simple and non-confusing tax laws that make it easy to comply, apply sanctions, etc.

Clearly, different combinations of responses are needed from the tax administration to different segments of taxpayers. For the highly compliant, the administration must adopt a highly facilitative and relationship oriented strategy with minimal interference in their business, largely designed to monitor ongoing compliance. The relationship should be highly open, collaborative and supportive. The dominant model here should be one of co-operative compliance. The administration should also resort to public recognition of good behaviour to encourage others to follow their example. Examples of such response would be the Authorised Economic Operator (AEO) programme in customs, in relation to which the TARC has made certain recommendations in Section VIII.4.k of Chapter VIII of its report. Some time ago, there was a scheme in both the Boards to give *Samman* awards to taxpayers. The scheme was to intended to strengthen the relationship between the tax administration and taxpayer and of giving due recognition to honest taxpayers. It was evidently hoped that such recognition would lead to the inculcation of a tax paying culture among taxpayers and healthy competition among them by encouraging honesty and not dishonesty. But it seems that although the *Samman* scheme has not been formally discontinued, it has fallen by the wayside and is not in practice. Since reward has a positive impact on human
behaviour, the TARC recommends that it should be re-started or re-introduced with emphasis on key dimensions of compliance and tax payment should not be the sole criterion (as was the case in the Samman scheme). The criteria should include timeliness and correctness of compliance in tax return filing, tax payments and other key aspects of compliance, giving appropriate weightage to the different parameters. The scheme should have categories to ensure that all segments of taxpayers, namely, large, medium and small are represented adequately in the awards. This will help in reaching out to even small and medium taxpayers who may otherwise be compliant but may not have high amount of tax payments to show. As noted in the previous section, many tax administrations design incentives for such taxpayers in collaboration with other agencies as well. The two Boards need to work along these lines. For example, the taxpayers getting Samman should get access for one year to airport lounges, priority in seat booking in railways, and other such incentives. Such physical comfort to the taxpayer will be demonstrative and will act as incentive for other taxpayers. The list of those getting Samman should also be publicly available. It will provide social recognition to the person and will help in instilling a competitive sense among other taxpayers, thereby improving voluntary compliance.

The response to triers again, considering that they might not be intrinsically non-compliant, should be marked by a high degree of understanding of their needs and a high degree of help and guidance. The approach to them should be positive instead of being primarily enforcement oriented. They will need occasional monitoring and the frequency of examinations in their case will have to be relatively greater compared to the highly compliant.

The fence sitters will need to be dealt with a balanced mix of persuasion and enforcement measures. The key to ensuring compliance on their part will be to create and maintain the perception that the probability of their being caught is high. Therefore, they will need to be monitored closely and penalised where serious or persistent non-compliance is noticed.

It is to the last category of habitual offenders that the whole range of penal measures, including prosecution, needs to be applied. And enforcement needs to be effective in that detection and punishment need to be executed with such swiftness and certainty as to make it a public example. It might be noted in this context that although provisions exist in the law for the publication of names and other details of the offenders, little is being done by the Boards to give publicity to such offenders.

It has to be admitted that any representation as above of the compliance spectrum is a simplified one – for the purpose of conceptual understanding – and there is a range of behaviours and motivations within them. Taxpayers are capable of adopting any of the attitudes described at different times. It is also possible that they may adopt differing attitudes simultaneously in relation to different issues, depending upon their perception of diverse factors in the compliance environment. It is important to bear in mind that structural factors in different industries have a direct influence on motivations and behaviours of businesses and risk managers need to be cognizant of this. Factors like economic trends in a given industry, the regulatory framework in
which it operates, its structural attributes in terms of consolidation or fragmentation, level of outsourcing, and the nature and intensity of competition in it, etc., need to be carefully studied in order to arrive at predictions about the likely behaviours of its members. The factors that operate in, say, the auto industry would be vastly different from a fragmented industry like steel re-rollers or textile processors, which again would be different from other industries like the resource industry or the ICT industry. Hence, the behavioural segmentation depicted in Diagram 12.3 will need to be combined with other relevant segmentation criteria to arrive at an assessment of appropriate compliance management strategies and development of plans for risk treatment.

Reflecting the illustration in Diagram 12.2 above, different functional verticals will need to adopt different criteria. The taxpayer services function may, for instance, resort to segmentation by the nature of the tax (personal income tax or corporate income tax), high net worth individual (HNWI), or size of business, based on turnover or tax payment, asset base etc., as the needs and capacities of large businesses, medium and small business often vary, while the compliance verification as well as enforcement functions may rely on assessment of taxpayers’ compliance behaviour that also takes into account the influence of economic and structural factors as narrated above. This would lead to strategic prioritization in terms of identification of priority sectors, choice of appropriate risk treatment interventions, capacity planning and resource allocation decisions with the object of getting optimal results in raising compliance levels. In certain sectors, enforcement intervention might have a sharper focus while in others compliance verification through audits may be considered the primary method of risk mitigation. In still others, based on assessment of the nature of risk, taxpayer education and outreach might be considered the most effective risk mitigation strategy. The planning in different functional areas, thus, will have to be in the context of such an overarching framework.

**Applying the strategies**

Strategies need to be applied in a way that demonstrates effective and efficient use of resources. Effective application of any specific compliance treatment strategy depends on three key capabilities – resources, design and execution. A tax administration is accountable to the government and the community for the cost-effective use of resources to achieve compliance outcomes. In terms of design, a tax administration needs to be able to engage the relevant industry or market segment, tax intermediaries, its own staff and other stakeholders in a collaborative process. In terms of execution, the tax administration needs to ensure that implementation of its treatment strategies is well planned, managed and communicated, demonstrating in the process a high standard of professionalism. These capabilities cannot be taken for granted and need to be consciously nurtured.

This has to be a dynamic and not a static process. The strategic goal of the tax administration should be to move the taxpayer population from the red end of the spectrum to the green end. In other words, it is to exert such influence on the compliance environment as would maximise voluntary compliance and minimise non-compliance. All decisions, whether strategic or
operational should be tested against the touchstone of whether they promote such movement or not. An ongoing measurement of the effectiveness of such actions is an integral part of risk management and a continuing review and reassessment and refining of risk mitigation actions on the basis of feedback, extensive data analysis and research should be an essential feature of the process. The main value of the model is that it contributes to a deeper understanding of taxpayer behaviour and its changes and lays the groundwork for the development of targeted strategies that encourage the motivation to do the right thing and constrain the motivation to resist or evade compliance. The evaluation of the outcomes of risk management process is, therefore, a critical aspect of compliance management.

**Evaluating the outcomes**

As is aptly said, what cannot be measured cannot be managed. Compliance measurement and measurement of the effectiveness of compliance risk treatment are essential ingredients of compliance management.

As discussed above, a compliance strategy is developed based on an assessment of indicators of risk that suggest that specific compliance behaviour warrants attention. For an evaluation of such a strategy to be worthwhile, it must have clearly defined objectives that are measurable. Without these, determining whether strategies impact taxpayer behaviour will largely be guesswork open to interpretation and subjective debate and this exposes the administration to the risk of continuing to sub-optimise their strategy selection.

It is, therefore, important that evaluation criteria be determined at the time the treatment strategy is being chosen or developed. Indeed, this is not only important from an evaluation perspective but also from a design perspective. Consideration of how a change in taxpayer behaviour is to be measured can often clarify the behaviour to be targeted. It can also help design a treatment strategy and its application in a manner that ensures that the data necessary for measurement is available in the required form.

Thus, it is necessary to develop compliance indicators\(^{238}\) that track compliance trends using a set of proxy measures derived from a variety of internal and external data sources. These indicators should enable the identification of compliance risks and issues for further study and the assessment of compliance effects of programme strategies and initiatives. They need to be identified by looking at each success goal and thinking about the changes expected if the strategies were effective and how they could be measured. When identifying indicators, consideration should be given to whether they are capable of showing:

\(^{238}\)An indicator is not a measure: it is a signpost to help staff understand whether the strategies adopted to treat a specific compliance risk have resulted in the change(s) being sought. It typically forms part of a suite of indicators chosen to help develop a credible picture of a strategy’s overall effectiveness.
• **Sustainability**: Identify indicators that can demonstrate progress and whether a positive change is maintained or declines over time. Select indicators that can show change over the immediate, intermediate and long term.

• **Ripple effects**: Include indicators that can show whether the strategies have had an effect on the wider population beyond the part of the population directly targeted by the strategies.

• **Unintended consequences**: Consider indicators that will show whether any unintended consequences have emerged as a result of the strategies used.

It is important that they are measurable and based on a combination of quantitative and qualitative data and are expressed in an objective and neutral form, bearing in mind that the purpose of an indicator is only to identify change, with no assumptions about the direction of the change.

Once a potential group of indicators for a compliance strategy has been identified, each indicator needs to be rigorously validated to establish its relevance to the purpose of measurement. At the heart of accurate measurement is the issue of data quality. Hence, data should be subject to quality standards and tested and filtered prior to analysis. As mentioned before, no strategy should be implemented without a clear process by which the outcomes can be evaluated and reported. Measurement considerations, therefore, must be an integral part of the development of a compliance strategy.\(^{239}\) There are a number of ways in which these measurements can be made. Prominent among such studies are:

• **Ex-ante and ex-post studies**: Ex-ante and ex-post studies assess changes as a result of an intervention. Measures are taken both before and after the intervention in an effort to understand whether there has been a change. For example, tracking behaviour over time, both before and after the compliance strategies are implemented, can help staff to understand whether there has been a change in behaviour that coincides with the implementation of the strategies. Great care, however, has to be exercised in determining the causal link between the intervention applied and the observed change. While in many situations such a link can be reasonably inferred, in others, it would need to be supported by detailed analysis of other supportive information.

• **Longitudinal studies**: A longitudinal study involves repeated observations of a specific set of participants over a period of time. It can allow a tax administration to measure key variables at different points in time. The same data are collected from the same participants at regular intervals. Longitudinal studies are particularly useful for understanding the long-term effects of a revenue body’s strategies.

When choosing a sample for a longitudinal study, consideration should be given to the likely effect of ‘churn’ on the sample size. Churn is the number of people who move in and out of a particular group over any given period of time. If a sample population has a high churn rate, it is likely a significant number of participants will drop out along the way. Increasing the sample size to allow for natural attrition of participants over time is one way to overcome this.

- **Measuring against standards/targets:** A standard or target is a reference point against which compliance behaviour or community confidence can be measured. It reflects a required or desired level of performance that indicates quality or success. For example, measuring behaviour against a standard or target allows a tax administration to see whether behaviour is moving towards (or has attained) what it regards as an acceptable standard of performance.²⁴⁰

Similarly, measurement needs will arise at several levels as depicted in Diagram 12.4 below. While the compliance effectiveness measurement at the strategic level would need to be oriented towards the measurement of outcomes, that at the operational level will have to be focused on measuring the effectiveness of specific risk treatment on the targeted transactions or segments. Thus, at the strategic level of the administration (the Boards in this case) the monitoring will primarily be of the outcomes such as a reduction in the tax gap, an increase in customer satisfaction, lower administration costs and compliance costs, etc. At the operational level of individual functions, it will be in relation to specific goals of the respective strategies and programmes and their outcomes in those functional areas. For example, for the compliance verification function, they could be audit effectiveness as reflected in the narrowing of the compliance gap in targeted segments, completion of planned audits in time, improvements in audit quality etc. At the tactical level, i.e. at the field level, the measurement will relate to specific cases and will include measures such as success rate in targeting (measured as the percentage of selection where predicted risk materialised), number of cases in which non-compliance was detected, evasion or avoidance detected etc.

**Diagram 12.4: Management levels of compliance monitoring**

<table>
<thead>
<tr>
<th>Management View</th>
<th>Focus of Compliance Monitoring</th>
<th>Provides Feedback on:</th>
</tr>
</thead>
<tbody>
<tr>
<td>STRATEGIC (The Boards)</td>
<td>Whole of tax system administration</td>
<td>Overall tax system health</td>
</tr>
<tr>
<td>OPERATIONAL (Functional Directorates)</td>
<td>Whole of tax and segment (or programme)</td>
<td>Overall health and administration of each tax</td>
</tr>
<tr>
<td>TACTICAL (Field Organisations)</td>
<td>Targeted compliance risk issues</td>
<td>Overall impact of risk treatment strategies</td>
</tr>
<tr>
<td></td>
<td>Targeted individual or groups of taxpayers</td>
<td>Programme management for segment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Impact of specific risk treatments on targeted compliance risk issues</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insight to individual group behavioural responses</td>
</tr>
</tbody>
</table>

*Source: Adapted from OECD*

Such measurement of changes has to feed back into the risk assessment process to ensure continuous improvement.

**Compliance measurement**

As noted earlier, there is currently no formal process of compliance measurement in the two Boards. Despite the difficulties inherent in the complexity of such an exercise, many developed tax administrations undertake compliance measurement as this is a useful guide for strategic planning and risk management. Broadly, the following methods are adopted for the purpose.

- **Tax gap analysis** – Tax gap is the difference between tax collected and the tax that should ideally be collected. It reflects tax revenue lost for a variety of reasons, including non-payment, evasion and use of avoidance schemes, error, failure to take reasonable care, interpretation of tax effect of complex transactions, operation of the underground economy, etc. The tax gap estimate is net of the department’s compliance activities. For example, in the UK, Her Majesty’s Revenue and Customs (HMRC) measurement work is largely focused around understanding the nature and extent of the tax gap. Measurement of this gap captures the measurement of compliance.\(^{241}\) HMRC calculates the tax gap by customer group, behaviour and type of tax.\(^{242}\)

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\(^{242}\)HMRC calculates tax gap in three categories. First, the tax gap by customer group consisting of large business, small-sized businesses, individuals and criminals. Second, the tax gap by behaviour, consisting of error, evasion, avoidance, legal interpretation, hidden economy, failure to take reasonable care and non-payment. Third, tax gap by
• **Audit-based compliance measurement** – The goal of audit-based compliance measurement is to determine the difference between each taxpayer's return as lodged and how it should have been lodged. Based on data, audit-based studies are of two types. First, random audit sample data is used to measure reporting compliance, which estimates the audit gap. Audit gap is the difference between the total amount of tax reported by taxpayers and the total amount reported if all tax returns were to be audited. Second, operational audit data can also be used to measure reporting compliance. However, the compliance measures resulting from operational data have the potential to be inaccurate and not representative of the taxpayer population. For example, the United States (US) National Research Programme (NRP) measures reporting compliance through audit-based data. The information obtained from these random audits can be used to estimate compliance rates within the populations sampled and to gain valuable insight into non-compliance. This information also enables comparisons between compliance rates among segments of the population and to track compliance trends over time.  

• **Survey-based compliance measurement** – Survey based compliance measurement also gives fairly reliable results as it uses responses from a sample of taxpayers where failure to report non-compliance has occurred. Using this method, the tax administration can capture an extensive range of explanatory variables that is otherwise only known to the taxpayers. These variables provide an understanding of compliance requirements, relevant values and attitudes, expectations of risks and the benefits of non-compliance, and other events that affect a taxpayer’s willingness to comply. For example, HMRC’s customer survey report measures the customer experience that is drawn from the perception of customers.

• **Analytical modelling**: Compliance can be measured through analytical modelling such as descriptive modelling or through predictive modelling. Various statistical and mathematical methodologies are used for extrapolating raw compliance measures, each of which holds the potential to provide varying degrees of descriptive and predictive power. This method is subject to the availability of audit-based compliance measurement data.

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241 However, different tax administrations use different ways to measure reporting compliance.


Measuring voluntary compliance

Considering that promotion of voluntary compliance is the principal objective of the administration, it becomes important to measure it in order to track whether it is improving or regressing. It is hard to measure it directly. The closest to measuring voluntary compliance is by measuring voluntary payment, as it is observable and measurable. Between voluntary compliance and enforced compliance, there is an element of mutual feedback – an element of enforcement is inherent in voluntary payments and there is an element of voluntariness in enforced payment. For example, all pre-tax return filing such as TDS, advance tax are considered to be voluntary payments, but there is an enforcement element as TDS Commissioners carry out enforcement activity that leads to the collection of TDS. Advance tax payments are also regularly monitored by Commissioners and often taxpayers are thereafter asked to pay taxes.

Similarly, there is an element of voluntariness in enforced payment. All post-scrutiny or audit payments have a voluntary element; for example, if any tax demand is made on a taxpayer and he simply pays it, it exhibits the voluntary component in that enforced payment. This shows the mutual feedback impact between the voluntary activity and the enforced activity of the taxpayer.

If the voluntary activity of a taxpayer has to be measured, which is also an important objective of the two Boards, the enforcement element will have to be removed from the voluntary payment so as to arrive at a true picture. One method that can be used to do so could be the principal component method in statistics. This method will help in segregating the feedback effect between voluntary payments and enforced payments. While the TARC is suggesting the principal component method, the Boards can decide to employ any other method among the many methods available as they deem fit.

The discussion above immediately makes apparent the organic link between the organisation’s strategic planning and the strategic risk management process. It also makes apparent the value of an integrated risk management framework encompassing both direct and indirect taxes.

If the two Boards are to move from the current situation to a robust and reliable compliance management, they will need to adopt the compliance risk management framework as outlined above, which would also include a compliance measurement programme. International experience bears out that strategic risk management is most effective in a unified tax administration wherein a unified and a holistic approach to assessing and managing risks can be adopted. In Chapter III of its Report, the TARC has recommended a roadmap to such convergence and unification. While

247 Principal components are defined as normalised linear combinations of various tax components, which have the property that the first principal component accounts for the largest proportion of total variation in all tax components, the second principal component accounts for the second largest proportion of total variation in all tax components and so on. If as many principal components as the number of tax components are computed, the total variation in all tax components is accounted for by all principal components together. Indexing the Effectiveness of Tax Administration, Economic and Political Weekly, December 15, 2007 and Business Standard, February 23, 2008
unification of the administrations may take time in India, it is critical, as already recommended by the TARC, that the two Boards develop a common risk management framework and design and implement their strategies based on extensive data sharing and a high degree of collaboration and co-ordination among themselves.

In terms of ownership, while the broad enterprise wide risk management framework will be the responsibility of the Strategic Planning and Risk Management (SPRM) function as recommended in Chapter III of the TARC’s Report, the ownership of risk management in each key area will need to reside with the relevant functions such as compliance verification and enforcement. It will need to be ensured that there is required cohesion between the organisation wide risk management and the risk management strategies and operations adopted in each functional vertical. This will demand a high amount of co-ordination which could be achieved by the Risk Management Committees in the Boards, comprising the Members of the Boards and heads of the functional verticals, which could meet, say on a quarterly basis, to review the performance of the various risk treatments across the different functions and ensure continuing alignment of the functioning of the different key functions with overall strategy of the organizations. It will also be necessary for the Boards to put in place mechanisms at the level of the SRPM and key functional verticals for CBDT-CBEC co-ordination, through such committees, which need to be given a clear charter of responsibilities. This will be an important function of the SPRM vertical.

This needs to be a properly structured and documented process. It is a good practice to maintain and regularly update risk registers, which document the strategic and operation risks and enables the monitoring of their management. While the SPRM vertical should maintain the risk register for organisation wide risks, the risk management functions within each vertical should maintain their risk registers.

Strong research and analytical capability is needed to support effective compliance management. Use of big data analytics and business intelligence tools can provide valuable insights about risks. The best results are obtained by teams that combine a high level of technical or specialised skills and strong domain knowledge and understanding. Hence, while existing compliance skills of the two Boards will continue to be valuable even after the implementation of sophisticated ICT systems, the induction of such skills and research capabilities will be a key element in effective risk management. Besides skills in ICT and data analytics, skills in areas such as mathematics and statistics and behavioural sciences that are not immediately associated with revenue administrations are particularly valuable in the identification and sizing of risks. Some tax administrations like New Zealand hire mathematicians with specialisation in risk analysis. These skills need to be created if compliance risk management is to attain sustained success. Chapters III and VII of the TARC Report had recommended the creation of a Knowledge, Analysis and Intelligence Centre (KAIC), to meet the needs of such advanced analytics. It also recommended that it should operate on the shared service model. While the KAIC will meet the needs of advanced analytics and research in the studies that might be assigned to it, each functional vertical will need to build and sustain the required analytical and risk management skills in house, coupled with high
degree of specialised knowledge about key sectors and industries. As already recommended by the TARC earlier, the HR policies of the Boards need to be revamped to make them conducive to building and sustaining such specialisation and skills, either by training internal candidates or by induction of specialists from outside.

Top management sponsorship is critical for the success of compliance risk management. For it to be effective, it is important for the compliance risk management methodology to be central to organisational reporting, governance and decision-making processes. Equally critical is the need to ensure buy-in of the management as well as the frontline staff. Effective communication by the leadership is necessary to establish a clear link between the compliance strategy and its execution at the frontline level. In internal communication, the officers responsible for risk treatment should have broad awareness of their role in the risk management process and get adequate guidance to carry out effective risk treatment. While the details of methodology and tools of risk assessment have to be necessarily secret, a general awareness among the taxpayers that the tax administration deploys an effective risk management programme itself has a salutary impact on the tax environment. It is, therefore, necessary to create and sustain the perception that such a system exists. This can be achieved by appropriate reporting of performance through annual reports on key result areas. The two Boards must publish this as part of their overall accountability framework.

Compliance management also needs to be underpinned by robust governance, including appropriate structures and processes, and human as well as technological resources in the tax administration. The current structures and processes in the Indian tax administration are unsuitable for effective compliance management, characterised as they are by lack of functional specialisation, a weak link between policy and delivery and an absence of accountability, as detailed earlier. Therefore, functional restructuring, accompanied by sound performance management, is an essential pre-requisite for such a framework to operate successfully.

The principal elements of a well performing compliance management framework are customer focus, compliance verification and enforcement. These are discussed below.

**XII.4.c Customer focus**

Taxpayer services can be defined as any activity that involves providing assistance and answers to taxpayers who have questions about filing, collections, audits and other issues. Service can be provided through multiple channels including call-centres, websites, e-mails and tax administration offices. By adopting efficient and effective operating practices in taxpayer services, tax administrations can not only reduce costs but also boost taxpayer satisfaction, which helps to increase voluntary compliance by making it easier for taxpayers to comply.

Section II.3 of Chapter II of the TARC’s report had noted the acute absence of customer focus in both the CBDT and CBEC and the absence of a focused and coherent organisation wide taxpayer services programme. It had made a number of recommendations relating to the structure and
COMPLIANCE MANAGEMENT

governance of the programme. Having covered this aspect in detail earlier, the TARC would not like to repeat it except to reiterate that those recommendations deserve serious consideration by the government. Among other things, the TARC has recommended the creation of a separate functional vertical for taxpayer services that will own the responsibility for this function and will be in charge of delivery of taxpayer services. It has also recommended a number of measures for improvements in this regard. While they are not being repeated here, the TARC wishes to re-emphasise the importance of the customer centric attitude in all aspects of administration.

Indeed, taxpayer services encompass a wider range of services than are technically regarded as taxpayer services. A number of areas that may fall within other functional responsibilities need to be recognised as taxpayer services. Dispute resolution, for instance, could be construed as a taxpayer service. Similarly, compliance verification also will have elements of taxpayer service. Indeed, other than purely enforcement functions, all these have elements that can be regarded as providing a service to the taxpayer.

Unfortunately, the absence of customer focus in the attitude and approach of the two Boards is palpable in every respect, whether it is the approach to legislation, policy or procedures. The aspect of customer convenience or compliance cost rarely receives the importance it deserves when any issue is addressed.

A number of examples of this inexplicable absence of consideration of the impact of decisions on taxpayer cost or convenience can be cited. In the Union Budget 2014, for example, provisions were introduced to provide for compulsory pre-deposit of 7.5 per cent and 10 per cent of the duty amounts (subject to a maximum of Rs. 10 crore) for admission of appeals before Commissioners (Appeals) and Customs, Excise and Service Tax Appellate Tribunal (CESTAT) in the indirect taxes. Earlier, the Tribunal could waive pre-deposit in its entirety in suitable cases. In the budget documents, the reasons that led to the introduction of these provisions are nowhere mentioned even cursorily. Reportedly, this was done to address the issue of a large proportion of the time of the CESTAT being devoted to hearing and disposal of applications for the waiver of pre-deposit, leading to delays in final disposal of matters. While there appears to be some logic in this, if one looks at it from the perspective of a taxpayer on whom a wholly unjustified demand has been inflicted, it cannot but appear vexatious. The measure would not have appeared as unfair as it does, had fairness, legality and judiciousness been the norm in the departmental orders. As is widely acknowledged, the real situation is exactly to the contrary. This, coupled with the persisting unwillingness of the departmental authorities to refund in time amounts that are held to have been erroneously collected from taxpayers, can only mean that the injury to the taxpayer, who has already suffered from an iniquitous and illegal demand, would be further compounded. Had these aspects been considered while analysing the problem and formulating the proposals, the solution would have achieved a balance between the need to reduce the burden on appellate authorities on the one hand and avoidable hardship to taxpayers on the other. More importantly, the Board would have addressed the root cause of the problem of clogging of the appellate fora with stay
applications, which is unjust and low quality orders on the part of its officers, rather that attempting to treat the symptoms of that malady.

The amendment to the CENVAT credit rules to discontinue the facility of inter-unit transfer of credit that was available to LTU clients is another case in point. With the stroke of a pen, a benefit that was initially held out as an incentive for compliant taxpayers to join LTUs, was withdrawn without notice. It was also not thought fit or necessary to share with the taxpayers what reasons impelled the CBEC to adopt this regressive measure. Such an approach and attitude can hardly be described as being calculated to promote a climate of voluntary compliance – a stated objective in the Vision of the CBEC – or to attract large taxpayers into the LTUs.

Similarly, the imposition of the minimum alternate tax (MAT) on special economic zones (SEZs) in 2011 has severely affected the business environment. Irrespective of the views that might be taken on the SEZ policy, it needs to be recognised that investments decisions which are over multi-year time horizons need a stable tax environment for investment certainty. Frequent changes in tax laws and administrative procedures adversely affect existing investors and discourage prospective investments, affecting the economy and attitude towards tax payments.

In relation to refund, the provisions of Section 143(1) of the Income Tax Act envisage refund to the taxpayer based on the claim in the return. However, through insertion of Section 143 (1D) in 2012, such refund is held back in cases where the return is selected for scrutiny by CASS. The taxpayer, therefore, has to wait for refund until the issue of the assessment order. Such taxpayers are clearly at a disadvantage vis-à-vis those whose returns are not selected and who get the refunds in an immediate and automated fashion. Such discrimination did not exist prior to 2012. Selection on the basis of risk assessment is the internal business of the department and, looking at it from the taxpayer’s perspective, it would certainly appear unfair and discriminatory. This is yet another example of absence of customer focus in the mentality of the department.
On the income tax side, countless assessees have faced difficulties owing to the tendency on the part of the assessing officers to arbitrarily adjust refunds against demands, many of them artificially created, without any reference to the assessees, which is a most unjust and unreasonable approach. The magnitude of the harassment resulting from the non-matching of TDS and the resultant denial of refunds led the Delhi High Court to issue detailed directions, in the form of a 7-point mandamus, following which the CBDT issued a series of instructions to address the issue (see Box 12.3). The fact that it took stern orders from the High Court for the CBDT to seriously address the burning issue of inflicting harassment on a large body of taxpayers, can only be a reflection its attitude towards the taxpayer. Had the impact of the change to centralised processing on the taxpayer been properly considered and included in change management planning, many of the difficulties eventually faced by the taxpayer would have been anticipated and plans put in place to mitigate them. This would have avoided the widespread inconvenience to the taxpayers and criticism of the department.

**Box 12.3 Public interest litigation in TDS issues**

In April 2012, Shri Anand Prakash, wrote a letter to the Delhi High Court voicing the agony of countless taxpayers, after he experienced utter helplessness and frustration due to numerous difficulties faced by taxpayers arising from the faulty processing of income-tax returns and TDS credit. Shri Anand Prakash pointed out that in processing the tax return under Section 143(1) of the I-T Act, there was invariably a mismatch between the TDS credit claimed and the TDS credit granted and demands were raised due to such mismatch. The department ignored the figure of TDS credit claimed and mechanically granted credit only for the credits shown in the online computer records, as available in Form No. 26AS. The taxpayers’ protests were ignored even when proof of the TDS deduction was produced. Thereafter, demands were raised and often adjusted unilaterally with refunds that may be due to the taxpayer in future.

The mismatches were primarily due to errors or failure on the part of deductors and the only recourse for the taxpayer was to chase the deductors, many of them being government departments against whom the taxpayer was helpless. However, when it came to issuing demands, or adjusting fictitious demands against refunds, the department seemed to show remarkable promptitude.

The letter also pointed out that before fully or partly adjusting the refunds against past arrears, no opportunity was being given to the taxpayer though Section 245 of the Act provides for this.

The Delhi High Court took notice of the letter, treating this as public interest litigation. After a detailed and critical examination of the issues, it delivered detailed orders in Writ Petitions (Civil) Numbers 2659/2012 and 5443/2013 on July 31, 2012 and March 14, 2013, respectively. These orders included a 7-point mandamus to the CBDT. Based on the mandamus, the CBDT issued necessary instructions implementing the directions of the Delhi High Court.

Concerns of taxpayer convenience and reduction in compliance cost get the short shrift when it comes to various procedures as well. The administrations show a marked propensity to respond in a knee jerk fashion to isolated instances of violations by a few taxpayers, leading to an increasing web of complexity in procedures. And such changes get permanently embedded in the procedure, long past the time when they may be needed, as there is no ongoing or periodic review of processes.
with a view to simplifying them. Often, to cover the risks arising from the administrations’ own inadequacy or ineffectiveness, taxpayers are burdened with additional requirements.

Customer focus, therefore, must inform all the activities of the administration and this entails that the values of continuous improvement and business excellence occupy a central place in the working of the administration, replacing the inward focus typically displayed. It is only then that there will be constant attention paid to increasing convenience and ease of compliance for taxpayers and reducing their compliance costs. In Section III.5.a of Chapter III, the TARC has recommended a directorate of business excellence whose task it will be to evaluate overall organisational effectiveness, formulate plans for overcoming deficiencies and for continuously improving performance quality.

The values that underlie taxpayer services thus need to be an integral part of tax governance and the tax administration must adopt a positive, solution-oriented approach in all their dealings with the taxpayer. It needs to be realised that every touch point of the taxpayer with the tax department creates a potential opportunity for the administration to establish a healthier relationship with the taxpayer and influence public perception about itself. Marketers recognise the power of “word of mouth communication”. The tax administration directly deals with only a small fraction, say 3 to 5 per cent of the total taxpayer population. However, the impressions these dealings leave with this small population are shared and shape the opinion of the entire society. A service-oriented attitude, therefore, is fundamental to the transformation of the taxpayer experience.

Critical to the success of taxpayer services is effective communication. Voluntary compliance requires that taxpayers must clearly understand their obligations. This means that laws must be expressed in language that is as simple and free of jargon as possible and should be unambiguous. The TARC has dealt with this aspect in Section III.4.a of Chapter III and made a number of recommendations relating to the drafting of legislation while discussing governance.

The important aspect is that there is a need to eliminate the asymmetry of information between the administration and the taxpayer. The taxpayer needs to have access to all that information that is relevant to compliance that is available to the tax administrator. As noted in the previous section, most administrations accord the highest priority to this aspect. The TARC has made a number of recommendations in relation to this in Section II.4.a of Chapter II and Section VII.3.c of Chapter VII of its report, including a maturity framework for continuous improvements in e-services. Both the Boards need to take measures in this direction, including the adoption of “what is not on the website does not exist” principle.

Small initiatives can lead to large successes as exemplified by the “nudge” letters in the UK mentioned in Appendix XII.1. Similarly, the CBDT’s recent initiative on information driven compliance deserves mention. In this, the CBDT, through data analysis in the non-filer monitoring system (NMS), was able to identify 34.28 lakh non-filers with potential tax liabilities. Customised letters with information summary were issued subsequently to all these cases. The electronic responses from the taxpayer were captured in the compliance module rolled out in February 2014;
an online monitoring system was implemented for this purpose. So far, a collection of Rs. 4000 crore has resulted from this activity. There does not appear to have been a similar programme on the CBEC side and there is need for it to take steps in that direction.

XII.4.d Cultivating a culture of compliance – starting early

The present tax culture needs to be changed. At present, both the Boards carry out information as well as educational campaigns, targeting taxpayers. But such campaigns need to be broader and should include a larger section of the population that would comprise students at different stages of their education. Recently, the CBDT had taken an initiative in this respect to launch courses on taxation for schoolchildren in the age groups of 10-12 years and 16-18 years. The same can be extended to reach out to students at the undergraduate level. This segment of people comprises soon-to-be taxpayers. They are at a key juncture in their socialisation and a tax awareness programme, carrying the message to them that tax compliance is an integral and necessary part of civic engagement, can have a salutary effect on improving voluntary tax compliance. This will also prepare these students, who are on the threshold of adulthood, to be responsible and compliant citizens. The campaign can educate students on the concept of taxation, generating interest and awareness in their minds. The important modes of message delivery will not only be through the college curriculum, through which age appropriate material will be presented through class room sessions and projects, but also through the organisation of quizzes, debates, essay competitions, games, online tutorials and other similar modes. The subject can cover the rationale for taxation, how the government raises revenue and spends it, the role of government in society and the relationship between the tax administration and the taxpayer. The overall strategy of this campaign will be to generate willingness among students to contribute towards nation building.

The message through the tax course will be to inculcate a belief that paying taxes is ethical and is a value norm. Students will get clear and objective inputs on the need for taxation at a determining stage, which will not only enable them to fulfil their tax related obligations, thus making better choices for the future, but also act as a pressure group for their parents and extended family, convincing them to pay their due taxes. By reaching out to students at a young and impressionable age, the strategy can bring about a long-term cultural shift in the entire society. This will be on the same lines as environmental education, which has been introduced recently by the government across all streams of undergraduate education.

In this context, on behalf of the TARC, the Secretary, TARC had discussed with the Chairman, University Grants Commission (UGC), the possibility of developing such a programme and the inclusion of the relevant educational material in the teaching curricula at the undergraduate level. In the course of these discussions, Chairman, UGC welcome the idea and suggested that if the relevant guidance material were to be provided, it would facilitate the introduction of the course in the teaching curricula. He further suggested that the proposal, with the guidance material, needs to be taken up by the Ministry of Finance with the Ministry of Human Resource Development and the UGC to enable the introduction of an undergraduate course compulsory across all streams of
Chapter XII

The course should cover topics like the role of taxation in governance and development of the economy, hallmarks of a good tax administration, the relationship between the taxpayer and the tax administration, importance of the voluntary compliance and simple “dos” and “don’ts” for voluntary compliance. A primer for the purpose, developed by the TARC with the help of an expert committee, comprising university and college professors, is given in Appendix XII.3. The TARC recommends that the Ministry of Finance should take up the matter with Ministry of Human Resource Development.

XII.4.e Compliance verification (Audit)

The primary mode of verification of compliance is the processing and verification of the data furnished in the returns filed by taxpayers. Although commonly referred to as “assessment”, this expression conveys an erroneous impression about the true nature of the process. This is because in an environment of self-assessment, it is the taxpayer who has assessed and paid his own taxes and submitted the information regarding his self-assessment, as prescribed by law, in the form of a return or a declaration. What the tax administration does, can more accurately be described as a verification of his compliance. As mentioned, on the direct taxes side, this verification is carried out by officers on the returns selected by CASS in the large majority of cases and on the basis of certain other criteria in cases like transfer pricing.

On the indirect taxes side, a distinction is made between scrutiny of returns and audit and the responsibilities as well as approach to risk appear to be divided. While the range officers in the field handle the scrutiny of returns, the audit branches (now, after re-structuring, by the audit commissionerates) are responsible for audit. The TARC believes that these activities need to be regarded as an escalating matrix of a compliance verification continuum as depicted in Diagram 12.5 below, and managed on the basis of a common risk assessment plan that includes the compliance history of the taxpayer.

Diagram 12.5: Compliance verification continuum

This will necessitate the following changes:

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248 Appendix XII.3 is designed to be a tear away guidance note for universities and therefore, the diagrams, tables and boxes are not in seriatim with the rest of the Chapter.
The return process should comprise robust system-based checks and validations to ensure the data are true, accurate and consistent. Any errors or corrections that cannot be fully automated and need human intervention should be handled in the central processing centre (CPC) itself and through the use of ICT base communication. This is happening already in the CBDT. Although initially, there were many problems encountered in the operation owing to deficiencies in data, lack of communication between the CPC and the assessing officers, etc., many of the issues are reported to have been resolved. As mentioned below, the CBEC needs to align its structures and processes with this paradigm.

Desk-based scrutiny or desk audit will be similar to the current “assessment” process. In short, this is compliance verification in the cases selected on the basis of risk assessment in the tax office itself. In the CBEC, the process of desk review, which currently is only a prelude to on-site audit, will have to be made richer to encompass full compliance verification.

On-site audits will be the last element of the compliance verification continuum to be undertaken on the basis of careful risk-based criteria. In the case of the CBDT, this will mean that their verification programme will have to include visits to assessees’ business premises, which it currently does not carry out. On the CBEC side, it will mean that every audit need not involve visits to factories or business premises of the assesse and a part of audit activities will be completed in the offices of the CBEC. It will also mean that the activities related to the current processes of preliminary and detailed scrutiny of returns will merge either in the return processing or desk audit and will be handled in the CPC or tax offices as the case may be.

Further, as elaborated below, the CBDT needs to consider adopting a process similar to EA 2000 followed in the CBEC, which is a robust and systematic way of handling audit.

In direct taxes, many tax administrations segment taxpayers and focus on wealthy and complex (in terms of sources of income) individuals in society. Although small in number, they contribute significant revenue. HMRC uses cluster analysis to identify the networks of HNWIs to improve their compliance management. Chapter XI of this Report deals with this in detail. The CBDT should similarly pay attention to this segment, which is practically absent today. Such analysis, in many instances, could be valuable for service tax as well.

The data in Tables 12.6 and 12.7 below depict the current state of scrutiny and verification of returns in central excise and service tax.
Table 12.6: Scrutiny of central excise returns

<table>
<thead>
<tr>
<th>Year</th>
<th>Opening Balance</th>
<th>Receipts</th>
<th>Disposals</th>
<th>Closing Balance</th>
<th>&lt; 3 months</th>
<th>3 - 6 months</th>
<th>6 - 12 months</th>
<th>1 - 3 years</th>
<th>3 years and above</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 08</td>
<td>86,943</td>
<td>78,383</td>
<td>80,386</td>
<td>84,940</td>
<td>75,255</td>
<td>6,990</td>
<td>2,268</td>
<td>354</td>
<td>73</td>
</tr>
<tr>
<td>FY 09</td>
<td>94,499</td>
<td>80,820</td>
<td>81,489</td>
<td>93,830</td>
<td>82,871</td>
<td>9,080</td>
<td>1,559</td>
<td>245</td>
<td>75</td>
</tr>
<tr>
<td>FY 10</td>
<td>101,911</td>
<td>83,413</td>
<td>85,811</td>
<td>99,513</td>
<td>88,219</td>
<td>9,422</td>
<td>1,348</td>
<td>432</td>
<td>92</td>
</tr>
<tr>
<td>FY 11</td>
<td>153,833</td>
<td>74,719</td>
<td>69,422</td>
<td>159,130</td>
<td>118,514</td>
<td>28,272</td>
<td>11,296</td>
<td>960</td>
<td>88</td>
</tr>
<tr>
<td>FY 12</td>
<td>308,734</td>
<td>89,713</td>
<td>103,898</td>
<td>294,549</td>
<td>171,259</td>
<td>68,765</td>
<td>38,082</td>
<td>16,388</td>
<td>55</td>
</tr>
</tbody>
</table>


Table 12.7: Scrutiny of service tax returns

<table>
<thead>
<tr>
<th>Year</th>
<th>Receipts during the year</th>
<th>Disposals during the year</th>
<th>Shortage/ Excess</th>
<th>Shortage/ Excess in percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 10</td>
<td>783,706</td>
<td>738,309</td>
<td>(-) 45397</td>
<td>(-) 5.79</td>
</tr>
<tr>
<td>FY 11</td>
<td>808,760</td>
<td>834,532</td>
<td>25,772</td>
<td>3</td>
</tr>
<tr>
<td>FY 12</td>
<td>955,996</td>
<td>721,123</td>
<td>(-) 234873</td>
<td>(-) 24.57</td>
</tr>
</tbody>
</table>


Considering that the respective manuals prescribe selection of 5 per cent and 3 per cent of excise and service tax returns to be picked up by officers for risk-based scrutiny, the figures appear inexplicable and of questionable credibility. If one were to go by the age wise break-up in central excise, it would appear that the large majority of returns were pending for less than three months. If that were so, it is unclear how such a large number of returns were picked up for scrutiny, in the face of the selection criteria of 5 per cent. Although the service tax data do not reflect the age of returns, the position appears similar there also. Apparently, therefore, there has been a large backlog of returns awaiting scrutiny. This would seem to indicate that the ACES system is not functioning as well as it should in terms of validations in the returns submission process.

The TARC believes that the operating principle in an efficiency driven process such as return processing should be to avoid the use of human resources in situations in which an algorithm can do the job. Human intelligence can be used for other activities where effectiveness is important.
and where it adds value. Further, in relation to statutory functions, the governing principle will have to be that discrepancies or issues that can be resolved remotely using ICT-based communication should be handled in the CPC itself and only those that need physical verification or physical interaction with taxpayers should be sent to the jurisdictional officers.

By going in for a centralised processing approach, the income tax department has followed this principle. Seeing the substantial improvements and the consequent economies that have been achieved, there is a strong case for the adoption of the same approach in indirect taxes. The TARC has recommended this in Section VI.3.a of Chapter VI of its report. Similarly, it has recommended centralised processing based on centres of excellence approach for customs as well in Section VIII.4.e of Chapter VIII of the TARC report.

A large number of discrepancies in returns, which are currently dealt with manually (hence the large workload as reflected in the data in the tables above), can be handled in the system without human intervention if a robust set of ICT-based validations are put in place. This is particularly important for the CBEC at the present juncture when the implementation of GST, which will lead to a quantum leap in the number of taxpayers to be handled by the CBEC and may necessitate processing of returns containing dealer level or invoice level transaction details, is on the anvil.

There is a need to revisit the returns in central excise and service tax. Currently, the data in the returns are not being utilised for meaningful analysis of trends and possible revenue leakage. The returns are not linked to the financials of the company and the reconciliation sought at the time of audit is not followed properly. There is an urgent need to prescribe an annual tax return in central excise and service tax, which is similar to the tax audit report prescribed under Income Tax Act, 1961. It should be accompanied by a CA certified reconciliation of the annual financial statement. Similar requirements exist in VAT administrations at the state level in India as well as abroad. The submission of that reconciliation can be timed with Form 3 CD or income tax returns, or better still, the data submitted to the income tax department could be shared between the CBDT and CBEC on the principle of “one data many users” as recommended in Section IX.5 of Chapter IX of the TARC’s report. Such a return would help officers in reconciling financial transactions vis-à-vis the correctness of tax liability. Proper design of this annual return has the potential to provide a 360-degree view of taxpayer compliance in relation to direct as well as indirect taxes to both departments. The monthly/quarterly returns can then be simplified mainly for tracking the flow of input credit. This can also form the basis of audit.

Going forward, time should not be lost by the CBEC in developing a common return for central excise and service tax and align the frequency of return submission across the two taxes. This would be a major step contributing to a smooth rollover into the goods and services tax (GST). If separate returns for goods and services are envisaged to be continued under the GST, India may be cited internationally as a unique outlier, calling it a GST with little true characteristic of the tax.

On the CBDT side, the integrated taxpayer data management system (ITD-MS) now generates a 360-degree profile of an entity by compiling information on a dynamic basis from all data sources...
to track tax payments. The government has so far implemented the ITD-MS tool in all 20 Directorates General of Income Tax (Investigation). Despite being in operation, it is not comprehensible why the ITD-MS has not been extended for audit selection. This needs to be immediately rectified so that the information is used for audit selection as well.

Structure

The TARC had, in Chapters III and V respectively of its report, recommended the creation of a separate functional vertical for compliance verification and had given certain recommendations about the process in line with best international practices.

With the creation of separate audit commissionerates as a part of its cadre restructuring, the CBEC seems to be moving in alignment with the TARC’s recommendation. The delinking of the audit function from the existing executive Commissionerates and the establishment of single function audit commissionerates is likely to bring greater depth of knowledge, cohesion, uniformity and specialisation in the sphere of audit. This, coupled with reorientation and strengthening of DG (Audit), has the potential to create a functionally integrated and vibrant audit vertical within the CBEC. The TARC is not aware of any such change in the restructuring exercise in the CBDT.

In the structure recommended by the TARC, the field formations in the CBEC were to report to the Principal DG (Audit), the idea being to ensure strong control and management of the delivery of the audit programme and a strong link between policy and delivery. It appears that in the proposed structure in the CBEC, the audit commissionerates will report to the respective zonal chief commissioners. The CBEC needs to change on this aspect, bearing in mind both administrative and functional dimensions. It needs to ensure that there is strong programme ownership and management control on the function vested with the DG (Audit), to ensure cohesion and coherence in audit functioning across the country. DG (Audit) should have primary responsibility for the management of performance and should be vested with the necessary authority to do so.

Similarly, the audit commissionerates should have a uniform administrative structure having both geographically oriented, as well as functionally oriented, jurisdictions that are controlled by its subordinate offices.

The functional responsibilities of Directorate General of Audit should, inter alia, include:

i) Programme ownership and management of the entire compliance verification programme, including the CAAP

ii) Risk management for the compliance verification function

iii) Policies and processes relating to compliance verification

iv) Development and maintenance of manuals
v) Research and analysis relating to key sectors of the economy and key issues of compliance

vi) Internal and external co-ordination, including with other relevant ministries, regulatory bodies, industry associations, etc.

vii) Lead role in competency building and skill development in key areas of compliance verification

The DG (Audit) should also regularly bring out Audit Technique Guides (ATGs) for specific industry/service sectors that can improve the skills of auditors undertaking departmental audit. The ATGs can be prepared by the Directorate of Audit after undertaking a detailed study on the specific industry/service sector, the legal provisions and statutory requirements governing the sector, the areas of non-compliance observed in such sectors, and the strategies and methods that can be applied by auditors while undertaking audits to obtain better results. Such guides are issued by several advanced tax administrations in the world.

Unfortunately, owing to lack of manpower and non-availability of reliable data for analysis, the risk management function is currently very weak. For effective risk management, there is need for strong ICT support, including an extensive use of data analytics (making extensive use of not only internal but also a wide range of external data) and business intelligence for accurate identification of risks. The potential benefits of use of third party data are exemplified in a recent initiative undertaken by DG (Audit), CBEC, as detailed in Appendix XII.2. Good success was achieved in detecting non-compliance in service tax using data obtained from the CBDT and other regulatory agencies. Similarly, the CBDT is reported to have secured spectacular results using data obtained from service tax authorities. While these are laudable initiatives, they need to be developed into a sustainable, institutionalised mechanism so that such data exploitation becomes an integral feature of tax administration. With the CBEC having implemented its data warehouse project and the CBDT planning its own, there should be substantial improvement in information availability for risk management for audit.

Providing programme leadership in CAAP audit is another major area of work for the Directorate of Audit. Increasingly, with the rapid pace of digitization, the importance of computer based audits, already high, is bound to increase and conventional audits are bound to diminish in relative importance. The skills in this area, however, are woefully inadequate. The CAAP audits at present are very rudimentary, except in a few rare cases. Most officers have very limited knowledge of the potential of CAAP, owing to lack of exposure and training.

Effective segmentation and proper matching of workload to resources available are fundamental to successful risk management. Audit planning and execution, including selection of taxpayers for audit, needs to take this into account. More sophisticated criteria need to be adopted in place of the selection norms in the CBEC as well as CASS in the CBDT. They need to do segmentation by industry as well as by size, based on careful risk assessment. The consequence of the current rather rudimentary approach is that the selection hardly inspires confidence.
In the CBEC, the result of the mandatory criterion of the annual audit of all units paying revenue of Rs.3 crore or above is that many large units get audited year after year with little result arising from repeated audits. In the CBDT, the mandatory scrutiny of transfer pricing cases involving international transactions of Rs.15 crore and above is leading to a disparity in practices creating widespread dissatisfaction among taxpayers. The perception cannot be avoided that the Departments subject compliant taxpayers to a higher degree of checks based on tax payment, while paying little attention to non-compliance elsewhere. Therefore, both the Departments need to give up the concept of mandatory audits and develop criteria which are based on sound risk assessment. In doing so, greater reliance needs to be placed on the risk evaluation of the concerned entities, and the frequency and the methodology to be adopted for compliance verification need to be decided based on such evaluation. The frequency as well as the depth of examination in the case of a low-risk business, thus, needs to be much lower than for a relatively more risky entity.

There is also the need to plan audits on a more sophisticated basis using robust segmentation and having regard to the availability of resources. Audit plans should be developed for each year based on decisions regarding the strategic priorities for the year. For a given year, for instance, the focus could be on certain key industries and taxpayers in that industry could be selected for audit based on their risk assessment. The plan should provide for a balance between priorities based on national as well as regional or local factors and the workload should be divided commensurately. Similarly, resources in terms of time and staff should be planned based on this strategy. The audits planned on the basis of national priorities, even though they might be delivered through the field audit commissionerates, should be planned and strongly co-ordinated by the DG (Audit) so that they are conducted in a synchronised manner. The selection of priority industries as well as businesses to be audited should be done by the Directorate General of Audit based on systematic and methodical risk analysis of internal data, economic indicators, regulatory changes affecting businesses, third party information from tax and other regulatory authorities and other relevant sources of data. The DG (Audit) should also consult trade and industry associations from time to time, wherever necessary. The selection should be intimated in advance so that audit plans can be co-ordinated between nationally driven and locally selected audits.

As indicated above, while audit coverage (i.e., numbers of units selected for audit in a year) should be calibrated with manpower availability in commissionerates, adequate coverage of different segments of taxpayers such as large, medium and small should be ensured. DG (Audit) will need to regularly review the segmentation criteria, audit team composition and number of days required for audit in each category to achieve optimal coverage. This should be done in consultation with the audit commissionerates so as to ensure that audit coverage by officers is made optimal.

There is also a need to integrate audits in indirect taxes. Currently, in the CBEC, audit is undertaken for each tax separately even though the business and financial records verified during the audit are common for all the three taxes administered by the CBEC. There is need to integrate the audit of assesses and this is eminently feasible when a specialised audit organisation has been set up. This will not only substantially reduce inconvenience and compliance cost for taxpayers, it will also
improve the quality of audit as the audit teams will be able to take an integrated view of the business. The role of DG (Audit) in relation to customs is at present not very clear. The CBEC needs to vest the programme ownership of customs audit clearly in the DG (Audit).

There is also need for the CBEC and CBDT to work towards joint audits in large cases. When the large business service (LBS) is established, as recommended in Section III.4.b of Chapter III of the TARC report, the audit function should be a part of that service. In the meanwhile, the two Boards could make a beginning in the existing LTUs and commence such audits. In its restructuring, the CBEC should establish separate audit commissionerates, with all-India jurisdiction, for LTUs. Further it should ensure that the audit staff is situated in the offices of the respective LTUs, which is essential from a customer service perspective. Considering that the administration of two LTUs is managed by the CBDT and that of the other three by the CBEC, they both need to ensure that the culture of separateness is set aside and audit is practiced as a common function.

Audit process

As has been noted earlier, the EA 2000 process for audit that was introduced more than a decade ago, is a robust process that provides for scientific, risk-based selection, systematic pre-preparation for audit, methodical and well documented conduct of audit and subsequent monitoring. It provides clearly laid out principles and practices. The audit procedure is delineated in Central Excise and Service Tax Audit Manuals. There appears to be no similar process in the CBDT. The TARC feels that the CBDT should adopt it, mutatis mutandis.

While the process is fundamentally robust, in practice a number of deficiencies have been noticed in actual performance. These are given below.

i) The work of creating the assessee master file has not been completed.

ii) While the audit manual prescribes an elaborate selection procedure, in actual practice, units that did not fall among those that had to mandatorily audited were selected by and large on the basis of revenue collected.

iii) Qualitative desk review papers are not prepared in many cases.

iv) Qualitative audit plans are not prepared in many cases.

v) Verification papers are not prepared in many cases.

vi) Audit plan registers are not maintained as prescribed in the manual and do not reflect whether all planned units have been audited and whether audit reports have been issued.

vii) Except in few commissionerates, the overall follow up action on audit paragraphs is not satisfactory. The success rate of show cause notices, issued on the basis of audit objections
in terms of confirmation of demand at the time of adjudication, is also not up to the mark, which reflects on the quality of the objections.

Such deficiencies need to be to be corrected by proper process management. Besides, the following improvements are needed.

i) Information management within audit commissionerates needs to be improved. This could be achieved by creating a central repository of all assessee master files in each commissionerate. Before undertaking an audit, each audit party/group should work from the master file of the assessee to be audited to access all available information and after completion of audit, update the same and return it to the section.

ii) There should be adequate preparation before the visit. The questionnaires and requirements of records, etc. sent to the assessee should be specific to facilitate timely completion of audit.

iii) A professional approach should be inculcated with the help of teams of experts. This has to be achieved by creating a network of teams having expertise in specialised areas such as different industry/service sectors, computer-based audits and detailed knowledge of accountancy. These resources should also be tasked with providing guidance to other officers wherever needed. Where required, such expertise should be sourced from outside.

iv) There should be extensive use of data analysis and third-party information for identifying the issues that need to be taken up during audit.

v) A shareable database of audit objections, best practices and key compliance issues should be created.

DG (Compliance Verification) of the two Boards should also continuously evaluate the effectiveness with which the audit/scrutiny cases are handled, using both lead and lag indicators. For example, instead relying only on the reports of short payments or spot recoveries during audit, they should track the result of the cases contested by taxpayers as they move through the appellate and judicial processes. The outcome of such studies, no doubt, may take three to four years to come in, but will provide useful insights into quality and indicate where the scrutiny might have failed – whether in marshalling facts, or in wrong or inaccurate application of legal provisions. Officers found to be weak should then be trained intensively even if the person has moved out from the post where the default was committed, and not be punished unless it is found that the mistake is repeated or the defect is wilful.

Skill development and capacity building

Audit requires specialised skills in (a) reconciliation of financial transactions vis-à-vis the tax liability of an assessee, (b) handling of financial/systems, application, products (SAP) or enterprise resource planning (ERP) related databases and (c) methodology of conducting professional audit, as envisioned in EA 2000. Further, in addition to knowledge of central excise, service tax and customs laws and procedures, the officers also need to gain knowledge of compliance requirements
under the income tax, Companies Act and VAT laws to do a comprehensive and meaningful audit. The experience gained through quality assurance reviews (QARs) of various commissionerates suggests that officers who have gained comprehensive expertise in this regard are few and far between. This is certainly a cause for concern and unless corrective measures are taken through capacity building efforts, the new audit commissionerates will also be plagued by the same problems, defeating the very objective with which they are being set up.

The following initiatives are recommended to strengthen skill levels and professional competencies.

i) Tie up with the Institute of Chartered Accountants of India (ICAI) and the Institute of Cost Accountants of India (ICWAI) to impart training in understanding financial records such as balance sheet, profit and loss account, trial balance and reconciliation of third party information.


iii) Introduce audit commissionerate attachment as part of induction training for probationary officers and inspectors, in addition to training in both the academies.

iv) Recognising that computer assisted audit would play a pivotal role, a CAAP lab may be set up in National Academy of Customs, Excise and Narcotics (NACEN) and National Academy of Direct taxes (NADT) Headquarters and regional units. CAAP training should be made compulsory.

v) Recognising the fact that TALLY, SAP and ORACLE constitute more than 90 per cent of the market pertaining to accountancy/ERP systems in India, NACEN and NADT should tie up with those software firms for (a) imparting training to officers and (b) building compliance verification tools in the software.

Finally, going beyond CAAP, the DG (Audits) in both the CBDT and CBEC need to develop skills and capacities for systems audit. As more firms adopt ERP systems, the accuracy of their compliance information depends on the reliability of their system. A thorough and regular audit of the system itself should enhance compliance. They should also, in partnership with the professional institutes such as the ICAI and ICWAI, explore the development of reliable certification programmes for officers.

**Transfer pricing audit**

A large proportion of high-value disputes in income tax relate to TP issues. It will be of value for the CBDT to issue standard positions on specific issues as guidance to the transfer pricing officers (TPOs) for TP disputes. This will help ease a lot of uncertainty and litigation for the taxpayers. The CBDT also needs to work on detailed guidelines to develop comparability adjustment. Although Rule 10 D of the I-T Rules provides for such adjustments, the guidance will allow TPOs
to apply the comparability adjustments, whether on account of capacity utilisation or for working capital adjustment or for risk adjustment on a uniform basis. At present, it is left to the discretion of the TPOs to apply comparability adjustment. This causes inconsistency and is also a cause of disputes. The guidelines will benefit both the taxpayers as well as the TPOs.

It has been reported that the TPOs use Transactional Net Margin Method (TNMM) in a majority of TP cases. This may be because there are a large number of cases of information technology or information technology-enabled services where TNMM is the most appropriate method. But, it can also be the case that comparable data for use of methods like cost-plus method (CPM) or resale price method (RSM) are not available.249 The present accounting data does not provide gross profit and so the databases used for TP analysis provide only net profit of a company or entity, and not gross profit. The CBDT needs to work with the ICAI on changing existing accounting rules so that gross profit is available to undertake better comparisons.

The basic principle of TP or advance pricing agreement (APA) is to find the arm’s length price. In APA, the agreed price is valid for a maximum of 5 years. But for arriving at future prices, no detailed economic analysis is made. Often, the advance prices are difficult to arrive at since they necessarily have to reflect future market positions. Therefore, it is imperative that the APA teams have trained economists. These economists will have the responsibility to undertake requisite economic analysis to arrive at advance prices.

The present level of TP work is not rationalised across all TPOs. While some TPOs have a large number of cases, some others do not have an adequate number of cases. The number of cases across TPOs, therefore, should be rationalised. This can be done at two levels – by the CBDT in case the TP cases are to be assigned the present territorial jurisdiction or by the Directorate General of Income Tax (DGIT) (International Taxation) for assignment within the same TP Directorate.

It is also essential that Additional/Joint Commissioner along with his team of TPOs visit the premises of a taxpayer in complex cases. This can be done in a limited number of cases to be decided with the approval of the DIT (TP) or DGIT. The visit should be undertaken on a mutually agreed date and time with the taxpayer and after issuing a detailed information request. This mechanism will provide the officers an opportunity to appreciate the business of taxpayers, discourage wild allegations from both sides and significantly reduce the time in completing TP audit. This will also help officers in understanding the business better. There can be fewer cases being picked up for TP audits and, once taken up, the cases should be thoroughly examined in the spirit of audit.

The above process for field visits should also be undertaken in select corporate scrutiny cases, which may require field audit, and not just desk audit. The process should be transparent and

249 TNMM uses profit level indicator for comparison. Profit level indicator is the ratio between the net profit and bases such as costs, sales or assets. The CPM and RSM methods compare gross profit margins. The TNMM is a one-sided method, whereas, in CPM and RSM, the price comparison is based on mark-ups over cost.
selection of cases should be made after detailed analysis of data. The need for such visits should not be routine. The success of the visit will depend upon transparency from both sides wherein the officer sends a well-researched information request to initiate the process. The visit must not be given the colour of a survey or search. The role of senior officers would be crucial in ensuring this as the success of the scheme would critically depend upon this. As a result of such visits, all open years should be disposed of instead of just one year as is being done now. A move should be made from single-year audit to multiple-year audit. Taxpayers should be encouraged to disclose full facts. A *bona fide* disclosure should be welcome rather than made the basis for penal action. All efforts should be made to minimise litigation and officers must be sensitised about their responsibility towards the taxpayers and the importance of quality in their work. If a TP audit is simultaneously in progress with a field audit by the regular tax officials in a corporate scrutiny case, the TP audit should be made a part of the scrutiny and a separate field visit should not be undertaken by the TPO.

**Approach to audit**

As already mentioned above, one major issue that needs to be fixed is the basic approach to compliance verification. Currently, the focus appears to be primarily to find fault in assessments. This approach overlooks two important outcomes that the process can lead to namely, compliance improvement and compliance measurement. The process, therefore, needs to be made far more collaborative and transparent. It should be a part of the auditor’s task to provide help and suggestions to taxpayers to improve compliance, which is the common practice internationally. An open discussion about the issues arising in audit, and taking on board the views of taxpayers on those issues before taking a final position should be encouraged as an integral part of the process. While this is provided for in the EA 2000 process, it is apparently followed more in letter than in spirit as the conduct of the audit parties is driven by the overwhelming revenue orientation in the administration. As part of this process, when the commissioners finalise the audit points in audit committee meetings, they should be required to give an opportunity to the taxpayers being audited before they take a final view on the audit points and their record should reflect the auditee’s view as well.

Further, as part of the quality management of audit, the DG (Audit) should independently seek feedback from the taxpayers being audited on their experience during the audit and their perception of how the audit parties conducted the audit. This can be done through a suitable questionnaire, to be sent from the DG (Audit) headquarters via email.

The performance evaluation of audit also needs to be made more broad-based. Currently, almost the entire focus in performance evaluation is on revenue involvement in the audit observations. Bearing in mind that audit is a critical feedback loop in risk assessment, evaluation should focus also on assessing the effectiveness and accuracy of audit selection and audit planning.

As mentioned earlier, many administrations abroad use audit as a compliance measurement tool. Proper analysis of audit findings can give insights into the state of compliance in different sectors.
of the economy and can also provide pointers to areas where it is necessary to sharpen enforcement through targeted intelligence driven investigations. A note on compliance measurement has been discussed above.

XII.4.f Enforcement

The creation of strong deterrence through effective enforcement is a critical part of compliance management. The perception that there is a high likelihood of being detected and punished pushes a large proportion of the population of taxpayers towards compliance. For effective deterrence, the full weight of the enforcement machinery needs to be brought to bear on deliberate offenders to ensure swift and certain punishment. However, it is equally vital to distinguish between deliberate evaders and other taxpayers against whom there is no evidence of deliberate evasion but are non-compliant because of ignorance about the introduction of a new levy, a contrary legal interpretation, incorrect guidance, etc. Failure to do so leads to inappropriate application of penal measures and leads to alienation of taxpayers.

In practice, in a large number of cases, penal provisions are being applied to what are essentially tax disputes. This is true of both the departments, and is particularly true in the case of service tax. Investigations are conducted and show-cause notices are issued by service tax field authorities and the DGCEI alleging deliberate violation of legal provisions where the provisions lend themselves to different interpretations and there is no evidence of intentional tax evasion. Normally, the severe penal provisions, where a mandatory penalty equal to the amount of tax involved can be imposed, are meant to be invoked only where there is intention to evade tax with mis-declaration, wilful suppression of fact, or collusion, and the tax demand can extend to five years instead of the normal one year. In practice, when any new information is accessed by the authorities, which according to them indicates a violation, it is taken as wilful suppression of fact with intent to evade payment of duty and notices invoking severe penalties and the extended period of demand are issued even though there is no evidence to show deliberate concealment of information or to indicate mala fide intent. Some of the notices on the service tax side also reflect a superficial or misconceived understanding of the nature of business practices in the service industry and fail even to identify the service, the service provider and the service recipient.

The complicated legal provisions in tax law give rise to confusion and varying interpretations. Whether it is the interchange fee involved in complex banking transactions, the definition of canteen, the applicability of reverse charge mechanism, or a host of others, the lack of clarity in law has led to different interpretations by the authorities and the taxpayer but the latter has been saddled with notices invoking the deterrent penalty and extended demand period meant for the deliberate tax evader. These sadly get locked up in litigation.

The judiciary, including the Supreme Court, has consistently commented adversely on this tendency. But the practice has not changed. With the adjudicating authorities invariably confirming the demand and imposing penalties, the matter enters the stream of litigation.
As has been noted earlier in this chapter, to encourage tax compliance by the taxpayer, legal provisions were introduced in the indirect taxation law some years ago to ensure that no show cause notice is issued if, during investigation or audit, the additional tax liability uncovered is voluntarily paid up by the taxpayer along with interest, and he has informed the tax authorities. However, show cause notices invoking provisions meant for intentional evaders are being invoked even in such cases, going into the stream of adjudication and litigation, or into the Settlement Commission, even though they could have been settled much earlier.

This cuts at the root of deterrence as well as voluntary compliance. A large number of disputes are generated because taxpayers feel compelled to contest the imposition of penalties as well as unjustified invocation of the extended period of limitation, rather than voluntarily comply within the framework of law. As earlier noted by the TARC, the Departments’ success rate in litigation is woefully low.

Such a situation leads to loss of credibility for the Departments. The enforcement wings should not be frittering away their resources on cases that can best be left to the compliance verification function and resolved through normal dispute management mechanisms. They should be focusing more on in depth investigations of fraud and such investigations should be of such quality as to ensure that the cases are capable of being successfully prosecuted.

Both the Boards need to establish adequate oversight mechanisms, including regular review of all detections and investigations by senior officers of the enforcement wings to ensure that the proceedings meant for deliberate offenders are applied only to cases where deliberate evasion is uncovered by proper application of mind and such investigations are effectively monitored. The performance review should also include the quality of show cause notices.

When a case is picked up for investigation or search action by enforcement agencies in the two Boards, claims are made by investigating officers regarding the likelihood of duty or tax evasion, and discovery of assets and documents during the search or investigation. Often, such claims are not corroborated by the evidence actually recovered by the officers. The appraisal/investigation reports ignore this fact and only concentrate on what was actually found rather than making a cost-benefit analysis of the results of these actions, comparing from where they started and what was actually found. This leads to questions regarding the effectiveness of investigation or search and the credibility of the information that led to such action. The officers must at all times bear in mind that the tool of investigation or search is one in the armoury that needs to be utilised with extreme care and circumspection.

In many tax jurisdictions, such wide-ranging search and seizure powers are not available to executive agencies and they need to seek warrants from judicial authorities. The Indian tax administration is enabled in that respect by being equipped with a tool that is often denied elsewhere. Infructuous searches not only lead to an avoidable invasion of privacy, but also to the fall in the esteem of the tax administration in the eyes of law-abiding citizens, thus strengthening the perception of lack of fairness. Therefore, it is important that search powers should not be used...
for roving enquiries. Further, because of the strong emphasis on on-the-spot recoveries, the TARC was informed that, often, coercion is exercised to get declarations and “voluntary payment” from the taxpayers. While officers collect credits for such results, there is little follow-up and monitoring of the success or failure of such cases as they travel through the departmental and judicial processes. As has been noted often enough in this as well as the previous chapters of the TARC Report, in the final analysis, many of these cases fail and the taxes actually do not accrue. India clearly lies as an outlier among global tax administrations in this regard as well.

The extremely short-term focus, excessive reliance on factors like indiscriminate seizures of documents and goods for reporting performance and the absence of quality evaluation have led to a drastic decline in the quality of investigations with long-term consequences for compliance management and effective deterrence. The administration needs to prize quality over quantity if deterrence is to play an effective role in its management of compliance. Therefore, far more attention needs to be paid to selecting the right cases and investigating them with thoroughness and competence. Each investigation should be conducted with a view to securing credible and reliable evidence that will meet the standard of proof for prosecution. Similarly, there should be consistent application of the policy relating to launching of prosecution. This can come about only if the prosecution function is adequately staffed and monitored as recommended in Section VI.14 of the TARC Report. The staff members in this function should include legal experts who can examine whether the quality of evidence would sustain prosecution.

Publicity of success in tax fraud cases is an effective deterrence to evasion. Section 287 of the I-T Act, 1961, Section 37 E of the Central Excise Act, 1944, Section 154B of the Customs Act, 1962 and Section 73 D of the Finance Act, 1994, provide for publication of details of tax offenders. The TARC has not found systematic use of these provisions by either Board, not even on the departmental websites. These provisions need to be appropriately used to publicise such details widely.

The most demonstrative element of credible deterrence is successful prosecution of offenders. As highlighted in the CAG’s performance audit report on the Income Tax department, a huge improvement is needed in this area. This is equally true of the CBEC. Both the Boards also need to ensure that the provisions for compounding of offences are used effectively and in a timely manner as an alternative dispute resolution mechanism. The TARC in Section III.5.a of Chapter III of its report had recommended a separate function vertical for prosecution in order to ensure that prosecutions are effectively managed.

XII.5 Summing up

In conclusion, it needs to be remembered that activities related to compliance management should not be seen in a disjointed fashion. It is a continuum ranging from taxpayer services to enforcement. For compliance management to be successful it needs to be supported by effective governance, risk management and robust performance management based on measurement and continuous monitoring of both lead and lag indicators as delineated in Section IV.3.d of Chapter
The compliance management philosophy needs to be woven around the following strategy themes:

a) Creating a culture of compliance, founded on values of trust, transparency and accountability and making compliance easy

b) Increasing customer value by improving taxpayer experience, reducing the cost of compliance and generating pride in compliance through recognition

c) Achieving operational excellence by building a culture of continuous improvement and effective risk management, thereby improving productivity

d) Developing organisational capacity in advanced analytics and risk management, improved customer services and more effective audits and enforcement

As noted in Appendix III.10 of Chapter III, international experience shows that a broad correlation exists between tax administration performance and the level of independence and autonomy accorded to it. The radical transformation that the TARC has been highlighting cannot be brought about unless the two Boards are granted a high degree of functional and financial autonomy as recommended by in Chapter III. It hardly needs reiteration that such autonomy cannot be accorded without a very high degree of accountability towards the government as well the taxpayers. The Boards must be prepared to face a much stricter scrutiny of their performance by all stakeholders and most importantly, the taxpayers. It is only then that a genuine culture of voluntary compliance can be engendered and sustained.

The additional challenge the CBEC is facing is the impending implementation of the GST. In the GST, both the centre and the states would be levying the tax on a common base. A very high degree of coherence and co-ordination between the states and the centre would be required if the tax is to be administered in a way that minimises the uncertainty and cost and maximises convenience for taxpayers. This would entail the development of uniform processes and procedures. It would also not do for the central and state administrations to adopt differing views and interpretations on the same transactions. Multiple audits by the centre and the state administrations could create a high level of costs and inconvenience. Hence, the centre and the states together will have to explore mechanisms where joint and co-ordinated working could be adopted in areas like compliance verification, dispute resolution and taxpayer services. It would also need to be examined whether and at which levels there could be common fora for resolution of disputes as also articulation and communication of clarificatory or interpretative statements by the tax administrations to ensure consistency in the applicability of the relevant laws. And in developing the legislation, rules and procedures, there needs to be extensive consultation between the tax administration and industry. Unless the world of the taxpayer is radically transformed along
the lines of the TARC’s recommendations, the full potential of such a transformative change in the landscape of taxation in this country is unlikely to be achieved.

**XII.6 Recommendations**

**i) Governance**

a) Timely clarificatory circulars can substantially reduce disputes and litigation. The TARC found very little proactive use of the statutory provisions that enable the Boards to issue such circulars. The TARC therefore recommends that:

- The two Boards must proactively issue clarificatory circulars.
- Such circulars should invariably invoke the relevant statutory provisions under which they are issued. They should be expressed in simple and lucid language, avoiding jargon.
- The Boards must ensure that all officers adhere to these circulars and avoid taking legal positions in disputes contrary to the circulars. (Section XII.4.a)

b) The TARC found that the success rate of the Departments in litigation was very low. This is on account of the poor quality of orders and aggressive revenue target-oriented decisions. The TARC recommends that:

- The Boards should ensure avoidance of such decisions by reviewing and improving the quality of orders from the perspective of fairness, legality and propriety, irrespective of the revenue consequences.
- They should desist from filing of appeals against well-reasoned and sound orders passed by their officers simply because they are pro-taxpayer.
- They should take notice of capricious orders, irrespective of revenue consequence and discipline the errant officers - even by meting out punishment where required. (Section XII.4.a)

c) At present, there is lack of trust and mutual suspicion between the taxpayers and the administration, which impedes the promotion of voluntary compliance. Therefore, the Boards must strive actively to create a trust-based administration. (Section XII.4.a)

d) Both the Boards will need to infuse life in their Vision and Mission statements to create a value-based administration by strengthening their internal governance supported by an effective performance management framework. This would require the development of performance measures and indicators that would bring about coherence between organisational goals and individual behaviour. (Section XII.4.a)

e) The NADT and NACEN must give the highest priority to shaping of leadership and inculcation of the code of ethics. This should be done through structured leadership programmes, designed with the help of national and international institutions of repute. (Section XII.4.a)
f) A wholesome set of goals that focus on minimising the tax gap should be set up and coherent strategies and programmes should be designed to achieve those goals in place of the present compulsive obsession with revenue maximisation by any means. (Section XII.4.a)

g) Both the Boards must recognise and accept a re-defined role of a regulator rather than that of purely an enforcer. (Section XII.4.a)

h) The values of taxpayer service should be imbibed not only in the taxpayer services function, but across the whole organisation. (Section XII.4.a)

i) A code of ethics containing the delineation of the standards of behaviour and conduct should be jointly developed by the Boards in order to give concrete shape to values such as professionalism, objectivity, courtesy and helpfulness and be actionable where deviance is noticed. This code could supplement the Conduct Rules governing the conduct of civil servants. (Section XII.4.a)

j) A coherent and clearly articulated framework should be developed by the two Boards that would weave the different aspects of the Departments’ functioning together into a well-directed movement towards the goal of compliance maximisation. This would enable an assessment of the overall performance against goalposts on that journey. (Section XII.4.a)

k) The strategic goal of the tax administration should be to exert such influence on the compliance environment as would maximise voluntary compliance and minimise non-compliance. All decisions, whether strategic or operational, should be tested against the touchstone of whether they promote such movement or not. (Section XII.4.a)

l) Both the Boards need to develop and implement an effective communication policy intended to eliminate asymmetry of information between the taxpayer and the tax administration and ensure that taxpayers have access to all information that is relevant to compliance. (Section XII.4.c)

\[\text{\textit{ii}) Customer focus}\]

m) A scheme similar to Samman but based on more sophisticated parameters should be jointly developed with suitable incentives including public recognition. (Section XII.4.b)

n) Customer convenience and compliance cost should form a central aspect of any planning for change, whether in law or procedures. (Section XII.4.c)

\[\text{\textit{iii}) Cultivating a culture of compliance}\]

o) In order to engender a sound tax compliance culture among the youth at an early stage, a tax awareness programme directed at undergraduate students should be considered for implementation in co-ordination with the Ministry of Human Resource Development and the University Grants Commission. (Section XII.4.d)
iv) Compliance risk management

p) Compliance philosophy needs to be built on the principle of trust combined with careful monitoring and management of compliance risks. (Section XII.4.b)

q) A common compliance risk management framework should be developed by both the Boards to manage strategic as well as operational risks using a structured risk management process. This should be based on:
   - Extensive research and analysis
   - A robust segmentation strategy for addressing compliance risks based on the relevant structural, economic and behavioural factors
   - The use of all compliance tools, namely taxpayer services, compliance verification and enforcement, in a manner that is calibrated according to behavioural segmentation of taxpayers
   - Continuous review of the effectiveness of risk treatment actions
   - Rewarding highly compliant behaviour by launching a scheme similar to Samman but based on more sophisticated parameters and providing more attractive incentives, besides public recognition. (Section XII.4.b)

r) Both the Boards should develop a robust compliance measurement framework to enable robust compliance risk management. (Section XII.4.b)

s) A high degree of coordination between the Boards as well as between different functional verticals within each Board needs to be ensured through coordination committees. This process needs to be a structured, formal one. (Section XII.4.b)

t) While the organisation-wide risk management should be the responsibility of the Strategic Planning and Risk Management (SPRM), the responsibility for risk management for functions such as compliance verification and enforcement would be with the relevant vertical. (Section XII.4.b)

u) The CBEC needs to implement a system similar to the NMS management system implemented by the CBDT. (Section XII.4.b)

v) Strong research and analytical capability should be developed to support effective compliance management. (Section XII.4.b)

v) Compliance verification

w) The CBEC should re-visit its current returns in central excise and service tax and move towards an annual tax return accompanied by a tax audit report as in income tax. Once feasible, instead of requiring a separate submission of Form 3 CD, the data submitted should be shared between the two Boards on the “one data, many users” principle. The monthly/quarterly returns should be simplified and used mainly to track the flow of input credit. (Section XII.4.e)
x) The CBEC should adopt the model of CPC for return processing in central excise and service tax, including a more intensive use of ICT for return processing. (Section XII.4.e)

y) The CBEC should also adopt a common return for central excise and service tax. (Section XII.4.e)

z) A greater alignment between the audit processes of the CBDT and CBEC should be brought about. (Section XII.4.e)

aa) The CBEC should integrate the central excise, service tax and customs audits. (Section XII.4.e)

bb) Both the Boards should work towards joint audits for direct and indirect taxes for large businesses. (Section XII.4.e)

c) In its restructuring, the CBEC needs to follow TARC’s recommendations in Chapter III of its report.

d) In the CBEC restructuring plans for audit, it should be ensured that audit staff for LTUs is housed in the LTU office itself, which is important from a customer service perspective. (Section XII.4.e)

e) On the CBDT side, the ITD-MS should be used for audit selection. (Section XII.4.e)

ff) The CBDT should *mutatis mutandis* adopt a process similar to EA 2000 as is prevalent in central excise and service tax, including on-site audits where required. (Section XII.4.e)

gg) The mandatory selection criteria for audit/scrutiny selection in both the Boards should be dispensed with. Both Boards should move towards multi-year audits from the current single-year audits and the frequency of audits should be determined by risk assessment and compliance behaviour of the taxpayers and the availability of resources for audit. (Section XII.4.e)

hh) Information management and risk management in DG (Audit) needs to be strengthened. Risk management should be based on extensive use of data analytics including third-party data. (Section XII.4.e)

ii) Audits should be conducted on the basis of annual plans that balance national and local risk priorities. (Section XII.4.e)

jj) Officers should be trained to adopt a collaborative approach to audit rather than a fault-finding one and the performance evaluation needs to focus on important dimensions beyond revenue recovery. (Section XII.4.e)

kk) Measures need to be taken to substantially upgrade the professional and technical skills of the staff in audit. (Section XII.4.e)

ll) There should be an ongoing performance evaluation that embraces all dimensions of audit, including compliance improvement and the consequent assessment of audit effectiveness. Such evaluation should be based on lead and lag indicators. (Section XII.4.e)
mm) Audit officers in both Boards should encourage voluntary disclosures and refrain from resorting to penal actions in the case of *bona fide* disclosures. (Section XII.4.e)

*vi) Transfer pricing audits*

nn) The CBDT should issue standard positions on specific issues as guidance to the TPOs for TP disputes to help ease uncertainty and litigation for the taxpayers. (Section XII.4.e)

oo) The CBDT should also develop detailed guidelines for developing comparability adjustment. (Section XII.4.e)

pp) The present accounting data does not provide gross profit and so the databases used for TP analysis provide only net profit of a company or entity, and not gross profit. The CBDT needs to work with the ICAI on changing the existing accounting rules so that gross profit is available in a uniform manner to undertake better comparisons. (Section XII.4.e)

qq) The APA team should have trained economists embedded for making economic analysis on advance prices. (Section XII.4.e)

rr) The workload across all TPOs should be rationalised. (Section XII.4.e)

ss) In selected cases, teams led by senior officers should undertake on-site visits in complex cases, scheduled in consultation with the taxpayer. A move should also be made from multi-year audits rather from the current single-year audits, to include all pending assessments so that repeated visits to the same assessee are avoided. (Section XII.4.e)

*vii) Enforcement*

tt) Enforcement activities should focus on cases of deliberate fraud and evasion and avoid wasting resources on cases which are essentially in the nature of tax disputes. (Section XII.4.f)

uu) Greater emphasis should be placed on the quality of investigations with a view to securing successful prosecution of offenders. (Section XII.4.f)

vv) Investigations should be completed in a timely fashion in order to ensure swift completion of proceedings. (Section XII.4.f)

ww) As recommended earlier, a separate functional vertical for prosecution should be created with the required legal expertise embedded in that vertical. (Section XII.4.f)

xx) Provisions for publication of details of tax offenders should be used for giving wide publicity so that a deterrent effect is created. (Section XII.4.f)
Audit officers in both Boards should encourage voluntary disclosures and refrain from resorting to penal actions in the case of bona fide disclosures. (Section XII.4.e)

The CBDT should issue standard positions on specific issues as guidance to the TPOs for TP disputes to help ease uncertainty and litigation for the taxpayers. (Section XII.4.e)

The CBDT should also develop detailed guidelines for developing comparability adjustment. (Section XII.4.e)

The present accounting data does not provide gross profit and so the databases used for TP analysis provide only net profit of a company or entity, and not gross profit. The CBDT needs to work with the ICAI on changing the existing accounting rules so that gross profit is available in a uniform manner to undertake better comparisons. (Section XII.4.e)

The APA team should have trained economists embedded for making economic analysis on advance prices. (Section XII.4.e)

The workload across all TPOs should be rationalized. (Section XII.4.e)

In selected cases, teams led by senior officers should undertake on-site visits in complex cases, scheduled in consultation with the taxpayer. A move should also be made from multi-year audits rather from the current single-year audits, to include all pending assessments so that repeated visits to the same assessee are avoided. (Section XII.4.e)

Enforcement activities should focus on cases of deliberate fraud and evasion and avoid wasting resources on cases which are essentially in the nature of tax disputes. (Section XII.4.f)

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An impact assessment toolkit is a set of guidelines to carry out analysis for regulatory proposals. An impact assessment statement, based on the toolkit, is developed at various stages of policy making. These assessments also provide alternatives to a tax regulation. The toolkit does not provide exhaustive guidance.

The stages of policy making – rationale, objectives, appraisal, monitoring and evaluation (M&E) – and feedback are given in Diagram 10A.1. These stages may be repeated and may not always be followed sequentially.

Diagram 10A.1: Stages of impact assessment

Chapter X

Impact Assessment

Appendix X.1

UK Impact assessment toolkit

An impact assessment toolkit is a set of guidelines to carry out analysis for regulatory proposals. An impact assessment statement, based on the toolkit, is developed at various stages of policy making. These assessments also provide alternatives to a tax regulation. The toolkit does not provide exhaustive guidance.

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Diagram 10A.1: Stages of impact assessment

The impact assessment toolkit sets out the rationale for government intervention, provides a mechanism to apply the principle of proportionality\footnote{The principle of proportionality relates to appropriate resource allocation for gathering and analysing data for appraisals and evaluations. The key factors driving the allocation decision will normally include the level of interest and sensitivity surrounding the policy, the degree to which the policy is novel, contentious or irreversible, the stage of policy development, scale, duration and distribution of expected impact, the level of uncertainty around likely impact, data already available and resources required to gather further data and the time available for policy development. Additionally, sensitivity analysis is used to demonstrate the significance of any uncertainty associated with the proportionate approach. It also includes certain effects that are not taken up in proportionate analysis which can affect the overall policy conclusion.} for the analysis of impact assessment and provides an introduction to how to value the costs and benefits of options and associated risks.

The UK HMRC uses a process of tax impact assessment for tax changes (discussed below). It uses the basic framework of proportionality analysis, as provided for in the toolkit, for various levels of quantitative and qualitative analysis. When quantitative analysis is not possible, qualitative analysis is carried out with a comparable level of rigour. The following five stages are used for quantitative analysis:

- **Stage I** – At this stage, who will be affected by the proposal is determined.
- **Stage II** – A full description of the impact (i.e. positive or negative on any group) and the order of magnitude (e.g., low, medium, high) are evaluated. Engagement with stakeholder begins.
- **Stage III** – The effects are begun to be quantified. Formal consultations begins.
- **Stage IV** – A value on the scale of impact is put by monetising the effect. It may be the case that the costs but not the benefits can be monetised. The use of indicators help sharpen non-monetised costs and benefits. Consultation continues.
- **Stage V** – All costs and benefits are fully monetised.

From the early stages of policy development, affected groups are identified (Stage I), the impact on these groups described (Stage II) and the order of magnitude estimated (Stage II). As the policy making process progresses, it is expected that the quality of data being used and depth of analysis would be refined. Engagement with stakeholders (through formal consultation) is undertaken around Stages III and IV. Since information required to enable full monetisation is required to be identified, consultation questions need to be tailored to gather the required information. Quantification (Stage III) and monetisation (Stage IV) are arrived at as far as possible, even if the numbers are indicative. Full monetisation is unlikely in the early stages and may only be possible in Stage V once stakeholders have been consulted.

Table 10A.1 illustrates the level of analysis which may be required for policy development. The symbol (\(\checkmark\)) indicates whether the step can be quantified, (?) indicates problems in quantification and (\(\times\)) indicates that this stage of process cannot be quantified. The table shows that full...
quantification may not be possible at each stage; similarly, monetisation at each stage is also not possible.

Table 10A.1: Levels of quantitative analysis at different policy stages

<table>
<thead>
<tr>
<th>Policy Development Stage</th>
<th>Progression of Quantitative Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Identify</td>
</tr>
<tr>
<td>Development</td>
<td>√</td>
</tr>
<tr>
<td>Options</td>
<td>√</td>
</tr>
<tr>
<td>Consultation</td>
<td>√</td>
</tr>
<tr>
<td>Final</td>
<td>√</td>
</tr>
<tr>
<td>Enactment</td>
<td>√</td>
</tr>
</tbody>
</table>


Flow chart for preparing impact assessment

The stages for framing policy, as shown in Diagram 10A.1, can be further explained as follows.

a) Development stage: This stage focuses on the definition and assessment of the policy challenge, the rationale for intervention/action, identification of policy objectives and gathering of evidence/data for that purpose.

b) Options stage: This stage focuses on identifying and developing options that will address policy challenges, and test these options by engaging with a wide range of stakeholders ahead of formal consultation.

c) Consultation stage: This stage refers to public consultation, which can also be a formal written consultation. It focuses on firming up options and the underlying analysis, so that adequate quantification of costs and benefits of each option can be attempted.

d) Final proposal stage: This stage focuses on costs and benefits of the preferred option and sets out the post-implementation review (PIR) plan, including when and how to measure the outcome.

e) Enactment stage: This stage enables revision to the final proposal of impact assessment to reflect the final contents of the intervention/action.

f) Review stage: This PIR stage is to evaluate the impact of the intervention/action, including any potential amendment to the intervention/action objectives.

Diagram 10A.2 depicts the flowchart for impact assessment. Reflecting that an impact assessment is a continuous process, there are certain points or stages within the overall process where an impact assessment must be formally produced and published.
The HMRC prepares Tax Impact Assessments (TIA) and Tax Information and Impact Notes (TIIN). A TIA is narrower in terms of technical content but broader in terms of coverage. Its preparation starts as soon as the policy idea is considered and is done for all policy changes, however small it may be. It is an open, transparent and exhaustive process. The aim of a TIA is not only to assess the impact of the policy change but also to identify the cost to the department of delivering the change. It also mentions in detail the background, logic and reasoning behind the policy change. It is essential for a TIA to have an audit trail to show that its various possible effects have been considered. TIA is prepared by the Knowledge, Analysis and Intelligence (KAI) team of HMRC. The quality check of TIA is done by the Regulatory Policy Committee (RPC).

The HMRC has recently introduced TIIN. It is prepared when the policy has been finalised or almost finalised. But it is presented alongside the budget, publication of draft legislation or final legislation. It provides a brief explanation of the policy objective with details of the tax impact on the exchequer, economy, individuals, business, society and the department itself. HMRC or HM Treasury is responsible for making TIINs; they mutually decide how the work is split between the two. The concerned Minister also signs on both TIA and TIIN as an integral part of tax policymaking.


Diagram 10A.2: Impact assessment flow chart

Tax Impact Assessments

The HMRC prepares Tax Impact Assessments (TIA) and Tax Information and Impact Notes (TIIN). A TIA is narrower in terms of technical content but broader in terms of coverage. Its preparation starts as soon as the policy idea is considered and is done for all policy changes, however small it may be. It is an open, transparent and exhaustive process. The aim of a TIA is not only to assess the impact of the policy change but also to identify the cost to the department of delivering the change. It also mentions in detail the background, logic and reasoning behind the policy change. It is essential for a TIA to have an audit trail to show that its various possible effects have been considered. TIA is prepared by the Knowledge, Analysis and Intelligence (KAI) team of HMRC. The quality check of TIA is done by the Regulatory Policy Committee (RPC).

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Appendix X.2

UK HMRC Impact assessment calculator

Regulatory impact assessment practitioners realise that the most troublesome step in the activity is the valuation of impact, in particular where information is not easily accessible. An expert in UK HMRC has developed new software called an impact assessment calculator. The calculator facilitates the calculation of figures needed for an impact assessment summary, using the profile of costs and benefits for each policy option. The calculator is a pre-programmed online tool in an excel spreadsheet with the facility to pre-fill financial calculations including the discount rate and the possibility of entering different policy options, thus obtaining the outcomes of those policy options. The flowchart appears in Diagram 10A.3.

A major aspect of the autonomous examination of an impact assessment is the Regulatory Policy Committee’s analysis of the cost and benefit to business that are incorporated in the impact assessment. These are incorporated in the impact assessment as an Equivalent Annual Net Cost to Business (EANCB). A negative EANCB means the policy is not beneficial to business.

The impact assessment calculator is used to calculate EANCB scores for policies with appraisal periods of up to 100 years. It facilitates comparison of the costs and benefits of each policy option by deriving the net present value of the EANCB of different policy options. Options have to adhere to the ‘One-in, Two-out’ principle. The net cost to business is presented in 2009 prices and discounted to 2010, to compare different policy options using consistent pricing and discounting. Where cost/benefit information has been provided using prices from a different year, the calculator adjusts the EANCB values into 2009 prices using HMTreasury’s GDP deflator.

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250 UK HMRC impact assessment calculator is downloadable from <https://www.gov.uk/government/publications/impact-assessment-calculator--3>

251 One-in, two-out is a government rule to prevent policymakers from creating new regulation that increases costs to business. Under this rule, if the government introduces a new regulation that involves a compliance cost, it has to remove or modify an existing regulation which involves a compliance cost that is twice as much as the new regulation does.
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The followchart appears in Diagram 10A.3.

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Appendix X.3

UK HMRC Impact assessment template

UK HMRC impact assessment template is taken from HMRC website.252

Table 10A.2: Summary of impact assessment of a new approach to compliance checks

<table>
<thead>
<tr>
<th>Department/Agency:</th>
<th>Title: Impact Assessment of A new Approach to Compliance Checks: responses to consultation and proposals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage: Consultation</td>
<td>Version: 1.0</td>
</tr>
<tr>
<td>Date: 10 January 2008</td>
<td></td>
</tr>
<tr>
<td>Related Publication: A new approach to compliance checks: responses to consultation and proposals and A new approach to compliance checks: draft legislation and commentary.</td>
<td></td>
</tr>
</tbody>
</table>

What is the problem under consideration? Why is government intervention necessary?

HMRC inherited individual powers which prevent it from taking a whole taxpayer view when checking tax liabilities. Non-compliance is a serious problem for both the government and the compliant population and HMRC must have a framework of checks to police the tax system and address risks. It is inevitable that compliant taxpayers will be subjected to checks when they inadvertently match a risk and an explanation is needed, or they are selected by random testing programmes. An aligned, flexible compliance checking framework is necessary to minimize the impact of these checks on the compliant.

What are the policy objectives and the intended effects?

To develop effective compliance activities which tackle the full range of non-compliance across taxes, beginning here with CT, IT, VAT PAYE and NICs. Compliance checks would be flexible and proportionate to risks and taxpayer behaviours. There would be a common approach to information gathering powers and time limits, where appropriate, balanced by safeguards to protect taxpayers’ rights. The ability to check risks common to more than one tax and take a whole taxpayer view would reduce taxpayer burden.

What policy options have been considered? Please justify any preferred option.

1. Do nothing; or
2. Align compliance checking powers; and/or
3. Align time limits for compliance checking.

Implementing options 2 and 3 together is preferred. This would give optimum alignment of powers which are essential for HMRC to achieve its original aspiration, to provide a unified service focused on the taxpayer and to do this more efficiently and effectively. Options 2 or 3 on their own would give some alignment, but leave some areas of duplication and inefficiency.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

Post-implementation review will take place after 2 years. Compliance powers will be reviewed continuously to ensure they continue to be capable of addressing new forms of non-compliance.

Ministerial Sign-off For final consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister

Date

---

Table 10A.3: Summary of impact assessment of a new approach to compliance checks: when policy option is “Do nothing”

<table>
<thead>
<tr>
<th>Policy option: 1</th>
<th>Description: Do nothing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ANNUAL COSTS</strong></td>
<td>Description and scale of key monetised costs by ‘main affected groups’</td>
</tr>
<tr>
<td>One-off yrs</td>
<td>There would be an opportunity cost to HMRC, the exchequer and the compliant taxpayer from foregoing the benefits of alignment following the formation of HMRC.</td>
</tr>
<tr>
<td>£ Nil</td>
<td></td>
</tr>
<tr>
<td>Average Annual Cost</td>
<td>Total Cost (PV)</td>
</tr>
<tr>
<td>(£ Nil)</td>
<td></td>
</tr>
<tr>
<td>Other key non-monetised costs by ‘main affected groups’. Business taxpayers and their representatives are most likely to interact with more than one of the main tax regimes. They can face a number of approaches by HMRC on the same point, but for different taxes, which may represent increased costs both for the taxpayer and HMRC and raise anxiety levels.</td>
<td></td>
</tr>
<tr>
<td><strong>ANNUAL BENEFITS</strong></td>
<td>Description and scale of key monetised costs by ‘main affected groups’</td>
</tr>
<tr>
<td>One-off yrs</td>
<td></td>
</tr>
<tr>
<td>£ Nil</td>
<td></td>
</tr>
<tr>
<td>Average Annual Benefit</td>
<td>Total Benefit (PV)</td>
</tr>
<tr>
<td>(£ Nil)</td>
<td></td>
</tr>
<tr>
<td>Other key non-monetised costs ‘main affected groups’</td>
<td></td>
</tr>
<tr>
<td>The current compliance checks and associated safeguards would be familiar to taxpayers, agents and HMRC.</td>
<td></td>
</tr>
</tbody>
</table>

**Key Assumptions/Sensitivities/Risks**

<table>
<thead>
<tr>
<th>Price Base</th>
<th>Time Period</th>
<th>Net Benefit Range (NPV)</th>
<th>NET BENEFIT (NPV Best estimate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td>Year</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>What is the geographic coverage of the policy/option?</td>
<td>Nationwide</td>
<td></td>
<td></td>
</tr>
<tr>
<td>On what date will the policy be implemented?</td>
<td>Not before April 2009</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Which organisation(s) will enforce the policy?</td>
<td>HMRC</td>
<td></td>
<td></td>
</tr>
<tr>
<td>What is the total annual cost of enforcement for these organisations?</td>
<td>(£ n/a)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does enforcement comply with the Hampton principles?</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will implementation go beyond minimum EU requirements?</td>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>What is the value of the proposed offsetting measure per year?</td>
<td>(£ n/a)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>What is the value of changes in greenhouse gas emissions?</td>
<td>(£ n/a)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will the proposal have a significant impact on competition?</td>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual cost (£-£) per organisation</td>
<td>Micro</td>
<td>Small</td>
<td>Medium</td>
</tr>
</tbody>
</table>

Are any of these organisations exempt? No No N/A N/A

**Impact on Admin Burdens Baseline** (2005 Prices)

Increase of £ nil Decrease of £ 0 nil Net impact £ nil

**Key: Annual costs and benefits: Constant Prices** (Net) Present Value
Table 10A.4: Summary of impact assessment of a new approach to compliance checks: when policy option is “Aligned compliance checking powers”

<table>
<thead>
<tr>
<th>Policy option: 2</th>
<th>Description: Aligned compliance checking powers.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ANNUAL COSTS</strong></td>
<td>Description and scale of key monetised costs by ‘main affected groups’ Costs for HMRC to train staff and write guidance are estimated to be £1 million. There would be one-off training costs for agents and taxpayers, although published Codes of Practice would minimise these. HMRC invites contributions that would assist in quantifying these costs.</td>
</tr>
<tr>
<td><strong>One-off (Transition) yrs</strong></td>
<td>£ 1 million</td>
</tr>
<tr>
<td><strong>Average Annual Cost (excluding one-off)</strong></td>
<td>£ Negligible</td>
</tr>
<tr>
<td><strong>Total Cost (PV)</strong></td>
<td>£ 1 million</td>
</tr>
</tbody>
</table>

Other key non-monetised costs ‘main affected groups’: As with any change in policy there would be initial lack of understanding and anxiety about the new compliance checking framework. The Codes of Practice would minimise this by giving guidance to the taxpayer on how the framework worked and the safeguards available.

| **ANNUAL BENEFITS** | Description and scale of key monetised costs by ‘main affected groups’ Benefits from quicker checks have not been measured yet as it is difficult to compare existing checks to those which may be possible under the proposed framework. HMRC would welcome evidence on the benefit to taxpayers of quicker checks. |
| **One-off yrs** | £ Negligible |
| **Average Annual Cost (excluding one-off)** | £ To be confirmed |

Other key non-monetised costs ‘main affected groups’ Taxpayers would spend less time undergoing checks compared to the current checking framework for individual taxes. This would benefit the compliant taxpayer and those who have made mistakes in their tax declarations. Taxpayers would have greater safeguards against the use of information and inspection powers.

Key Assumptions/Sensitivities/Risks While we feel that this option would help to reduce taxpayers’ compliance costs and make HMRC more efficient in carrying out its responsibilities, we do not have the evidence base to provide accurate figures for the overall impact. We will endeavour to do so once further research is complete.

<table>
<thead>
<tr>
<th>Price Base</th>
<th>Time Period</th>
<th>Net Benefit Range (NPV)</th>
<th>NET BENEFIT (NPV Best estimate)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td>Year</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>What is the geographic coverage of the policy/option?</td>
<td>Nationwide</td>
<td></td>
<td></td>
</tr>
<tr>
<td>On what date will the policy be implemented?</td>
<td>Not before April 2009</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Which organisation(s) will enforce the policy?</td>
<td>HMRC</td>
<td></td>
<td></td>
</tr>
<tr>
<td>What is the total annual cost of enforcement for these organisations?</td>
<td>£ n/a</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does enforcement comply with the Hampton principles?</td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will implementation go beyond minimum EU requirements?</td>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>What is the value of the proposed offsetting measure per year?</td>
<td>£ n/a</td>
<td></td>
<td></td>
</tr>
<tr>
<td>What is the value of changes in greenhouse gas emissions?</td>
<td>£ n/a</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will the proposal have a significant impact on competition?</td>
<td>No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual cost (£-£) per organisation</td>
<td>Micro</td>
<td>Small</td>
<td>Medium</td>
</tr>
<tr>
<td>Are any of these organisations exempt?</td>
<td>No</td>
<td>No</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Impact on Admin Burdens Baseline (2005 Prices) (Increase – Decrease) Increase of £ nil Decrease of £ Not Known Net impact £ Decrease

Key: Annual costs and benefits: Constant Prices (Net) Present Value
## Table 10A.5: Summary of impact assessment of a new approach to compliance checks: when policy option is “Aligned time limits for compliance checking”

<table>
<thead>
<tr>
<th>Policy option: 3</th>
<th>Description: Aligned time limits for compliance checking.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ANNUAL COSTS</strong></td>
<td>Description and scale of key monetised costs by ‘main affected groups’</td>
</tr>
<tr>
<td>One-off yrs</td>
<td>See Assumptions below.</td>
</tr>
<tr>
<td>Average Annual Cost (excluding one-off)</td>
<td>£ Negligible</td>
</tr>
<tr>
<td>Total Cost (PV)</td>
<td>£ Negligible</td>
</tr>
<tr>
<td>Other key non-monetised costs</td>
<td>‘main affected groups’</td>
</tr>
<tr>
<td><strong>ANNUAL BENEFITS</strong></td>
<td>Description and scale of key monetised costs by ‘main affected groups’</td>
</tr>
<tr>
<td>One-off yrs</td>
<td>See Assumptions below.</td>
</tr>
<tr>
<td>Average Annual Cost (excluding one-off)</td>
<td>£ Negligible</td>
</tr>
<tr>
<td>Total Benefit (PV)</td>
<td>£ Negligible</td>
</tr>
<tr>
<td>Other key non-monetised costs</td>
<td>‘main affected groups’</td>
</tr>
</tbody>
</table>

### Summary: Analysis & Evidence

Key Assumptions/Sensitivities/Risks: The extension to VAT claim time limits would increase the likelihood of tax revenues being reduced through litigated cases. The annual impact is difficult to forecast and would depend on the type of cases. Further work is being undertaken during the consultation period to assess the potential impact to the exchequer of these proposals.

- **Price Base**: Time Period, Net Benefit Range (NPV), NET BENEFIT (NPV Best estimate)
- **Year Year £ £**
- **What is the geographic coverage of the policy?option?** Nationwide
- **On what date will the policy be implemented?** Not before April 2009
- **Which organisation(s) will enforce the policy?** HMRC
- **What is the total annual cost of enforcement for these organisations?** £ n/a
- **Does enforcement comply with the Hampton principles?** Yes
- **Will implementation go beyond minimum EU requirements?** No
- **What is the value of the proposed offsetting measure per year?** £ n/a
- **What is the value of changes in greenhouse gas emissions?** £ n/a
- **Will the proposal have a significant impact on competition?** No
- **Annual cost (£-£) per organisation** Micro Small Medium Large
- **Are any of these organisations exempt?** No No N/A N/A

<table>
<thead>
<tr>
<th>Impact on Admin Burden Baseline (2005 Prices)</th>
<th>(Increase – Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase of £ nil</td>
<td>Decrease of £ Not Known</td>
</tr>
<tr>
<td><strong>Net impact</strong></td>
<td>£ Small Decrease</td>
</tr>
</tbody>
</table>

### Key: Annual costs and benefits: Constant Prices (Net) Present Value
Standard cost model

The SCM is today the most widely applied methodology for measuring cost of regulations. The SCM has been developed to provide a simplified, consistent method to estimate the costs imposed on business by a tax administration. It takes a practical approach to measurement and provides estimates that are consistent across policy areas.

The SCM methodology is an activity-based measurement of a business’s administrative burden that makes it possible to follow up on further developments of the administrative burden. Results from the SCM are directly used for rule simplification. The results of the SCM often help in identifying specific regulation and sometimes, the part of the regulation that is specifically burdensome for businesses.

The SCM was developed in the Netherlands over a period of about 10 years. It solved problems associated with the measurement of the administrative burden. The SCM has been found to be able to handle the complexity of regulations where other methods have failed. Hence, it is considered an efficient tool for rule simplification. Due to these benefits, the method has been increasingly used by other countries, mostly in the OECD, that want to measure the cost of regulations. For instance, European Union members have used SCM as a tool for microeconomic analysis and for making impact assessments of proposed measures (ex-ante) and for simplification of existing measures (ex-post) for VAT, CIT, PIT and social security contributions. The model has been applied irrespective of business size or sector. The SCM can also take into account cross-border comparisons, but this can be complicated. One advantage that has led to the increasing use of the SCM model is its relatively low cost.

Methodology of SCM

A key strength of the SCM is that it uses a high degree of detail in the measurement of administrative costs, going down to the level of individual activities. The SCM method\(^ {254} \) can be divided into three steps:

\[ a) \text{ Breaking down regulation into manageable components that can be measured} \]

The first step to break down a regulation can be divided into three components – information obligations, data requirements and administrative activities.

\[ \]

\[ \text{\textsuperscript{253} For example, a study conducted in 2005 in the Netherlands, Denmark, Norway and Sweden to quantify VAT-related administrative burden showed that the comparison was complicated, although comparable. See SCM Network.} \]

\[ \text{\textsuperscript{254} See SCM Network.} \]
i. Information obligations

Information obligations are those arising from a regulation to provide information and data to the public sector and/or third parties (e.g. civilians). An information obligation does not necessarily mean that the information has to be transferred to the public authority or private persons, but may include a duty to have information available for inspection or for supply on request. A regulation may contain many information obligations. Examples of information obligations can be applications for subsidies or grants, reports about labour conditions, pay roll, annual accounts, labelling provisions, and so on.

ii. Data requirements

Each information obligation consists of one or more data requirements. The data requirement is for each element of information that must be provided in complying with an information obligation. Examples of data requirements are identity of business, business turnover, VAT number, number of employees, and so on.

iii. Administrative activities

To meet each data requirement, a number of specific administrative activities have to be carried out. Activities may be done internally or can be outsourced. Examples of activities are description, calculation, reporting/submitting information, and archiving information.

Once the regulation is broken down into these components, the next step is to quantify the actual administrative burden of the regulation.

b) Measuring Administrative Burden

Costs imposed on a business for complying with government regulations may be determined through business interviews. Through them, it is possible to specify the time businesses spend to comply with a government regulation.

The SCM estimates the costs of completing each activity by combining three elements:

- Price: price consists of a tariff, wage costs plus overhead for administrative activities done internally or hourly costs for external services.
- Time: the amount of time required to complete the administrative activity.
- Quantity: quantity comprises the size of the population of businesses affected and the frequency with which the activity must be carried out each year.

The final SCM formula after combining these elements is:

\[
\text{Cost per administrative activity (or per data requirement) = Price } \times \text{ Time } \times \text{ Quantity}
\]

where

\[
\text{Quantity = population } \times \text{ frequency}
\]

An example of the cost calculations is given below.
An administrative activity takes 3 hours to complete (time) and the hourly cost of the members of staff completing it is Rs.10. The price, therefore, is 3×10 = Rs.30. If this requirement applies to 100,000 businesses (population), each of which has to comply 2 times a year (frequency), the quantity will be 2×100,000 = 200,000. Hence, the total cost of the activity will be 200,000×30 = Rs.6,000,000.

c) Simplifying a regulation

After quantifying the regulatory burden, the next step is to simplify the process and/or alter the legislation. The cost indicator helps to focus on specific parts of the legislation that are particularly burdensome for businesses to comply with. It helps in identifying which department or ministry is responsible for burdensome regulation and the share of department/ministry in the total burden. In the Netherlands, a 25 per cent reduction target was set in 2003, to be realised by 2007. Reduction plans were developed that estimated progress towards the reduction target. This approach resulted in a reduction in the regulatory burden.

The structure of the SCM is summarised in Diagram 10A.4.

Diagram 10A.4: Structure of the SCM


The steps involved in SCM measurement has also been represented as in Diagram 10A.5.255

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An administrative activity takes 3 hours to complete (time) and the hourly cost of the members completing it is Rs.10. The price, therefore, is $3 \times 10 = Rs.30$. If this requirement applies to 100,000 businesses (population), each of which has to comply 2 times a year (frequency), the quantity will be $2 \times 100,000 = 200,000$. Hence, the total cost of the activity will be $200,000 \times 30 = Rs.6,000,000$.

**c) Simplifying a regulation**

After quantifying the regulatory burden, the next step is to simplify the process and/or alter the legislation. The cost indicator helps to focus on specific parts of the legislation that are particularly burdensome for businesses to comply with. It helps in identifying which department or ministry is responsible for burdensome regulation and the share of department/ministry in the total burden.

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The structure of the SCM is summarised in Diagram 10A.4.

Diagram 10A.5: Steps in SCM measurement


**Step-by-step guide**

The step-by-step guide to carry out SCM measurement is given in Table 10A.6. The process can be split into 4 phases and 15 steps.
Table 10A.6: Step-by-step guide to carry out SCM measurement

<table>
<thead>
<tr>
<th>Phase 0: Start-up</th>
</tr>
</thead>
<tbody>
<tr>
<td>The business-related regulation to be included in the analysis is identified</td>
</tr>
<tr>
<td>before the preparatory analysis is started. Initial meetings of the department,</td>
</tr>
<tr>
<td>the central coordinating unit, consultants and other key stakeholders are held</td>
</tr>
<tr>
<td>in the case of large analyses, especially baseline measurements, and for certain</td>
</tr>
<tr>
<td><em>ex-ante</em> analyses and updates.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Phase 1: Preparatory analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 1 Identification of information obligations, data requirements and</td>
</tr>
<tr>
<td>administrative activities and classification by origin</td>
</tr>
<tr>
<td>Step 2 Identification and demarcation of related regulations</td>
</tr>
<tr>
<td>Step 3 Classification of information obligations by type (optional step)</td>
</tr>
<tr>
<td>Step 4 Identification of relevant business segments</td>
</tr>
<tr>
<td>Step 5 Identification of population, rate and frequency</td>
</tr>
<tr>
<td>Step 6 Business interviews versus expert assessment</td>
</tr>
<tr>
<td>Step 7 Identification of relevant cost parameters</td>
</tr>
<tr>
<td>Step 8 Preparation of interview guide</td>
</tr>
<tr>
<td>Step 9 Expert review of steps 1-8</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Phase 2: Time and cost data capture and standardisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 10 Selection of typical businesses for interview</td>
</tr>
<tr>
<td>Step 11 Business interviews</td>
</tr>
<tr>
<td>Step 12 Completion and standardisation of time and resource estimates for each</td>
</tr>
<tr>
<td>segment by activity</td>
</tr>
<tr>
<td>Step 13 Expert review of steps 10-12</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Phase 3: Calculation, data submission and reports</th>
</tr>
</thead>
<tbody>
<tr>
<td>Step 14 Extrapolation of validated data to national level</td>
</tr>
<tr>
<td>Step 15 Reporting and transferring to database</td>
</tr>
</tbody>
</table>


The four-phased approach can be described in greater detail to demonstrate how they can comprise helpful tools for policy makers to assess and manage the work in progress.
### Step 1– Start-up

The first step begins with the identification of information obligations ensuing from rules and regulations issued by the government. For example, identification of the target groups, administrative activities, forms and documents regarding obligations will be in Step 1.

**Diagram 10A.6: Step 1 in SCM determination**

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Goal</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Start-up (identifying information obligations)</td>
<td>Identification of obligation for determining compliance costs</td>
<td>Going through the regulation and identification of the information obligations, Gathering forms and documentation, Processing the information in the cost model, Preparing interviews with government employees</td>
</tr>
<tr>
<td>2</td>
<td>Investigate the information obligations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Collecting data from reliable sources</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Calculate and report about compliance cost</td>
<td>SCM of the investigated regulation</td>
<td></td>
</tr>
</tbody>
</table>


### Step 2 – Investigate the information obligations

In Step 2, the focus is on verifying and supplementing information obligations and activities ensuing from the regulations, further detailing the target groups and classifying the information obligations by national/international origin.
Chapter XIII

Diagram 10A.7: Step 2 in SCM determination

1. Start-up (identifying information obligations)
2. Investigate the information obligations
3. Collecting data from reliable sources
4. Calculate and report about compliance cost

Goal: Determine the background of the obligations
Activities:
- Doing interviews with government employees to determine
  1. The purpose of the obligations
  2. The target groups
  3. How the obligation officially needs to be carried out
- Describe the information obligations in administrative activities
- First rough calculation based on expert judgement
- Analyse the first results and determine the further procedure

Result: First indicative calculation of the compliance cost


Step 3 – Gather data

During this phase, the required information is gathered in a number of interviews with businesses. At the end of this step, all information necessary to complete the calculation of the cost of compliance is known and entered in the SCM.

Diagram 10A.8: Step 3 in SCM determination

1. Start-up (identifying information obligations)
2. Investigate the information obligations
3. Collecting data from reliable sources
4. Calculate and report about compliance cost

Goal: Calculating costs of administrative activities
Activities:
- Planning and conducting interviews with businesses to get information on
  1. How the obligations are met in practice
  2. The time and costs
  3. The possibilities for reduction
- Collecting data with reliable sources
- Verifying interview panel records
- Reporting on the interview results
- Align interview results with ministry specialists

Result: Calculation of the compliance costs

**APPENDICIES**

**Step 4 – Calculate and report AB**

Based on the above steps, SCM results, both quantitative and qualitative, are summarised. It is important that these results are discussed with key stakeholders.

**Diagram 10A.9: Step 4 in SCM determination**

<table>
<thead>
<tr>
<th></th>
<th>Start-up (identifying information obligations)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Investigate the information obligations</td>
</tr>
<tr>
<td>3</td>
<td>Collecting data from reliable sources</td>
</tr>
<tr>
<td>4</td>
<td>Calculate and report about compliance cost</td>
</tr>
</tbody>
</table>

**Goal:**
Calculation of compliance costs and determining reduction possibilities.

**Activities:**
- Analysing results and improvement preposition.
- Organising a meeting with specialists and businesses.
  1. Clarify the survey.
  2. Align the compliance cost calculation.
  3. Discuss prepositions on reduction of compliance cost.
- Compile the final report

**Result:**
Calculation of the compliance costs


**Different types of SCM measurements – *ex-ante* and *ex-post***

SCM can be used to measure regulatory burden. *Ex-post* measurement is a measurement of factual administrative consequences for businesses in respect of an implemented law, statutory instrument or other initiative. It is a statement of the overall regulatory costs that businesses have to bear in following a set of regulations at a given point in time. It could be made up of selected areas of regulation or of all regulations that affect a business.

*Ex-ante* measurement measures the administrative consequences of a rule or initiative before it is implemented. An SCM measurement, therefore, could also consist of a measurement of the anticipated regulatory consequences of a draft law in the form of a bill, draft executive order or any other initiative. The results from an *ex-ante* measurement could form part of the overall impact assessment of economic and administrative effects on the public sector, businesses, citizens, and so on.

It is necessary to make a distinction between the types of regulatory costs measured by SCM. The two types of regulatory costs mentioned in the SCM network are one-off costs and recurring costs. One-off costs are the costs that are only sustained once in connection with businesses in adapting to a new or amended legislation/regulation and will not include the costs that a business might have in relation to complying with existing regulations for the first time; for example, as a consequence of increased turnover or expansion into new areas in the business. As such, only the introduction of a new or amended regulation can give rise to one-
off costs. Recurring costs are those regulatory costs that the businesses constantly incur in complying with the information obligations from regulation. These arise at regular intervals such as with VAT returns or TDS returns. There can also be costs that arise at irregular intervals for an individual business, for example, if they are to file Form 15CA and 15CB under the I-T Rule, 1962, for remitting amounts abroad. Common to these two types of costs is that they arise in connection with a given situation for the business, hence the term situation-determined costs. Such costs include those associated with starting or expanding a business.

**Parties involved in SCM measurement**

An SCM is based on a high degree of involvement by a range of players who, in different ways, have detailed knowledge of the rules to which the businesses are subjected and how compliance with these rules could affect the businesses. They are usually businesses practitioners, professional experts, consultants/experts in the field, professional bodies/industrial organisations, or government departments.

**Choices to be made before starting to measure**

SCM is quite detailed with fixed definitions. Before starting an SCM measurement, it is important to make some decisions on a number of matters. At the same time, SCM provides a considerable degree of independence while selecting a particular rule or regulation to be measured. The choice can be made according to the requirement. Some choices to be made before starting to measure are as follows:

a) **Private businesses, charities, or the voluntary sector**

SCM is designed to measure the administrative burdens on private businesses. Before beginning an SCM measurement, it is essential to have a clear definition of what is meant by ‘private businesses’.

b) **Whether or not to measure rules that are not implemented in national legislation**

Another important decision to be made before starting to measure is to identify the regulations to be measured.

c) **Whether to measure voluntary regulation or not**

In order to measure regulations, it is important to distinguish between two types of regulations—compulsory regulations that businesses have to follow and voluntary regulations that businesses might choose to follow.

**Which cost does the SCM measure**

Regulations have a number of consequences for businesses. The costs of regulation can be divided into direct financial and compliance costs, including administrative costs. Direct financial costs are the result of a concrete and direct obligation to transfer a sum of money to the government or competent authority. These costs, therefore, are not related to a need for
information on the part of the government. Such costs include fees charged and taxes. For example, the fee to apply for a Permanent Account Numbers (PAN) will be a financial cost of regulation. Compliance costs, on the other hand, are the costs of complying with regulation, with the exception of direct financial costs and long-term structural costs. In the context of the SCM, compliance costs can be divided into ‘substantive compliance costs’ and ‘administrative costs’. Substantive compliance costs are those that businesses sustain because of a regulatory requirement while administrative costs reflect administrative activities that the businesses would continue to conduct if the regulations were removed.

Diagram 10A.10 illustrates different types of costs that a regulation might impose on businesses.

Diagram 10A.10: Different costs of regulation to businesses


Central co-ordinating units in different countries

Most advanced economies assign central agencies to co-ordinate the work of SCM measurement. In the Netherlands, the Ministry of Finance is responsible for co-ordinating the measurements. In Denmark, the central co-ordinating unit is the Division for Better Business Regulation in the Danish Commerce and Companies Agency. In Norway, it is the Ministry of Trade and Industry which co-ordinates the SCM measurements. In Sweden, Nutek, the Swedish Agency for Economic and Regional Growth co-ordinates the measurements. In the UK, the
Better Regulation Executive in the Cabinet Office is responsible for co-ordinating the SCM measurements.
Appendix X.5

Sampling method and other methods for impact assessment

Survey methods can be broadly categorised into cross-sectional and longitudinal. Cross-sectional analysis involves data collection at one specific point in time while longitudinal survey is a correlation research study that involves repeated observations of the same variable over long periods of time. A combination of both is panel data analysis, based on observation of multiple variables over multiple time periods for the same firms or individuals. Since cross-sectional surveys provide a snapshot at a single point in time, they do not capture the process of change. In practice, most surveys are based on cross-section design as longitudinal and panel studies are very expensive.

I. Sampling

A census survey that measures the entire target population is both costly and time consuming. Sampling, the process of selecting a representative subset from the population, helps address these concerns. A sample design includes identifying the sampling method and the estimator. It is based on survey objectives and availability of resources. Since the results of the analysis are based on sample data, the sampling method (selecting the right sample) is fundamental. The sample must be selected in stages to indicate the locations in which the interviews are to take place and to select households efficiently. The size of the sample must take account of the trade-off between cost, accuracy, and thoroughness. It is also driven by the type of analysis to be employed, sampling technique used and the population heterogeneity.

Additionally, the sample must be a true representation of the population. In many instances, despite careful designing, certain characteristics of the sample may be distributed differently from that in the population. This might result in biased estimates. Such biases can be corrected mathematically, for example by applying post-stratification survey weights. For instance, if a survey was conducted on residents of a city, one would need the population census data that shows the demographic characteristics of that city. The sample data is then compared with this supplementary data to ensure that the distribution of demographic characteristics such as age, gender, education, etc., is similar to that of the population. In case of difference, appropriate weights are assigned.

Although survey is a popular data collection and research tool, it has inherent limitations that must be addressed by paying careful attention to sample design and measurement. There are two common types of errors: errors of observation (poor measurement of cases that are surveyed) and errors of non-observation (omission of cases that should have been surveyed). Errors of observation occur due to poor questionnaire design, characteristics of the respondent, or due to the surveyor’s inability to administer the questionnaire appropriately. Errors of non-observation can arise under three different circumstances. The first is when there is inadequate coverage of the population due to a poor sampling frame.256 In the absence of a ready sampling frame is the source from which the sample is drawn.
frame, basic information pertaining to the objective of the study is collected from a large number of households. This exercise of preparing a sample frame is called house listing. House listing reduces the non-sampling error. The second error of non-observation is an error due to the process of random sampling. The third error can be attributed to poor/no responses. This distorts the sample and hence, makes it difficult to generalise the findings.

Common methods of sampling are classified under probability sampling. Statistical theories explain how a survey based on probability sampling can produce estimates for the target population that are unbiased and have a measurable sampling error. The types of probability sampling are simple random sampling, systematic sampling, stratified random sampling and cluster sampling (one/multi-stage). These are described next.

II. Methods of sampling

**Simple Random Sampling:** Simple random sampling, with or without replacement, is a scheme with the probability that any of the possible subsets of the sample is equally likely to be chosen. The method of sample selection is implemented using a table of random numbers.

**Systematic Sampling:** Systematic sampling, also referred to as interval random sampling, is a systematic sample with a random start. In this method, starting with a randomly selected person, every $k^{th}$ person, is included in the sample. A limitation of this method is the problem of periodicity – a pre-arranged list can coincide with the sampling interval.

**Stratified Random Sampling:** In this method, the population is divided into "strata" and samples are selected from each stratum. The purpose of stratification is to organise the population into homogenous subsets and select an appropriate number of elements from each set. Stratified random sampling increases the sample efficiency and ensures that each sub-group is adequately represented. In a specific case of stratified random sampling, the sample size of every stratum is made proportional to the size of the stratum in the population.

**Cluster Sampling:** Cluster sampling is similar to stratified sampling. In this technique, the population is divided into groups or clusters and a simple random sample of the group is selected. The motivation for cluster sampling is to reduce cost. It does not provide the accuracy of the stratified method, but is a practicable solution when dealing with relatively large populations. The primary disadvantage of cluster sampling is the margin of error which, while smaller than the percentage of error in random sampling, is much greater than the percentage in stratified sampling.

The steps for multi-stage cluster sampling are illustrated in Diagram 10A.11 below.
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Diagram 10A.11: Steps for multi-stage cluster sampling

Source: AC Nielson

Non-probability sampling techniques\(^{257}\) can be divided into accidental or purposive sampling. In accidental, haphazard or convenience sampling, the respondents are those who are available at the time of the survey, mostly volunteers. In such samples, there is no evidence of complete representation of the population. In the case of purposive sampling, responses are sought from a pre-defined group. Purposive sampling can be very useful for situations where one needs to reach a targeted sample quickly and where sampling for proportionality is not the primary concern. With a purposive sample, one is likely to get the opinion of the target population, but there is a likelihood that sub-groups in the population that are readily accessible are more heavily represented in the sample. Modal Instance Sampling, Expert Sampling, Quota Sampling, Heterogeneity Sampling and Snowball Sampling are types of purposive sampling. Most sampling methods are purposive in nature because the sampling problem is often approached with a specific plan in mind.

\(^{257}\) Usei Darkwa, University of Chicago, Sampling tutorial, available at <http://www.uic.edu/classes/socw/socw560/SAMPLING/sld001.htm>
III. Data analysis and other empirical models

After collecting data and examining the distribution of each variable, the task is to look for causality and correlation among two or more variables. Some tools that may be used include regression-based econometric models, derivatives such as the t-test, analysis of variance, and cross-tabulation (contingency) tables. The choice of the model adopted depends on the research objective, characteristics of the variables, shape of the distribution, level of measurement, and whether the assumptions required for a particular statistical test are met.

A variety of approaches include:

- Cross-tabulation analysis:

- Multivariate regression analysis

- Micro simulation
  EUROMOD, Institute for Social and Economic Research, University of Essex available at <http://repository.essex.ac.uk/7780/1/2_IJM_6_1_Sutherland_Figari.pdf>

- Experiments

- Cost-benefit analysis
  The cost-benefit analysis methodology is often used as a key analytical framework to ensure that a proposed regulation is appropriate to the given problems that it seeks to address. The approach helps to identify, quantify and monetise the implications of regulation on markets, ex-ante and ex-post. Ideally, carrying out a cost benefit analysis explores alternative policy options and determines the costs and benefits that are to be measured. The approach monetises direct costs and benefits for different alternatives and compare them to arrive at an appropriate choice. Often, cost benefit analyses focus only on determining which regulatory option has the highest net benefit (as in a “net benefits” analysis). This is different from the “benefit/cost ratio” technique common to cost-effectiveness analyses (which is, benefits divided by costs as opposed to the difference of benefits and costs). Diagram 10A.12 explains the different steps for cost benefit analysis.

Source: Assessing the costs and benefits of regulation, European Commission
The cost benefit analysis methodology is often used as a key analytical framework to ensure that a proposed regulation is appropriate to the given problems that it seeks to address. The approach helps to identify, quantify and monetise the implications of regulation on markets, ex-ante and ex-post. Ideally, carrying out a cost benefit analysis explores alternative policy options and determines the costs and benefits that are to be measured. The approach monetises direct costs and benefits for different alternatives and compares them to arrive at an appropriate choice.

Often, cost benefit analyses focus only on determining which regulatory option has the highest net benefit (as in a “net benefits” analysis). This is different from the “benefit/cost ratio” technique common to cost-effectiveness analyses (which is, benefits divided by costs as opposed to the difference of benefits and costs). Diagram 10A.12 explains the different steps for cost benefit analysis.

**Diagram 10A.12: Steps for a cost benefit analysis**

1. **Step 1 – What are the alternative policy options?**
2. **Step 2 – What costs and benefits must be measured?**
3. **Step 3 – Partial or general equilibrium analysis?**
4. **Step 4 – Monetise direct costs, for all alternatives**
5. **Step 5 – Monetise direct benefits, for all alternatives**
6. **Step 6 – Assess indirect impact**
7. **Step 7 – Discount monetised impact**
8. **Step 8 – Present impact and compare options**
9. **Step 9 – How robust are the results?**
10. **Step 10 – Consider distributional and cumulative impact**

*Source: Assessing the costs and benefits of regulation, European Commission*
Use of analytics in Enterprise data warehouse by CBEC

The Enterprise Data Warehouse has been increasingly playing a critical role in the provision of data to support policy formulation/decision making. Reporting and analysis of data in EDW SmartView has been provided in the form of pre-defined reports, dashboards, ad-hoc queries and cubes.

The Enterprise Data Warehouse provides analytical reports pertaining to areas such as notification-wise duty foregone, profiling of top importers of gold, export promotion scheme utilisation for imports of gold, stop filers/late filers/non-filers etc.

The key dashboards actively being used from the Enterprise Data Warehouse are listed below. They enable data analysis at various levels:

- **Commodity level dashboards** for key commodities have been developed to facilitate efficient analysis of commodity import trends. It provides national, zone and port level trends of commodity imports across time, and facilitates distribution analysis based on various dimensions – port wise distribution, importer wise distribution and country of origin wise distribution. The in-built facility to create customised reports helps in monitoring the effect of policy changes or notifications.

- **Revenue monitoring dashboard** enables macro and micro level analysis of revenue across indirect tax regimes. The revenue tracker designed shows the overall revenue realisation figures against moving target both at the national and zonal level. The dashboard indicates the top revenue contributing commodities/services and assessee's and their month-on-month trends. The dashboard also facilitates monitoring of important parameters such as the Public Ledger Account (PLA) and Central Value Added Tax (CENVAT) ratio etc.

- **Free Trade Agreement (FTA) dashboard/reports** help understand the utilisation rate of each FTA and the cost of these bilateral trade relationships with various countries. It also helps monitor the cost competitiveness of domestic production vis-à-vis imports to take proactive measures to help Indian industry. These dashboards can be very useful in policy decisions relating to international and domestic trade. (This is currently work in progress).

- **Import dependence risk analysis** helps understand the country wise import distribution for sensitive commodities and helps analyse potential alternative sources. It can help in monitoring the critical dependence on another country for the import of a commodity and the alternative sourcing country without much impact on the cost effectiveness of trade. (This is currently a work in progress.)
Data Exchange

A. Data Exchange (Tax 360) prototype

The CBEC, on behalf of Department of Revenue, has initiated a multilateral exchange of data between key central and state direct and indirect tax agencies, the Ministry of Corporate Affairs (MCA) and Directorate General of Foreign Trade (DGFT). The exchange aims to analyse registration, returns and payments data of a taxpayer across customs, central excise, service tax, income tax and VAT for the states of Andhra Pradesh, Gujarat, Kerala, Maharashtra, Tamil Nadu and West Bengal along with MCA and DGFT data sets to identify opportunities to increase the tax base and to unearth cases of outright fraud and mis-declarations.

The initial pilot done with the Maharashtra Sales Tax Department (MSTD) as the sample VAT department led to the recovery of additional revenue for MSTD. The CBEC, helped identify mismatch cases, where investigations are currently underway, and also helped increase the MSTD’s VAT tax base by identifying unregistered dealers active in other tax systems. The extended pilot involving all the tax systems as identified in the paragraph above is underway and is expected to be completed by the end of the current financial year, provided all participants extend the necessary support. Key analyses done in the pilot with Maharashtra and proposed to be carried to the extended pilot include the following:

i. Identification of taxpayers registered in tax system but not registered in the other tax systems in which they are expected to be registered (e.g., taxpayers registered with CBDT with Maharashtra as the state but found not to be registered with MSTD)

ii. PAN with multiple Importer Exporter Code (IEC) registration numbers analysed for their export and import activities

iii. Business Identification Numbers (BIN) having multiple PANs

iv. Service tax turnover mismatches across service tax returns and income tax, tax deduction at source (TDS)

v. Analysis of business codes as disclosed in income tax returns (ITR) against service tax registration to identify potential non-registrant service providers

vi. Customs import as declared with Customs compared against Import value as declared to MSTD

vii. Year-on-year sales and tax paid growth compared across tax systems

viii. Sales and purchases comparison across MSTD returns and income tax returns

ix. Analysis of customs import and export data, service turnover, manufacturing turnover data as disclosed to MCA against as declared to CBEC

x. Returns and payment activity report across tax systems
B. CBEC-CBDT Bilateral Data Exchange

Apart from the multilateral exchange of data for the Data Exchange (Tax 360) pilot, the CBEC has also engaged with the CBDT for a bilateral exchange of data pertaining to service tax to identify potential cases of unregistered service providers and unearth mismatches in data as declared by the taxpayer across the CBEC and CBDT. The first round of analysis on service tax data pertaining to FY2012-13 was carried out in January 2014 and has resulted in identification of actionable cases for both the agencies. Similar analysis on service tax data pertaining to FY2013-14 has been initiated in October 2014 and is currently underway. Key analyses included the following:

i. Service tax turnover mismatches across service tax returns and income tax, tax deduction at source (TDS) and income tax returns.

ii. PAN not registered with service tax and are declaring receipts from services over Rs 10 lakh in ITR 4,5 & 6 or receiving amount exceeding Rs 10 lakh as per their TDS records.

iii. PAN registered with service tax but not paying service tax although declaring receipts from services in ITR 4,5 & 6 or receiving amount exceeding Rs 10 lakh as per their TDS records.

Road Ahead

The existing stack of applications has been enhanced with the best-of-breed advanced visual analytics and fraud management tools. Advanced visual analytical techniques would enable the user to visually analyse indirect tax data across multiple domains. Further, implementation of a specialised fraud management tool would help detect and prevent opportunistic and professional fraud at entity and transaction level across customs, central excise, and service tax. Thus, revenue leakages can be identified to stop improper payments proactively.

One immediate area of work proposed to be undertaken is revenue forecasting across customs, central excise and service tax respectively.
Chapter XI

Expanding the base

International best practices

While countries have adopted various ways to expand their tax base, the most common measures taken for expanding the base include presumptive taxation; adoption of a single identification number; taxation of SMEs and wealthier citizens; increased tax enforcement, including more demands for disclosure and transparency; review and refinement of tax incentives/exemption/deductions; changes to withholding taxes; tighter transfer pricing regulations and oversight; and expanding the indirect tax net over more goods and services. Some of these measures are detailed in the following paragraphs.

i) Adoption of single identification number

Taxpayers’ Identification Number (TIN) has been introduced to develop a reliable and comprehensive taxpayers’ data base and to ensure mandatory use for all payments in order to expand the tax net. TIN is a pre-requisite for banks to upload tax payments and is required from each taxpayer when payments for personal income tax, petroleum profit tax, corporate tax, capital gains tax, education tax, value added tax and withholding tax are made to collecting banks. Field surveys to detect unregistered taxpayers as well as extensive publicity campaigns have often accompanied the drive to allocate TINs. The use of TIN has facilitated connecting taxpayers to their returns, payments and major taxable transactions with third parties.

ii) Review of exemptions/incentives/deductions

Some countries are tightening requirements for certain incentives to raise revenue while others are giving more generous incentives. For example, under Korea’s revised R&D tax law, 3 per cent of a company’s reserve used for future R&D, which was previously deducted for corporate income tax purposes, is no longer be deductible. On the other hand, Singapore has proposed to extend its Productivity and Innovation Credit Scheme for another 3 years. Further, businesses can continue to enjoy the 50 per cent tax deduction on spending incurred on R&D activities conducted in Singapore for another 10 years. Denmark, Norway and Finland have announced new restrictions on interest/business expense deductibility.

In Mauritius, a number of allowances/deductions have been removed. These include those allowable under personal income tax; those not linked with production of income like donations; incentive such tax holidays and tax credits, etc. In addition, complex systems of exemptions have been simplified. As part of the reform package, the discretionary powers of
the Minister of Finance to exempt or refund tax or duty in respect of customs duties, excise duties, registration duties and land duties and taxes have also been removed. By reforming its tax incentive regime, Mauritius has reportedly pre-empted high-income earners from abusing various tax deductions, reliefs and donations to reduce their tax liability. In Mauritius, tax expenditure has fallen from 3.23 per cent of GDP in FY2006-07 to 1.30 per cent of GDP in 2012.

Following international experience, India also should, as part of an open, transparent and accountable budgetary process, measure the cost of granting tax incentives (through tax expenditure computations) to be able to assess their relevance and impact on revenues.

iii) Expansion of VAT and other indirect taxes

Many governments are taking steps to expand the base of goods, services and other activities subject to indirect taxation. China is aiming to broaden the tax base via the greater use of a VAT, although some changes in the short term may actually lower the overall indirect tax burden. China has merged VAT and Business Tax (BT), which allows for input tax credit under VAT that would not have been available under the BT system.

iv) Improvement in taxpayer services

Taxpayers’ services provided by the Nigerian Federal Inland Revenue Service (FIRS) are continuously improved through the ITAS (Integrated Tax Administration System), which is an accounting software acquired with the twin objectives of streamlining and strengthening collection functions. It enables a holistic view of a taxpayer’s record such as accounting, appeals, assessment, collection, database and refunds. It has been adopted to consolidate all automation processes and projects.

The concept of an integrated tax office/one-stop-shop aimed to reduce the cost and burden of tax compliance by making it possible for taxpayers to carry out all their tax transactions with respect to assessment and payment of VAT, corporate tax, and personal income tax in a single tax office. The integration of files has made it easier for the tax administration to match and cross-reference data.

The focus on the taxpayer as a customer and the need to provide better services to the taxpayer according to his need has been emphasised by the TARC in Chapter II of the first TARC report. This creates a conducive environment for voluntary compliance and goes a long way in bringing hidden/non-compliant taxpayers in the tax net.

v) Risk-assessment System 258

In Canada, a centralised and automated method is used. The Canada Revenue Agency (CRA) employs a variety of means to assess tax compliance risk such as macro-level analysis, national case-based risk identification processes, national risk assessment systems and the audit

processes, data mining, automated workload selection tools, national systems and strategic information analysis (aggregate analysis), and compliance measurement framework (CMF). The US-IRS uses a statistical method, Discriminate Function (DIF) Workload Selection Model to score and select most tax returns for potential audit.

In France, risk identification process is not managed centrally, but at the level of a local or specialised directorate in charge of audit activities. Selection of cases to be audited is made through different channels, all using a specific form (3909) that details the reasons why the taxpayer file is proposed for a possible audit. There are two different approaches used: one based on information collected at the local level, the other based on risk assessment, such as, intelligence gathering and reporting, and centralisation and risk analysis.

**vi) Presumptive taxation**

Presumptive taxation involves the use of indirect means to ascertain tax liability, which differ from the usual rules based on the taxpayer's accounts. The term "presumptive" is used to indicate that there is a legal presumption that the taxpayer's income is no less than the amount resulting from the application of the indirect method. Various presumptive taxation methods are in use including reconstruction of income; percentage of gross receipts; asset-based taxation; industry specific methods; methods based upon outward signs of lifestyle; taxation of agriculture, etc. Asset-based taxation has been adopted by countries like Argentina and Mexico. Ghana applies a minimum tax based on an individual’s profession or trade. France and Belgium use a contractual method based on an advance agreement between the taxpayer and tax administration to base the tax liability on estimated income instead of actual incomes.

In Israel and France, extensive work has been done to establish prevailing profit rates in various business activities. Israeli *Tachshivim* is a standard assessment guide that is prepared for various trades and professions by economists of the tax department and continually updated. France's *forfait* system is used to assess the income tax of farmers, unincorporated business enterprises, and professional persons whose gross receipts fall below stipulated levels.259

Simplifying the taxation system for SMEs in developing economies has been accorded priority to facilitate registration of hidden taxpayers and enhance voluntary compliance. Apparently, there is no unique simplified tax system for all countries. In Malaysia, SMME is undefined in Malaysia’s Income Tax Act 1967. However, some preferential tax treatments in the Act for “Special Classes of SME” has been provided for resident companies with paid-up capital not exceeding RM2.5 million in ordinary shares. This provides for a mechanism to have some kind of taxpayer segregation, and enables the tax administration to pay special attention to SMEs.

In Australia, small businesses with an annual turnover of less than AUD2 million can access a range of tax concessions. This applies regardless of whether a business is a sole trader, partnership, company or trust. Concessions are also available for income tax in the form of

259 Richard Goode, *Government Finance in Developing Countries*, The Brookings Institute, Washington, 1984; contains a description of these systems.
simplified trading stock and depreciation rules, immediate deductions for prepaid expenses and a limited two-year amendment period. Further concessions are also available on pay-as-you-go instalment and capital gains tax rules. In case, these small businesses find it difficult to meet their tax because they lack time or resources, or have inadequate record keeping and business practices, the Australian Tax Office focuses on early intervention to help them meet their obligations.

In Singapore, considerable attention is paid to helping small and medium enterprises cope with restructuring costs and encouraging the workforce to raise skills and nurture innovation to enhance productivity.

Tanzania, in July 2004, rationalised its presumptive scheme by introducing a new simplified taxation schedule for small business taxpayers as part of a drive to make it easier for informal sector operators (including start-up businesses) to register, formalise their accounting system and start paying taxes. The specific objectives of the presumptive scheme included (a) rationalising the turnover tax regime; (b) increasing administrative efficiency by minimising real resources needed to administer income tax and stamp duty payable by small businesses separately; and (c) enhancing compliance by minimising the time spent on filling in the relevant forms and visiting the tax administration offices every month. The simplified tax regime applied to small business taxpayers which referred to all resident sole proprietors with a gross business turnover not exceeding USD 14,981.27 per annum. The system has had a good impact on the number of registrations with small income tax contribution. As of December 2008, a total of 300530 small taxpayers had been registered.

To expand the tax base, the Tanzania Revenue Authority (TRA) adopted the block management system (BMS). The basic objective of the BMS was to promote compliance and register all eligible traders within a particular business, sectoral or geographical area, capturing their correct level of economic activities and gathering tax information. The BMS has simplified registration of traders, and brought non-filers and non-payers into the tax net through closer monitoring and collaboration with local government authorities. By reaching out to the unreached, the BMS has widened the tax base.

The problem of identification and registration of small taxpayers is largely caused by traders not having permanent business premises, mostly hawking along the town streets or displaying their goods on the pavements, which they pack and shift at the end of each working day. Local Tanzanian government agencies (LGA) have started to mobilise small traders by providing them with permanent trading sites and infrastructure enabling easy identification of small traders for guidance on business management basics such as marketing and obtaining loan facilities. These efforts have helped TRA to identify and register traders in the informal sector, bringing them into the tax net and providing them with basic tax education and assistance to enable them to comply with tax laws. Small traders’ associations have been formed and the TRA is able to partner with them so that all taxpayers are reached and captured.
vii) Enhanced enforcement and exchange of information

Different measures have been adopted by different countries to enhance their enforcement efforts. According to EYs 2014 Tax Risk and Controversy Survey, 69 per cent of the world’s largest companies have reported that they have seen an increase in the number of aggressive tax audits in the last few years. Several countries have taken steps to tighten their policing of companies’ tax activities. Hong Kong is strengthening its co-operation with other tax authorities on the exchange of information. Australia has revamped its tax disclosure requirements by requiring the ATO to publicly report the gross income, taxable income and tax payable of companies with an annual income of AUD-100m or more. The Canada Revenue Agency (CRA), introduced a Contract Payment Reporting System (CPRS) in 1999 to encourage voluntary correct reporting of income and to detect unreported income (of filers and non-filers) for income tax and GST/harmonised sales tax and to detect businesses not registered for GST/harmonised sales taxes. HMRC introduced a Construction Industry Scheme (CIS) in 1972 to prevent loss of tax revenue from sub-contractors in the construction industry and this scheme was used for collection of revenue and compliance checking.

The US-IRS introduced the Information Returns Program (IRP) and back-up withholding to encourage voluntary correct reporting of income and to detect unreported income (including by non-filers) by matching reports received with tax records.

Tanzania, through extensive collection of information from different parts of the country, and through different modes of communication, has been able to register traders for VAT and graduated them to the normal taxation system, to curb tax evasion and enhance voluntary compliance. TRA uses tax audits and systematic information cross-checking as a means to identify unregistered taxpayers and discover unreported incomes of registered taxpayers. The ITAX system intelligence matching is also used as a systematic information cross-checking mechanism.

Electronic tax register (ETR) machines tabulate sales receipts at the close of each business day and electronically send that data to the TRA for an accurate tax assessment. Even petrol stations are required to issue ETR receipts. A pilot project was started with engine petrol stations to test the new ETR machines fixed to the petrol pumps. When the handle is lifted, the machine starts counting how much has been spent. When the handle is returned to the pump, it automatically issues the receipt. Under this system, pumps cannot serve the next customer before issuing a receipt for the preceding customer. TRA has embarked on a massive campaign to change people’s attitudes to demand ETR receipts for anything they buy and anyone who sells anything without issuing an ETR receipt risks being fined 3 million Tanzanian shillings ($1,900) on the spot or twice the amount of tax evaded, whichever is more.

India needs to strengthen its information reporting and collection system as also its co-operation with other tax authorities and sister agencies on the exchange and effective use of third party information as elaborated in Chapter IX of TARC’s second report.
viii) Tax informant programme

In Canada Revenue Agency's (CRA) efforts to fight international tax evasion and aggressive tax avoidance, the new Offshore Tax Informant Programme (OTIP)\(^{260}\) allows the CRA to give financial awards to individuals who provide information related to major international tax non-compliance that leads to the collection of owed taxes. The OTIP draws on international best practices from across the globe. The CRA considers factors such as timeliness, whether the informant himself has been compliant in his own taxpayer behaviour, and whether the information given by the informant such as on the assets own by the alleged evading taxpayer actually matches what is identified by the CRA. The award levels are 5 per cent, 7.5 per cent, 10 per cent, 12.5 per cent, and 15 per cent. All awards are treated as the informant’s taxable income. The OTIP's Oversight Committee reviews the award recommendations to make sure that they are fair and in keeping with the programme's payment criteria.

A number of OECD member countries also provide rewards for information regarding taxpayer non-compliance. The United States Internal Revenue Service, for example, has a Whistle blower Office that rewards individuals who come forward with information on major cases of tax evasion.

ix) High net-worth individuals (HNWI)

Taxing the rich has become one of the easiest ways to collect revenue. Many foreign countries are trying to bring in this regime but are keeping an extremely high threshold limit. While there is no super rich tax per se abroad, the rate for the highest slabs in the US, UK, Europe and Australia is quite high. The marginal tax rates for 2012 for US saw the highest rate at 35 per cent for those earning $388,351 and above. It has six tax slabs of 10, 15, 25, 28, 33 and 35 per cent. The lowest slab at 10 per cent is for those earning up to $8700. Similarly, UK’s basic tax rate stands at 20 per cent for those earning up to £34,370 (about Rs.30 lakh) and the highest is 50 per cent for income of £150,000 (Rs.1.28 crore) or more. Australia levies a 9.7 per cent effective tax for those earning between AUD-18201 (Rs.10 lakh) and AUD-37000 (Rs.21 lakh); the highest rate ranges from 30.30 per cent to 44.90 per cent for incomes of AUD-180,001 (Rs.1.02 crore) and more. UK’s £34,370 translates to around Rs.30 lakh, against India’s basic exemption limit of Rs.2.50 lakh.

Australia’s approach towards HNWIs is to achieve practical certainty and reduce on-going compliance costs, increase collaboration with other tax jurisdiction in the exchange of information, and to manage individual taxpayer compliance according to the level of tax risk they represent using a risk differentiation framework to categorise levels of risk. The Australian Tax Office has specific funding for compliance strategies focusing on wealthy individuals and profit shifting arrangements. Some factors that attract the attention of the Australian Tax Office in relation to the use of trusts and other investment vehicles include arrangements where trusts

or their beneficiaries who have received substantial income are not registered, or have not lodged tax returns or activity statements.

Canada launched the Related Party Initiative (RPI) in 2004 as a pilot project to identify and examine HNWIs in Canada. Since 2009, it has been converted into an on-going programme. The objectives of the RPI are to identify and respond to high-risk compliance issues involving HNWIs and their related economic entities. The UK HMRC also started a pilot project with 6,000 HNWIs to improve understanding of the needs of different customers’ and their behaviours in order to respond to them appropriately; help them to get their affairs right and pursue those who bend or break the rules. HMRC allocated resources to maximise revenue flows, close the tax gap and improve customer’s experience of tax administration in the UK, while simultaneously reducing operating costs in a sustainable way (HMRC, 2011).

The OECD (2009) study on HNWIs recommends dedicating units with tax administrations to engage with very wealthy individuals, performing both a service and compliance function. The report suggested that such an HNWIs unit would provide a number of benefits in terms of improving capabilities within the administration in relation to HNWI’s tax affairs and their links with connected entities. This will also help compliance by gaining a better understanding of behavioural drivers of those HNWIs as well as the role of a range of advisers, the report suggested.

Following the OECD recommendations, the UK HMRC established a dedicated unit for service and compliance to improve capability, knowledge and expertise in the tax administration, coordinate responses on connected entities and other taxes, understand behavioural drivers, their tax planning and facilitate co-operative compliance by gathering and using information effectively about the segment (and sub-segments). The HMRC adopted cluster analysis, to create segments - the size and the asset groups giving income. The result of such cluster analysis have been shown in Diagrams 11.1, 11.2 and 11.3.

x) Partnering with academia

Academic analysis can be used intelligently to expand the tax and taxpayer base by entering into a partnership with academia. A partnership between El Salvador’s Dirección General de Ingresos Internos (DGII) and academia is an example where students were assigned to support various programme functions, particularly the Taxpayer Service programme and assigned as aides to the technical staff of the Audit and Taxpayer Non-Filer programmes.
## Table 11A.1: Growth of direct tax revenue

<table>
<thead>
<tr>
<th>FY</th>
<th>GDP</th>
<th>Total Direct Tax Collection</th>
<th>Direct Tax as per cent of GDP</th>
<th>Per Cent Growth over previous year</th>
<th>Corporate Tax (CT)</th>
<th>CT as per cent of GDP</th>
<th>Per Cent Growth over previous year</th>
<th>Income Tax (I-T)</th>
<th>I-T as per cent of GDP</th>
<th>Per Cent Growth over previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>56,30,063</td>
<td>3,33,818</td>
<td>5.93</td>
<td>6.93</td>
<td>2,13,395</td>
<td>3.79</td>
<td>10.62</td>
<td>1,20,034</td>
<td>2.13</td>
<td>3.33</td>
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<tr>
<td>2009-10</td>
<td>64,77,827</td>
<td>3,78,063</td>
<td>5.84</td>
<td>13.25</td>
<td>2,44,725</td>
<td>3.78</td>
<td>14.68</td>
<td>1,32,833</td>
<td>2.05</td>
<td>10.66</td>
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<tr>
<td>2010-11</td>
<td>77,95,313</td>
<td>4,46,935</td>
<td>5.73</td>
<td>18.22</td>
<td>2,98,688</td>
<td>3.83</td>
<td>22.05</td>
<td>1,47,560</td>
<td>1.89</td>
<td>11.09</td>
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<tr>
<td>2011-12</td>
<td>90,09,722</td>
<td>4,93,959</td>
<td>5.48</td>
<td>10.52</td>
<td>3,23,224</td>
<td>3.59</td>
<td>8.21</td>
<td>1,70,788</td>
<td>1.90</td>
<td>15.74</td>
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<td>2012-13</td>
<td>101,13,281</td>
<td>5,58,965</td>
<td>5.53</td>
<td>13.16</td>
<td>3,56,326</td>
<td>3.52</td>
<td>10.24</td>
<td>2,01,795</td>
<td>2.00</td>
<td>18.16</td>
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</table>

*Source: CBDT.*
### Table 11A.2: Growth of indirect tax revenue

<table>
<thead>
<tr>
<th>Year</th>
<th>Gross Tax Revenues</th>
<th>GDP</th>
<th>Service Tax (ST)</th>
<th>Per cent growth over previous year</th>
<th>ST as per cent of Gross Tax Revenue</th>
<th>ST as per cent of GDP</th>
<th>Central Excise (CE)</th>
<th>Per cent growth over previous year</th>
<th>CE as per cent of Gross Tax Revenue</th>
<th>CE as per cent of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008-09</td>
<td>6,05,298</td>
<td>56,30,063</td>
<td>60,941</td>
<td>18.79</td>
<td>10.07</td>
<td>1.08</td>
<td>1,08,613</td>
<td>(-)12.13</td>
<td>17.94</td>
<td>1.93</td>
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<tr>
<td>2009-10</td>
<td>6,24,527</td>
<td>64,77,827</td>
<td>58,422</td>
<td>(-)4.13</td>
<td>9.35</td>
<td>0.9</td>
<td>1,02,991</td>
<td>(-)5.18</td>
<td>16.49</td>
<td>1.59</td>
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<td>2010-11</td>
<td>7,93,307</td>
<td>77,95,313</td>
<td>71,016</td>
<td>21.56</td>
<td>8.95</td>
<td>0.91</td>
<td>1,37,701</td>
<td>33.7</td>
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<td>1.77</td>
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<td>2011-12</td>
<td>8,89,118</td>
<td>90,09,722</td>
<td>97,509</td>
<td>37.31</td>
<td>10.97</td>
<td>1.08</td>
<td>1,44,901</td>
<td>5.23</td>
<td>16.3</td>
<td>1.61</td>
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<tr>
<td>2012-13</td>
<td>10,36,460</td>
<td>101,13,281</td>
<td>1,32,601</td>
<td>35.99</td>
<td>12.79</td>
<td>1.31</td>
<td>1,75,845</td>
<td>21.36</td>
<td>16.97</td>
<td>1.74</td>
</tr>
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</table>

*Source: CAG report No.6 & 8 of 2014 (Indirect Taxes)*
### Table 11A.3: (MRR – EX) Revenue from SSI, Non-SSI and other units (Quarterly Report)

(Rs. Crore)

<table>
<thead>
<tr>
<th>Description</th>
<th>2008-2009</th>
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<th>2009-2010</th>
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<td></td>
<td>No.</td>
<td>Revenue</td>
<td>No.</td>
<td>Revenue</td>
<td>No.</td>
<td>Revenue</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(PLA)</td>
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<td></td>
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<tr>
<td></td>
<td></td>
<td>(CV)</td>
<td></td>
<td>(CV)</td>
<td></td>
<td>(CV)</td>
</tr>
<tr>
<td>Total No. of Units</td>
<td>100,165</td>
<td>120,912.5</td>
<td>148,314.77</td>
<td>101,709</td>
<td>111,599.81</td>
<td>113,915.01</td>
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<tr>
<td>Total No. of Non-SSI Units</td>
<td>70,642</td>
<td>119,308.01</td>
<td>141,049.06</td>
<td>72,802</td>
<td>109,854.52</td>
<td>108,416.55</td>
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<td></td>
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<tr>
<td>Total No. of SSI duty paying Units</td>
<td>20,518</td>
<td>1,530.86</td>
<td>6,884.02</td>
<td>21,186</td>
<td>1673.44</td>
<td>5,388.8</td>
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<tr>
<td>Total No. of SSI Units availing full exemption</td>
<td>9005</td>
<td>73.64</td>
<td>381.69</td>
<td>7721</td>
<td>71.85</td>
<td>109.66</td>
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<tr>
<td>Total No. of units paying PLA revenue of more</td>
<td>6,849</td>
<td>110,502.75</td>
<td>88,497.83</td>
<td>5,425</td>
<td>99,405.75</td>
<td>59,465.21</td>
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<tr>
<td>than Rs. 1 crore per annum</td>
<td></td>
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<tr>
<td>Total No. of EOU SSI Units</td>
<td>2,229</td>
<td>526.88</td>
<td>1,199.86</td>
<td>2,115</td>
<td>582.19</td>
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<tr>
<td>Total No. of STP units</td>
<td>3,488</td>
<td>13.72</td>
<td>12.9</td>
<td>3,586</td>
<td>5.45</td>
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Source: Directorate of Data Management, CBEC
### Description

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<tr>
<th>Description</th>
<th>2011-2012</th>
<th>2012-2013</th>
<th>2013-2014</th>
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<tr>
<td></td>
<td>No.</td>
<td>Revenue (PLA)</td>
<td>No.</td>
</tr>
<tr>
<td></td>
<td>(CV)</td>
<td>(CV)</td>
<td>(CV)</td>
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<tr>
<td>Total No. of Units</td>
<td>120,869</td>
<td>152,333.17</td>
<td>201,160.27</td>
</tr>
<tr>
<td>Total No. of Non-SSI Units</td>
<td>84,232</td>
<td>149,912.38</td>
<td>194,294.66</td>
</tr>
<tr>
<td>Total No. of SSI duty paying Units</td>
<td>27,745</td>
<td>2,310.94</td>
<td>6,652.81</td>
</tr>
<tr>
<td>Total No. of SSI Units availing full exemption</td>
<td>8,892</td>
<td>109.85</td>
<td>212.79</td>
</tr>
<tr>
<td>Total No. of units paying PLA revenue of more than Rs. 1 crore per annum</td>
<td>6,168</td>
<td>135,694.95</td>
<td>108,872.72</td>
</tr>
<tr>
<td>Total No. of EOUs</td>
<td>2627</td>
<td>712.34</td>
<td>1,198.04</td>
</tr>
<tr>
<td>Total No. of STP units</td>
<td>5610</td>
<td>298.31</td>
<td>496.76</td>
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*Source: Directorate of Data Management, CBEC*
<table>
<thead>
<tr>
<th>Assessee Type</th>
<th>ITR filers</th>
<th>Stop filers</th>
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<tr>
<td></td>
<td>Corporate</td>
<td>Non-corporate</td>
</tr>
<tr>
<td>RI &lt;= 0</td>
<td>3,27,804</td>
<td>5,36,284</td>
</tr>
<tr>
<td>RI &gt; 0 and &lt; 1 lakh</td>
<td>99,177</td>
<td>23,47,355</td>
</tr>
<tr>
<td>RI &gt;= 1 lakh and &lt; 2 lakh</td>
<td>26,517</td>
<td>130,07,762</td>
</tr>
<tr>
<td>RI &gt;= 2 lakh and &lt; 5 lakh</td>
<td>38,589</td>
<td>104,72,946</td>
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<td>RI &gt;= 5 lakh and &lt; 10 lakh</td>
<td>29,898</td>
<td>29,28,948</td>
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<tr>
<td>RI &gt;= 10 lakh and &lt; 50 lakh</td>
<td>55,844</td>
<td>12,99,846</td>
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<tr>
<td>RI &gt;= 50 lakh and &lt; 1 crore</td>
<td>15,675</td>
<td>75,863</td>
</tr>
<tr>
<td>RI &gt;= 1 crore and &lt; 100 crore</td>
<td>25,327</td>
<td>47,897</td>
</tr>
<tr>
<td>RI &gt;= 100 crore and &lt; 500 crore</td>
<td>603</td>
<td>88</td>
</tr>
<tr>
<td>RI &gt;= 500 crores</td>
<td>192</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>6,19,626</strong></td>
<td><strong>307,16,999</strong></td>
</tr>
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</table>

*RI: returned income*

*Source: CBDT*
Chapter XII

Compliance management

Appendix XII.1

International best practices

1) Customer relationship

a) Reform and simplify the tax law

The complexity of tax law contributes to the tax gap because tax administrations have limited resources to commit to administering a wide array of tax provisions. Additionally, tax laws are seldom clear-cut and there are significant areas within these laws that are uncertain or ambiguous, where taxpayers and tax administrations might have reasonable but differing interpretations of what the tax laws require.

A stable tax system is vital to business. The United Kingdom (UK) government avoids unnecessary changes to tax legislation. In bringing forward reform, the government works with businesses to ensure that any changes improve the sustainability and long-term stability of the corporate tax system. The Office of Tax Simplification (OTS)\(^2\) was created to identify areas where complexities in the tax system for both businesses and individual taxpayers could be reduced and to publish their findings for the Chancellor to consider ahead of his budget. The OTS has since conducted reviews of different aspects of the tax system, including tax relief, small business tax simplification, taxation of pensioners and employer share schemes. The government has responded to the OTS reviews of pensioner taxation and unapproved employer share schemes. In recent years, the United States (US) Inland Revenue Service (IRS) has taken a number of steps to reduce taxpayer burden, including the establishment of the Office of Taxpayer Burden Reduction.\(^2\) The Canada Revenue Agency (CRA) continuously works with the Department of Finance and small business

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\(^2\) Other steps include improvements in IRS forms, processes and procedures include simplifying the filing requirements for various forms such as Form 944 (Employer’s Annual Federal Tax Return), eliminating the need for filing Form 2688 (Application for Additional Extension of Time to File US Individual Income Tax Return) by allowing the taxpayer to get an automatic six-month extension to file, and the creation of the earned income tax credit (EITC) Assistant, an online tool that helps taxpayers determine their eligibility for the EITC and the estimated EITC amount.
stakeholders to identify simplification options that could reduce the compliance burden on small business taxpayers.\footnote{263}{Legislation received Royal assent on December 14, 2007. Required systems changes were implemented in October 2008. The remainder of systems changes were implemented in October 2009.}

Published guidance enhances compliance by providing detailed substantive and procedural rules, helps compliant taxpayers better understand how to determine and pay their tax liability, reduces disputes between the tax administration and taxpayers regarding the proper interpretation of tax law and the procedures necessary to comply with it and makes it more difficult for non-compliant taxpayers to avoid detection or incorrectly claim that their behaviour is permitted under tax law. The US Treasury Department and the IRS resolve many difficult issues and remove impediments to voluntary compliance through published guidance, thus helping taxpayers determine how to comply with their tax obligations.\footnote{264}{Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance, IRS, US Department of Treasury, August 2, 2007}

In order to enhance taxpayer compliance so that they voluntarily file tax returns and pay taxes appropriately, the Japanese National Tax Agency (NTA) provides taxpaying individuals and groups with guidance on how to improve bookkeeping standards and tax returns. The guidance includes assistance to firms that are launching a new business, as well as explanatory sessions that are held when laws are amended. The NTA is assisted by various private co-operative organisations in this effort, which plays an important role in enhancing tax compliance. Because they are closer to taxpayers, guidance through such organisations promotes effective dissemination of information among members.\footnote{265}{IBFD paper on ‘Improving Tax Compliance in Developing Countries via Self-Assessment Systems - What Could Bangladesh Learn from Japan?’ available athttp://unpan1.un.org/intradoc/groups/public/documents/unpan/unpan014413.pdf}

In Hungary, a simplified tax return form has allowed private individuals with simple tax affairs to file their returns faster, more easily and with reduced risk of making errors. An initiative in New Zealand has significantly improved the timeliness of the delivery of binding rulings by introducing a collaborative and streamlined process, involving closer liaison between tax agents and the tax administration, both before applications are lodged and while considering applications. The initiative, developed in consultation with the New Zealand Institute of Chartered Accountants, the New Zealand Law Society and the Corporate Taxpayer Group representing large business taxpayers, involves changes in approach and process by both the applicant and the revenue body, as well as changes in policy. The changes were designed to shorten the process and to introduce a more collaborative approach both between the applicant and the revenue body and within the revenue body itself.

For many people, tax is a complex subject and complexity has been shown to contribute to non-compliance. Assistance directed at lowering unintentional non-compliance (by way of taxpayer error) should reduce tax loss and boost the legitimacy and perceived fairness of the tax administration. Simpler tax systems should encourage greater compliance and lower costs...
through the use of fewer tax agents. A reduction in complexity should reduce the scope for tax avoidance and evasion.

Most taxpayers voluntarily pay the correct tax on time every year because they believe that doing so is important and the actions of tax administrations must make it easier for these taxpayers seeking to voluntarily comply. Recognising this, the best practicing tax administrations provide facilities that help taxpayers reduce errors and make voluntary compliance easier for them. UK’s Her Majesty’s Revenue and Customs (HMRC) provides toolkits that provide guidance on areas of frequent error seen in returns and sets out the steps that can be taken by taxpayers or agents to reduce those errors. They help taxpayers or agents ensure that returns are completed correctly by minimising errors, focusing on the areas of possible error that HMRC considers important and demonstrating reasonable care. The Australian Taxation Office (ATO) provides full tutorials on how to complete returns by avoiding commonly made errors. For example, the ATO works with businesses to help them get their business activity statements (BAS) right the first time so they can save time and money and ensure any refund due is correct and processed quickly. This enables the ATO to spend more time focusing on their customers and helping them grow their businesses. They also provide tips to avoid making mistakes.

For personal income tax, pre-filled tax returns aided by technology have been a significant development over the last few years. Many tax administrations have come to realise the significant benefits that accrue from the use of pre-filled tax returns. This has already been discussed in Section II.4.a.xi of the first report of the TARC.

Rulings have been previously discussed in Appendix V.2 of the first report of the TARC.

b) Fair treatment

By far, the most efficient way of closing the tax gap is to encourage voluntary compliance. The key to encouraging voluntary compliance is that taxpayers feel they are being treated fairly. Tax morale has to be addressed with regard not only to taxpayers but also legislators and governments. The four fundamental tax maxims are timeless: equality, certainty, convenience of payment and economy in tax collection. Taxpayers like to understand the justification for their tax burden. The tax structure must be clear, consistent and acceptable. The tax structure has to guarantee equality of taxation in general.

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266 Use of these toolkits is voluntary. Only those toolkits that are relevant to the clients’ circumstances and for completing the return should be referred to. The toolkits can be used as straightforward check lists to complement or check and refresh the existing processes or as a training aid for staff, available at http://www.hmrc.gov.uk/agents/toolkits-essential-info.htm, accessed in September 2014.

In 2012, US Taxpayer Advocate Service (TAS) conducted a statistically representative national survey\(^{268}\) of over 3,300 taxpayers who operated businesses as sole proprietors. It found the extraordinary lack of public trust in the method by which the US government was funded profoundly disturbing. As a result, in order to alleviate taxpayer burden and enhance public confidence in the integrity of the tax system, the National Taxpayer Advocate urged the Congress to vastly simplify the tax code. The Canadian CRA provided taxpayers with the CRA Service Complaints, Taxpayer Bill of Rights and Taxpayers’ Ombudsman initiatives to provide them with an additional level of confidence in the CRA’s service. The Ombudsman operates independently and at arm’s length from the management of the CRA and reports directly to and is accountable to the Minister of National Revenue. The UK HMRC strongly believes that the relationship between HMRC and taxpayers should be one that includes receiving adequate customer service, not being subjected to unfair or unwarranted demands by HMRC and ensuring that taxpayers believe that they are being treated equally, regardless of whether they are an individual or a business and regardless of how wealthy they are.\(^{269}\)

In a number of countries, the relationship between tax administrations and taxpayers is no longer a transactional one. It is based on a concept of mutual understanding wherein the tax administrations believe their taxpayers to be fair unless there is reason to think otherwise. To ensure that the level of taxpayer confidence is retained in the tax administration, a “service and client/customer” approach should be adopted by tax administrations, which is more likely to encourage trust than a “cops and robbers” approach based on sanctions. The Australian ATO also, via its charter,\(^{270}\) believes that most people are willing to comply with laws if they feel they are trusted and treated fairly and get the help they need to understand the law.

Designing incentives for compliance can foster a climate for better tax relations. Tax morale can be affected significantly if the strict policies that are applied against a dishonest taxpayer are applied even to an honest taxpayer. Regulations that prevent free riding by others and establish fairness and equity help preserve tax morale. Rewards could be more effective than punishments to eliminate undesired behaviour or to motivate desired behaviour because it is perceived as supporting.\(^{271}\) In 2004, the Malawi Revenue Authority decided to reward tax compliant taxpaying businesses by giving them tax compliance certificates on an annual basis at the end of their accounting period if their legal requirements and liabilities are met. The government of Malawi reported that this initiative led to an increase in tax compliance for large

\(^{268}\) Only 16 per cent said they believe the tax laws are fair and only 12 per cent said they believe taxpayers pay their fair share of taxes.


\(^{271}\) A detailed theoretical study in economics by Falkinger and Walther in the year 1991 analysed the possibility of pecuniary rewards as an economic incentive for taxpayers to be honest. In their model, a taxpayer who is investigated has to pay a penalty for the evaded tax and receives a reward for the paid tax. The authors show that, a mixed penalty-reward system improves the taxpayer’s position on the one hand and does not lower the tax revenues of the government on the other. Thus, introducing rewards, coupled with an increase in penalty constitutes a welfare improvement.
and medium taxpayers and also led to a motivational effect on other smaller taxpayers, who were keen to qualify for the certificates. Overall, incentives on both sides resulted in a climate of improved relationships between the Malawi Revenue Authority and businesses, based on the principle of reciprocity. There also exists some anecdotal evidence about the implementation of rewards to enhance tax compliance, especially in Asian countries. For example, Japan offers to have your picture taken with the Emperor if the taxpayer was found to be honest. The Philippines put the name of the taxpayer into a lottery if the taxpayer was found to be compliant with the value-added tax (VAT). South Korea considers allowance into airport VIP rooms, certificates or awards and discusses the possibilities of free parking in public parking facilities.

In an effort to appear fair in their practices, a number of tax administrations have decided to significantly reduce the level of red tape so that human interface can be reduced and enable the entire business to be conducted smoothly online. In order to reduce red tape faced by these small businesses, the US enacted the Small Business Regulatory Enforcement Fairness Act (SBREFA) in order to institute a National Ombudsman authorised by Congress to hold hearings, help and assist small entities, including small business owners, small government entities and non-profit organisations when they had experienced unfair or excessive enforcement action by a federal agency. The ATO also adopted a number of strategies in an effort to cut red tape by allowing the entire business to be conducted online. In May 2010, the Australian ATO adopted the AUSkey, which is a single digital key to access government online services. The ATO also introduced the Australia Business Register (ABR) and Standard Business Reporting (SBR) making it quicker and simpler to complete annual returns and lodge reports for the ATO. Similarly, the Red Tape Reduction Commission (RTRC) was announced by the Government of Canada in January 2011. Its mandate was to identify irritants to small businesses that result from federal government rules and regulations. The Government of Canada's Red Tape Reduction Action Plan included six systemic reforms, under three

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274 Unfair or excessive federal regulatory enforcement actions include excessive audits, investigations, fines, penalties, threats, retaliation, harassment, rude or unfair treatment by a federal agency.

275 When using SBR, small businesses can complete and lodge directly online forms in categories such as activity statement (BAS and Instalment Activity Statement), fringe benefits tax (FBT) return, etc. Currently, over 430 federal, state and local government agencies are able to use this information to help ensure that businesses are provided with the appropriate services, PAYG payment summary, tax file number (TFN) declaration, company tax return and associated schedules, partnership tax return and associated schedules, trust tax return and associated schedules, fund tax return and associated schedules, and self-managed super fund annual return and associated schedules.

276 For the purposes of the Red Tape Reduction Commission, red tape is defined as unnecessary and undue compliance burden, which is the time and resources spent by business to demonstrate compliance with federal government regulations.

major themes – reducing the burden on businesses, making it easier to do businesses with regulators and improving service and predictability. The Government of Canada’s Action Plan has introduced measures to control administrative burden on businesses and ensure that regulators are sensitive to the needs of small business when they design regulations.278

Feedback, through surveys for instance, is also vital to the tax administration’s ability to improve services for taxpayers and enhance taxpayer morale and confidence in the tax system. A section of the survey questions can be devoted to attaining valuable feedback from taxpayers. The UK Administrative Burdens Advisory Board (ABAB) is a strong independent small business voice for the HMRC. ABAB brings the small business view about current services and planned changes, and challenges the HMRC to use that insight to make improvements.279

The CRA maintains the confidence of benefit recipients, taxpayers, and client governments by applying validation activities. Tools are used to verify the accuracy of information provided by individuals, focusing on the validation of information from population segments identified as high-risk. The ATO is also aware that by fostering better relations with tax agents, and listening to their feedback, tax agents can help them inform clients of their rights and obligations under the tax system and assist them in facilitating online dealings with the ATO.

c) Communication

Over the past decade, all tax administrations have witnessed an explosion of ways in which people interact with the government, businesses, the tax community and each other. Businesses increasingly market products and services to customers using co-ordinated efforts across various in-person and digital interactions. Several major cities now use social media to help identify and dispatch services to address citizen issues and all levels of government are increasingly providing tools to transact digitally and deliver services more conveniently and efficiently. Like these entities, tax administrations also interact with taxpayers, keeping their preferences in mind.

In addition to identifying and adapting to taxpayer needs, tax administrations must clearly communicate with taxpayers to reduce their compliance burden and, as a result, the downstream workload of the tax administrations. If taxpayers receive unclear messages, they are more likely to either make a mistake or contact the tax administrations for clarification, resulting in an increased workload for all parties. To this effort, tax administrations must improve the clarity of information provided to taxpayers so that they understand their tax responsibilities and the tax credits for which they are eligible. To reduce the taxpayers’ compliance burden, the US IRS has delivered focused communications that has helped in easing voluntary compliance. Moreover, the IRS has improved the clarity of their tax products.

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278In November 2012, 52 small business owners and 91 representatives and bookkeepers in seven cities across Canada participated in the CRA Red Tape Reduction consultations. These consultations helped the CRA identify refinements to certain action plans that respond to priorities identified by small businesses.

279The ABAB is an independent body that holds the HMRC to account for delivering the commitments in ‘Making tax easier, quicker and simpler for small business’. ABAB has played a key role in testing and influencing the way in which the HMRC has delivered changes affecting small businesses, such as simpler income tax and modernising reporting of Pay As You Earn, (PAYE) - Real Time Information.
and communications, including tax forms, publications, notices, letters and other online and in-print communication. They have also improved the variety and targeted use of different media for their outreach and education campaigns, embracing new technologies and approaches. Finally, tax regulations are designed in a way to provide greater clarity and certainty for the taxpayer and tax community.

In addition, tax administrations are now becoming increasingly aware that the needs of all their customers are not the same and there might be some who might need extra help and have provided specially customised services for such taxpayers.

- **ICT-enabled communication**

Tax administrations have broadened the taxpayers’ access to secure digital services by innovating on their service delivery models to provide better assistance to those seeking to comply. This has been made a priority by expanding online services such as e-filing, online registrations, checking the status of refunds, etc., launching updated websites and instituting virtual service delivery. By making greater use of new technologies, these tax administrations have also become more agile and service-friendly to the taxpayer through the self-service and electronic-service taxpayer options available on their websites and on mobile devices, such as webinars available on the websites of tax administrations that are online seminars given by experienced tax officers to help taxpayers, tax professionals, organisations, businesses and government officials to gain clarity on a particular topic. The US IRS, UK HMRC, Canadian CRA and the Australian ATO broadcast webinars on a variety of subjects aimed at educating tax professionals, small businesses, industry organisations, government agencies, etc., on issues affecting them as well as their clients. They also have dedicated YouTube Channels wherein they upload videos aimed at educating taxpayers on a variety of topics such as recent changes in the law and how to respond to these changes, ‘how to’ videos, etc.

Tax administrations now offer telephone services that are available 24 hours a day, 7 days a week. In addition to this, there are dedicated phone lines for enquiries related to businesses, individuals, registered tax professionals, non-profit organisations, etc. In order to handle calls more efficiently, HMRC made a business decision to replace some of the existing touchtone Interactive Voice Responses (IVRs) with a new speech recognition technology – Intelligent Telephony Automation (ITA). The CRA’s toll free telephone networks provide help and

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280 In FY 2012, 22 notices were redesigned to provide clearer guidance to taxpayers.

281 These administrations are seen to be carrying out in-depth research to gain a much better understanding of these customers and helping them get their tax right and claiming their entitlements. These customers might include those who have hearing difficulties, those who might have difficulty in using the telephone or internet to gain information, customers with a low proficiency in English and foreign migrant workers, older customers, customers with health problems such as autism, etc., mental health issues or combined physical difficulties, digitally-excluded customers in specific areas of the country, where the availability of broadband is limited and those on a low income in general, customers with lower literacy levels and dyslexic customers who would have difficulty with reading and writing, customers who lack confidence in dealing with their tax affairs or need support to resolve tricky issues, and newly self-employed taxpayers seeking advice on their tax responsibilities.

282 The overall aims of the ITA system are to reduce call volumes, improve call centre performance by increasing call attempts handled, improving and making routing faster and shortening the time required to handle an enquiry.
information to taxpayers through automated and agent-assisted services. These networks are managed in real time to balance call volumes across the country and to provide maximum accessibility. The ATO also uses a fast and convenient self-help service that uses a speech recognition system.\textsuperscript{283}

Tax administrations have moved beyond traditional channels of communication by making tax applications available on the mobile phones of taxpayers, giving them a convenient way to make payments, check the status of their refunds, get reminders, updates, etc. The IRS2Go phone app gives people a convenient way of checking on their federal refunds. The HMRC has also worked with the private sector to develop smartphone apps that would help the taxpayers maintain an accurate record of their business expenditure. Similarly, MyTax, the new ATO phone app, has a streamlined tax return designed specifically for people with straightforward tax affairs. It is available on tablets, smartphones and computers. The CRA has also developed the Business Tax Reminders mobile app that is recommended for small and medium-sized businesses and allows users to create custom reminders for key CRA due dates related to instalment payments, returns and remittances, and customise and tailor the reminder system for their personal business deadlines with either calendar or pop-up messages.

In an effort to better communicate with taxpayers, tax administrations send customised e-mails to taxpayers on a variety of topics depending upon the type of taxpayer segment they fall within, for example, self-employed, small, medium, large taxpayers, etc. Through HMRC’s email system, taxpayers can choose which subjects they are interested in. HMRC then sends taxpayers a series of emails with a structured set of advice about the chosen topic.\textsuperscript{284} The US IRS offers its taxpayers an opportunity to join the small business/self-employed (SB/SE) mailing list that is a nationwide list server.\textsuperscript{285} The ATO occasionally uses emails for promotional and information purposes. The ATO also uses short message service (SMS) for informational purposes from time to time. SMS messages from the ATO include reminders, confirmation of appointment and receipt, and notifications of delay to electronically lodged tax returns.

Apart from this, the ITA aspires to reduce customer demand for advisers, provide capability for customer self-service, improve overall customer experience and consequently satisfaction with HMRC call centres and minimise the customer’s need for repetitive contact and reduce ‘getting wrong’ options. Available at http://www.hmrc.gov.uk/research/report274.pdf, accessed in September, 2014

\textsuperscript{283}The ATO often offers a unique auto call-back when a customer calls the ATO. The customer has the option to leave his/her name and contact number and can hang up rather than wait on hold in the queue. When the customer reaches the top of the queue, he/she will receive a call back. When called back, an announcement is made asking if the customer can take the call, and if he/she accepts, he/she is transferred to a customer service representative. Ninety-five per cent of call-backs are successfully connected. Available at https://www.ato.gov.au/About-ATO/About-us/Contact-us/Phone-us/, accessed in September 2014.

\textsuperscript{284}Taxpayers can set up email reminders and notifications using one of the options available in PAYE Online. This means they will automatically get sent an email when there’s something new for them to view. HMRC also periodically sends emails to customers to support their business life events. They also send self-assessment email reminders if taxpayers opt to receive them.

\textsuperscript{285}Tax tips are simple, straightforward messages and reminders to help with tax planning and preparation. Tax tips are issued daily during the tax-filing season and periodically during the rest of the year.
Taxpayers’ attitude about paying taxes echoes everything that a tax administration does. Therefore, it may be wise to consciously incorporate normative appeals in all actions such as mass media campaigns, letters sent by the tax administration, seminars and in moments of personal contact.

The HMRC deploys this method of prompting compliant behaviour. It sends nudge letters to encourage compliance among taxpayers. The nudge theory is applied to change the behaviour of the recipient (of the nudge) by ‘gentle encouragement’, usually by a carefully timed reminder or nudge. This might take the form of a letter, email or targeted advertising. It is usually regarded as best applied by being directed at the individual recipient in a personal way.  

Nudge experiment

HMRC conducted the nudge experiment in order to check whether people care about whether or not they are acting morally. Their willingness to pay taxes, or to stop procrastinating, depends on whether the moral question is salient to them, on whether they are incurring “moral costs.” When tax delinquents are told that most people pay their taxes on time, they are far more likely to pay up.

In the first of two careful experiments, Hallsworth and his colleagues sent letters to more than 100,000 citizens in 2011. All the letters noted that the recipients had not yet made correct tax payments, but there were different versions of what followed that reminder. The first said: “Nine out of ten people pay their taxes on time.” The second version said: “Nine out of ten people in the UK pay their taxes on time.” The third said: “Nine out of ten people in the UK pay their taxes on time. You are currently in the very small minority of people who have not paid us yet.” The fourth did not refer to social norms, but added this sentence: “Paying tax means we all gain from vital public services” such as the National Health Service, roads and schools. The letters were exceedingly effective. Overall, those who received one of these letters were nearly four times more likely to pay their tax bill than those who did not. The most effective letter was the third: in less than a month, it produced $3.18 million in additional revenue. If that letter had been used across the entire sample, it would have produced an additional $18.9 million. Hallsworth and his colleagues’ second experiment involved nearly 120,000 taxpayers and more than a dozen different letters. Some of the letters referred to a general norm about existing practices (in social science parlance, a "descriptive norm"): “The great majority of people in the UK pay their tax on time.” Other letters were more specific: “The great majority of people in your local area pay their tax on time” or “Most people with a


287 This was confirmed by an important study from the UK. The study’s lead author was Michael Hallsworth, a doctoral candidate at Imperial College London and an adviser to the UK’s Behavioural Insights Team. (Richard Thaler, co-author of the book "Nudge," an adviser to the Behavioural Insights Team.) available at http://www.bloombergview.com/articles/2014-04-15/nudging-taxpayers-to-do-the-right-thing, accessed in September, 2014.
debts like yours have paid it by now.” Some of the letters referred to what people in the UK think taxpayers should do (in social science parlance, an “injunctive norm”): “The great majority of people agree that everyone in the UK should pay their tax on time,” or “Nine out of ten people agree that everyone in the UK should pay their tax on time.” Some of the letters emphasised that people could save money by paying now rather than later: “We are charging you interest on this amount.”

With this experiment, Hallsworth and his colleagues replicated their earlier finding: “norm” messages have a large impact. They also found that descriptive norms have a bigger effect than injunctive norms. Finally, highlighting a penalty that would increase over time made it more likely that people would pay. Within a period of about three weeks, Hallsworth and his colleagues were able to generate about $15.24 million in additional tax revenue. Note that letters of this sort are essentially cost-free to produce and send; so the benefits of the intervention were easily justified.

Similarly, the CRA began a letter campaign to inform selected taxpayers about their tax obligations and to encourage them to correct any inaccuracies in their past income tax and benefit returns. ATO sends letters in the form of reminders to taxpayers. The Mexico’s *Servicio de Administración Tributaria* (SAT) sent letters by way of an experiment to individual taxpayers prior to the income tax return filing season. They were able to deduce that there exists a significant statistical relationship among risk level and compliance. Evidence has shown that the programme had a significant impact on the behaviour of taxpayers tagged as medium and low risk.

A number of tax administrations are seen employing face-to-face assistance channels such as the IRS Taxpayer Assistance Centers (TAC). These are the taxpayers’ source for personal tax help when they believe that their tax issues cannot be handled online or by phone and they want face-to-face tax assistance. The HMRC has also introduced a new service asking customers who are deaf, hard of hearing or have a speech impairment, to complete an online form to request a face-to-face appointment. The ATO also offers personalised, specialist help to customers under which taxpayers can organise a business assistance visit by phoning the ATO. The Japanese NTA also conducts an annual ‘Know-Your-Taxes Week’, during which tax authorities set up booths, kiosks, etc., in public areas in order to meet people and provide tax information or answer any questions that they may have.

The Inland Revenue Authority of Singapore (IRAS) has a taxpayer feedback panel, which serves as a structured and regular communication channel for taxpayers’ feedback on tax policies, processes, service and initiatives. The taxpayer feedback channel such as the biennial taxpayer survey reaches out to various segments of taxpayers to understand and meet taxpayers’ needs and expectations in an ever-changing economic and business environment.288

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288 Section II.4.a.viii of the first report of the TARC
**Taxpayer assistance in Canada**

The CRA has made significant strides in providing taxpayers with information to help them better meet their obligations. Some of the taxpayer outreach initiatives launched in the past 15 years are:

- New employer visit programme – Department officials are available on request to visit new employers in their own premises.

- Small business information seminars – These seminars provide basic information on selected topics in separate modules for individuals who are thinking about starting a business or who have recently started one.

- Electronic letter creation system – In order to prepare consistent and accurate responses to outgoing correspondence, 17,000 standard responses and letters have been developed in both official languages.

- TELEFILE - A free telephone help service is available seven days a week to allow clients to file certain simple tax returns by phone.

- Teaching Taxes Programme – Each year, the CRA supplies “Teaching Taxes” kits free of charge to teachers and students in high schools and colleges across Canada.

- Tax ombudsman – The taxpayers’ ombudsman is an independent and impartial officer who is appointed to look into complaints about the service provided by the CRA. The ombudsman operates at arm’s length from the CRA and reports directly to the Minister of National Revenue. The ombudsman’s office submits an annual report to the minister that is tabled in Parliament, and may issue other reports and/or recommendations concerning any issue within the office’s mandate. The ombudsman is the final level of review and complements existing service-related complaint resolution mechanisms internal to the CRA.

- NETFILE – Individual personal income tax returns can be filed via NETFILE, provided they are prepared using approved commercial tax preparation software packages or Web applications.

- Corporation Internet filing – For 2002 and later years, corporations can file their tax returns on the Internet, which results in immediate confirmation, faster processing, and faster refunds.

- Business registrations – Businesses can register for corporate tax, payroll, and customs either in person, by mail, or over the Internet.

- Internet information – All tax forms, publications, and guides are available in both official languages over the internet.
d) Outreach and education

Taxpayer behaviour needs to be influenced in different ways depending on the context. It is always good to foster a social and personal attitude in favour of tax compliance. If there is no positive attitude in favour of compliance, deterrence can work in the short run. In the long run, a high level of voluntary compliance can only be achieved by establishing an attitude in favour of compliance. This, in turn, can only be achieved if the tax system and tax administration are perceived as just and fair regarding both procedures and outcome. Education and outreach programmes can help in achieving this objective by adopting a hybrid approach to education and outreach programmes to encourage tax compliance, entailing both persuasive appeals and deterrent messages. A hybrid approach has been seen to be adopted by tax administrations, in which, apart from some motivating messages, tax administrations must advertise and spread awareness about the consequences of avoiding tax liabilities. In order to co-ordinate tax education, the Japanese NTA has formed a body called the ‘Council for Promotion of Tax Education’ in each major city. This council consists of the NTA, local tax authorities, and educational organisations. The steps taken include issuing supplementary textbooks for the purpose of tax education, conducting classes on taxes, sponsoring high school essay contests on tax topics and conducting seminars on public finance and the economy.

Public information seminars are also effective tools in a tax administration’s arsenal for communicating with taxpayers. The ATO provides free seminars and workshops on a variety of topics delivered by experienced tax officers. For example, The ATO offers a scheduled programme of free seminars for small business operators and those just starting or thinking about starting a new business.289

Similarly, media campaigns can also help in spreading compliance awareness among taxpayers. The Spanish Council of Ministers had passed the “Plan for the Prevention and Correction of Tax, Labour and Social Security Fraud”. Through this, the different administrative bodies responsible for these different areas pooled their efforts in a common campaign that emphasised the negative effects of all kinds of non-compliance, especially in a situation of serious deficit in the Spanish budget. The campaign highlighted the benefits that all Spanish society got from these attitudes and behaviours to face the economic crisis and recover from it.

2) Co-ordination with partners and stakeholders

The accuracy of prepared returns is paramount to the overall level of compliance and processing efficiency for any tax administration. In recent years, it has become significantly more important that tax administrations work closely with external partners to achieve their mission. The US IRS is implementing a comprehensive oversight programme for return preparers – individuals who prepare tax returns for compensation. The IRS conducted a six-month review and concluded that oversight of this community could improve tax administration and compliance by raising standards for returns filed by this group, essentially

leveraging IRS resources by focusing on one individual doing many returns as opposed to the more traditional one-on-one examination. The regime includes registration, testing, background checks and continuing education requirements.

The HMRC recognises the valuable contribution that agents make to the smooth running of the tax system by providing support to many businesses. The UK HMRC has delivered many improvements to their services for agents, including agent account managers and toolkits.\textsuperscript{290}

Tax intermediaries are also an integral part of Canada’s tax system. They perform a valuable role in explaining complex tax laws to their clients but there are some intermediaries who encourage non-compliance, in which case the CRA addresses those cases quickly and effectively. Engagement plans have been developed for different types of intermediaries, including intermediaries representing taxpayer segments such as large and multinational enterprises, scientific research and experimental development (SR&ED), small and medium enterprises and individuals.\textsuperscript{291} The CRA continuously reaches out to third parties also to help achieve policy goals. This can take a variety of forms including engaging academics for discourse on policy, partnering with provinces and territories to address the underground economy, engaging in social media and inviting tax practitioners to be involved in the production of the CRA commentary.

The Netherlands Tax and Customs Administration (NTCA) also works with a co-operative approach towards fiscal intermediaries. For this group, the NTCA has adopted the strategy of customer intimacy wherein the largest tax intermediaries (top 150) and intermediaries that were members of an industry organisation were made eligible to enter into a horizontal monitoring agreement with the NTCA. Among the benefits of horizontal monitoring were that focus was placed on the processes and policies that led to tax compliance (or compliance failures) and that major compliance risks were tackled upfront, leading to a low-intervention regime and increased certainty for the companies and tax intermediaries as well as the tax administration.

The Australian ATO also conducts regular meetings to consult with tax practitioners and representatives of major accounting, tax and legal professional associations on how they can better administer tax laws. Consultation is an integral part of the ATO’s regulatory approach, and helps them to stay tuned to the changing nature of the marketplace and helps them respond as best as they can to the needs of key stakeholders.

### 3) Voluntary disclosure programmes

If a taxpayer has made a tax mistake or left out details about income on his tax return, the CRA offers a second chance in the form of the VDP.\textsuperscript{292} VDP gives the taxpayer an opportunity to pay only the taxes owed plus interest, avoiding penalties and potential prosecution on the

\textsuperscript{290}70 per cent of small businesses use a paid agent for help with at least some aspects of their tax.

\textsuperscript{291} OECD Paper on Study into the Role of Tax Intermediaries, available at http://www.oecd.org/tax/administration/39882938.pdf

\textsuperscript{292} Information Circular IC00-1R4
information accepted. Under normal circumstances, a taxpayer is entitled to utilise the benefits of the VDP only one time. A disclosure can be filed to correct inaccurate or incomplete information or to provide information previously omitted. A valid disclosure must be voluntary (made before becoming aware of any compliance action taken by the CRA), a penalty must apply to it, the information must be at least one year overdue and the information should be complete. Taxpayers are expected to remain compliant after using the VDP. A second disclosure for the same taxpayer would only be considered by the CRA if the circumstances surrounding the second disclosure were beyond the control of taxpayer. This programme is a permanent opportunity offered by the CRA.293

The ATO’s voluntary disclosure294 provides taxpayers with the opportunity to bring their tax affairs into order. When a taxpayer makes a voluntary disclosure that increases the tax that he should have paid (or reduces his credit), the ATO generally reduces any interest and administrative penalties that would be otherwise imposed. These voluntary disclosure schemes usually have set deadlines, such as ‘Project DO IT’ for disclosure of offshore income. Singapore’s IRAS, on the other hand, offers a permanent VDP295 that aims to encourage taxpayers who have made errors in their tax returns to voluntarily come forward in a timely and self-initiated manner296 to correct their errors and set their tax matters right and be compliant subsequently, in exchange for reduced penalties. These errors could be due to ignorance or negligence or taxpayers can voluntarily choose to disclose their past actions involving wilful intent to evade taxes. The VDP also requires details of controls put in place or that will be put in place to prevent recurrence of similar error(s), including date of implementation of controls along with documentary evidence to support the same. Singapore’s IRAS runs periodic programmes, which use mass mailers or other communication channels to encourage taxpayers to make voluntary disclosures on specific issues and keep making updates to the existing programme.297

4) Segmentation

Because taxpayer populations are not homogeneous, many tax administrations turn to segmenting the taxpayer population into groups with similar characteristics and identify compliance risks at these segment levels. Segmentation breaks down the taxpayer base into sub-populations or segments with similar characteristics and features. In a tax administration

294 When a taxpayer tells the ATO about a false or misleading statement made by them or a change that increases their tax or reduces credits and this is done without any prompting, persuasion or compulsion, it is referred to as 'voluntary disclosure'.
295 IRAS’ Voluntary Disclosure Programme applies to Income Tax, GST, Withholding Tax and Stamp Duty.
296 A voluntary disclosure is considered timely and self-initiated when it satisfies the following:
(a) It is made before a taxpayer receives a query from Singapore’s IRAS relating to its tax matters; or
(b) It is made before a taxpayer receives notification from IRAS of the commencement of an audit or investigation of its tax matters.
context, segmenting the taxpayer population into sub-populations of taxpayers facilitates more precise identification and categorisation of compliance risks. This, in turn, leads to a richer understanding of the true compliance risks and should ultimately assist in the specification and delivery of risk treatments.

i) Segmentation by size

Segmentation by size entails ‘small’ businesses, ‘medium-sized’ businesses, and ‘large’ businesses that are often defined on the basis of turnover or gross revenues, but may also be defined on the basis of assets or number of employees. The segmentation process must produce segments where the members have similar tax compliance or business qualities and/or characteristics. It is these homogeneous features that permit a tax administration to more accurately identify appropriate compliance strategies and to effectively target their application. For example, The US IRS’s Small Business and Self-Employed (SB/SE) Division was formed to address the specific needs of small businesses and self-employed individuals. Within SB/SE, the IRS’s Stakeholder Liaison office has been instrumental in designing, developing and delivering compliance strategies and educational products and services focused on small business taxpayers' needs. Furthermore, the IRS website covers topics from all areas of the US IRS. This includes specialised services such as dedicated local offices, payroll and practitioner partners, meetings with the small business community, small business products, TAS, etc. 298 Similarly, the UK HMRC works with small businesses to develop new products and services, getting insight into how businesses experience tax, researching customer needs, developing products with businesses and responding to ongoing feedback such as complaints. Making tax easier, quicker and simpler for small businesses means delivering sustained improvements to how the tax system is managed, with a strong focus on using new technology to transform their services. The Canadian CRA’s Action Task Force on Small Business Issues299 was created to ensure that the administrative policies and practices of the CRA impose the least burden possible on small businesses making it easier for them to voluntarily comply, while providing the CRA with the information it needs to confirm compliance with tax-related regulations and to identify and effectively address instances of non-compliance.

Similarly, UK’s system for the High Net-Worth Unit (HNWU) is based on a system of co-operative compliance. Co-operative compliance means enhancing the relationship between HMRC and its customers to deliver an outcome where both parties work together to achieve the highest possible level of compliance at appropriate cost. This approach is one that HMRC intends to have with its HNWI customers to further its intention to tailor its services and activities to its taxpayers’ needs to improve voluntary compliance. It relies on the foundation stones of a relationship characterised by trust, openness and transparency. Ireland’s co-operative compliance also envisages a new form of relationship between the Irish Revenue and


large business, one where both parties work together to achieve the highest possible level of compliance across the taxes and duties for which particular businesses need to account.  

ii) Segmentation by industry

The UK HMRC has undertaken a number of campaigns in order to maximise compliance amongst a particular group. Groups targeted currently or in the past have included plumbers, tutors and coaches, medics and electricians. A new initiative launched by the CRA, the Industry Campaign Approach (ICA) enables the CRA to work with industry associations in sectors to provide businesses with sector-specific tax information that would help them comply with their tax obligations. If an industry sector is covered by a campaign, the CRA increases communication on particular tax issues that concern the sector, either through the industry associations or directly. The purpose of providing this information is to increase awareness and help businesses meet their tax obligations. New businesses in this sector will be contacted to make sure that they receive the support needed to meet their tax obligations "right from the start”.

To select the priority sector industries for compliance strategies, the South Africa Revenue Service (SARS) considers the industry’s overall risk rating, revenue risk posed by the industry, specific lifecycle risks relating to registration, filing, declaration and payment, border and consumer protection risks, systemic legislation and policy gaps and risks, which system optimisation would have the biggest impact on compliance, which education and empowerment initiatives would have the biggest impact on compliance and what leverage opportunities they have to maximise compliance. Seven broad areas of focus have been included in SARS’s five-year compliance programme. These areas are wealthy South Africans and their associated trusts, large business and transfer pricing, construction industry, illicit cigarettes, undervaluation of imports in the clothing and textile industry, tax practitioners, trade

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301 These HMRC run campaigns are designed to help people bring their tax affairs up to date, help them keep them that way and help stop them getting it wrong in the first place. This is done by providing opportunities that make it easier to be compliant, including offering incentives to self-correct, bringing together a basket of activities to encourage voluntary compliance in the target population, looking for opportunities to inform customers who are entering the targeted risk area for the first time and using what is learned to help the HMRC improve processes to deal more efficiently with customers in the future. These campaigns offer people a chance to get their tax affairs in order on the best possible terms.


303 CRA contacts industry associations representing the businesses in the sector covered to explain to them the campaign and to receive their feedback. If an association has not been contacted, the association could inform the CRA of their association's interest via e-mail.

intermediaries and small businesses. The approach in developing the compliance programme used by the SARS is given in Diagram 12A.1.

Diagram 12A.1: Five-stage approach in developing the compliance programme used by the South Africa Revenue Service

Source: SARS

iii) Segmentation by taxpayer attitude or behaviour towards compliance

Behavioural economists emphasise that peer pressure can make delinquent taxpayers pay what they owe. The ATO compliance model helps the ATO understand different attitudes to compliance among taxpayers and their advisers. Based on that understanding, different strategies are applied to address risks to the fair operation of the tax system. Diagram 12A.2 shows the ATO compliance model.

Diagram 12A.2: Australian Taxation Office’s Compliance Model

Source: ATO
The SARS applies a model similar to the ATO’s, where depending upon the taxpayers’ attitude towards compliance, different strategies are employed to encourage compliance. Table 12A.1 further elaborates this.

Table 12A.1: South Africa Revenue Service model for determining compliance strategies based upon taxpayers’ attitudes towards compliance

<table>
<thead>
<tr>
<th>Compliance is influenced by…</th>
<th>What they are doing…</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attitude and willingness to pay their fair share</td>
<td>Understanding what informs taxpayers’ attitudes and willingness to comply</td>
</tr>
<tr>
<td>Knowing what their obligations are</td>
<td>Educating taxpayers about their obligations</td>
</tr>
<tr>
<td>Knowing how to comply</td>
<td>Educating taxpayers about how to comply</td>
</tr>
<tr>
<td>Ease of compliance</td>
<td>Making it easy to comply</td>
</tr>
<tr>
<td>Legal treatment of some tax positions</td>
<td>Making the legal treatment clear</td>
</tr>
<tr>
<td>An understanding of the possible consequences of non-compliance</td>
<td>Utilising both monetary and other punitive measures that escalate according to the context and severity of non-compliance</td>
</tr>
<tr>
<td>Perception of a credible threat of detection of non-compliance</td>
<td>Establishing frameworks that constitute a credible threat of detection</td>
</tr>
</tbody>
</table>

Source: SARS

The UK HMRC launched a national publicity campaign in November 2012 aimed at changing the behaviour of people who break the rules on tax or are tempted to break the rules.305 Using billboards, posters on telephone kiosks and bus shelters, radio and online advertisements, this campaign was launched to raise awareness among those breaking the rules that HMRC is closing in on undeclared income. The aim of this campaign was to encourage people who are not paying the right amount of tax to declare their unpaid tax voluntarily and pay it.

The Canadian CRA assists benefit recipients in meeting their obligation and obtaining their entitlements for complying with tax laws though outreach activities. Outreach focuses on changing attitudes and behaviours, influencing values and providing messaging related to service and non-compliance.

iv) Segmentation by tax type

The ATO has a goods and services tax (GST) voluntary compliance programme to deter fraud and evasion and to help people understand the heightened risks that accompany deliberate non-compliance. This will positively influence voluntary compliance, leading to willing engagement with the tax system. In 2011, ATO commissioned TNS Social Research\textsuperscript{306} to conduct a major programme of research that utilised their behavioural change model to research the beliefs and external factors that have an impact on GST compliance behaviour. The objective was to understand the attitudes and behaviours that drive compliance (or non-compliance) with GST obligations.

It was found that most businesses were confident about meeting their GST obligations and believe they do so successfully. Businesses indicating weaker growth, business owners with lower levels of business acumen and newer businesses found it more challenging than others to meet their GST obligations and showed lower levels of confidence. There were found to be correlations between effective business systems and voluntary compliance. Those with good business systems in place had greater BAS self-sufficiency, were less resentful about the GST system and found compliance easier. Findings from the research are being used to guide and inform communication activities supporting the GST compliance programme in the key focus areas of lodgement, debt, serious evasion and refund integrity. The research will also be used to establish benchmarks that will be monitored and reported against as part of the compliance effectiveness measures for the programme.

The Singapore’s IRAS launched the Assisted Compliance Assurance Programme (ACAP) to provide a holistic framework for businesses to proactively self-manage their GST risks and treat tax risk management as part of their corporate governance framework. To assist GST-registered businesses comply with tax obligations, the IRAS has designed a suite of GST initiatives to facilitate their voluntary compliance. ACAP focuses on conducting a holistic review of the effectiveness of the GST Control Framework to manage GST risks and secure ongoing GST compliance.

5) Compliance measurement

Measuring the effectiveness of tax administrations is fundamental to determining whether governments are fulfilling their responsibility in spending public money. The rationale for monitoring and measuring taxpayers’ compliance is derived from the primary goal of tax administrations, which is to improve overall compliance with tax laws. Compliance by taxpayers with these basic obligations is also viewed in terms of whether such compliance is achieved voluntarily (voluntary compliance) or corrected by verification/enforcement actions carried out by the revenue body (enforced compliance). In a tax administration context, this distinction is highly relevant as ‘enforced compliance’ has a cost, and very often a significant one. In line with their overriding goal and mission, all revenue bodies should be aiming to improve the overall level of ‘voluntary’ compliance and by definition, rely less on ‘enforced’

\textsuperscript{306}TNS is a leading market research and market intelligence company.
compliance. Other terms often used in a tax ‘compliance’ or ‘non-compliance’ context are ‘tax evasion’ and ‘tax avoidance’ or ‘unacceptable tax minimisation arrangements’.\(^{307}\)

The US IRS’s National Research Programme (NRP) is a comprehensive effort to measure the level of taxpayer compliance by considering three distinct types of compliance – payment compliance, filing compliance and reporting compliance.\(^{308}\) The three classes of compliance measures are designed to answer three questions in order.

- Did the taxpayer file on time? If the answer to this question is no, the associated non-compliance is captured by filing compliance measures. If the answer is yes, one can proceed to the next question.

- Did the taxpayer report his/her tax liability accurately? If the answer to this question is no, the associated non-compliance is captured by filing compliance measures. After determining the appropriate reporting compliance, one can proceed to the next question.

- Did the taxpayer pay the full amount he/she reported as tax liability? If the answer to this question is no, the associated non-compliance is captured by payment compliance measures.

The ultimate goal of the measures is to provide benchmarks against which the IRS can evaluate the effectiveness of programmes designed to improve taxpayer compliance with the Tax Code. The filing rate and non-filing tax gap assists the US IRS management in the evaluation of efforts to improve voluntary filing compliance.\(^{309}\)

In order to measure the success of their compliance interventions, the ATO has developed the compliance effectiveness methodology. The hypothesis against which the ATO applies the methodology and measures the success of its compliance strategies (or compliance effectiveness) is that if their compliance strategies have been effective, then they should see positive and sustainable changes in compliance behaviour with one or more of the key compliance obligations, and/or community confidence. The ATO compliance effectiveness methodology\(^{310}\) has a phased approach that enables focus and reflection. It consists of 4 phases.

\(^{307}\) OECD Paper on Monitoring Taxpayers’ Compliance: A Practical Guide Based on Revenue Body Experience, June 22 2008

\(^{308}\) The three measures provide different views of the compliance puzzle and when placed next to one another, provide a comprehensive picture of the overall level of compliance. The filing compliance measure tracks the proportion of required returns that are timely. The IRS’s reporting compliance measure (the voluntary reporting rate) is the proportion of tax liability accurately reported on timely filed returns. The payment compliance measure tracks the proportion of reported tax that is paid in a timely manner. Extracted from “Report to Congress on the Current State of Knowledge about Federal Tax Non-compliance,” IRS, Department of the Treasury, February 2000, page 3.


\(^{310}\) While this methodology focuses on a bottom-up approach looking at discrete, priority compliance risks, the ATO is also developing effectiveness measures from a whole of ATO or top-down approach. The aim is to embed effectiveness thinking into their administration so that effectiveness becomes part of business-as-usual at the ATO.
Phase 1 is about understanding and articulating the risk and making sure that it aligns with the ATO’s business intent of optimising voluntary compliance, making payments under the law and building community confidence. This phase starts after the risk has been identified, quantified and prioritised through the corporate risk management framework. Phase 2 is about clearly expressing the outcome the ATO wants to achieve and what would be different if they were successful. This phase also involves identifying the right mix of treatment strategies that treat the drivers (causes) and not just the behaviours (symptoms). Phase 3 involves identifying potential indicators and applying a series of business validation tests to ensure that they are viable and useful. Phase 4 deals with the technical validation of the indicators and the evaluation and reporting of effectiveness. The potential indicators identified in Phase 3 are validated from a technical perspective, and the effectiveness of the compliance strategies in changing behaviour, building community confidence, or both, over the immediate, intermediate and long term is evaluated.311

The CRA conducts research and analysis aimed at better understanding and monitoring of compliance, identifying areas and levels of non-compliance and evaluating the effectiveness of strategies used to address non-compliance. The framework is a tool for monitoring and measuring compliance, as well as evaluating and refining compliance strategies. Annual compliance monitoring reports provide data for tracking compliance indicators within the framework and feed into the CRA’s annual reports. The annual reports for the years following the implementation of the framework contain examples of reporting against the framework, showing levels cascading down from strategic outcomes through a range of expected outcomes and expected results to performance expectations or indicators.312 In order to develop a more overarching, strategic and rigorous approach, the CRA developed the compliance measurement framework shown in Diagram 12A.5.

Diagram 12A.3: Canada Revenue Agency’s compliance measurement framework

Source: Canada Revenue Agency


6) Compliance verification (Audits)

In the past, audits were the sole treatment for compliance available with the tax administrations. They acted as public sanctions making the extent of the tax administration’s enforcement powers visible within the community and encouraged compliance. The audit programme of a tax administration performs a number of important roles that, when effectively carried out, can make a significant contribution to improved administration of the tax system. These include promoting voluntary compliance, detecting non-compliance, gathering intelligence and information on the “health” of the tax system (including patterns of taxpayers’ compliance behaviour), educating taxpayers and identifying the areas of law that require clarification.

Apart from induced effects, a programme of taxpayer audit also may promote voluntary compliance from indirect effects. Two categories of indirect effects have been identified in a study conducted by the US IRS – subsequent period effects and group effects. Subsequent period effects refer to an increase in taxpayer compliance following an audit. Erard\textsuperscript{313} examined the reporting behaviour of taxpayers who were audited by the IRS and, by chance, were selected for audit again two years later. He hypothesised that taxpayers who were previously audited would exhibit greater compliance in subsequent time periods, either because the audit process teaches taxpayers how to more accurately comply or because beliefs about audit probabilities are conditioned on prior audit experience. However, Erard was unable to confirm the existence of subsequent period effects. A second form of indirect effects, referred to here as group effects, results when an individual’s behaviour is influenced by the values and norms of his/her peers.\textsuperscript{314}

The conduct of audits is facilitated if audit officials can prepare their plan of audit with some awareness of how particular industries and businesses are conducted and the likely level of profitability and expenses that might be expected of a business of a particular size and located in a particular region. To this end, a number of tax administrations have developed systems of industry/business profiles and/or provide industry benchmark data obtained from various sources. The US IRS has established an extensive series of ATGs that focused on developing highly trained examiners for a particular market (industry) segment. The guides, which are made public, contain examination techniques, common and unique industry issues, business practices, industry terminology and other information to assist examiners and, in particular, highlight unique issues and approaches that may be relevant for an industry/business type using one or more of the various indirect income measurement techniques.


In Australia, the ATO derives industry benchmarks from data disclosed, principally in monthly (for larger taxpayers) and quarterly (for small and medium enterprises (SMEs)) Business Activity Statements (BAS), required from all businesses.

In the UK, HMRC has detailed reports on specific industries called ‘Tactical Information Packages’ (TIPs). These TIPs explain how an industry operates and provide information about industry performance and trends. The industries that HMRC has reports on tend to be ones that, from experience, have been non-compliant. The reports are used to provide background on an industry before an investigator begins an enquiry and to help investigators create “business economics models (BEMs)’.

Most tax administrations prefer to be selective when choosing which tax returns to audit, selecting the returns of only those taxpayers who are believed to be the most non-compliant. Sometimes, returns are chosen at random. Random selection means every tax return has an equal probability of being audited, regardless of a particular individual’s compliance status. A tax administration can initiate a programme of random audits for a number of varied reasons. For example, random audits might be used to measure evasion activity among different groups of taxpayers in order to develop or validate a return selection system. They also might be used to identify emerging evasion trends or to profile new forms of economic activity such as use of ICT. For example, by focusing random audits on a sectoral basis, the CRA is able to gather sufficient data to develop profiles of specific sectors and refine its risk assessment methodologies to take into account sectoral differences, which allows more accurate identification of risks in relation to specific cases in a given sector.315

Tax administrations can initiate random audits to measure compliance. The UK’s Income Tax Self-Assessment Random Enquiry programme was designed to produce measures of the probability of a customer being non-compliant. A third use of random audits could be to evaluate the effect of enforcement activities and policies. Similarly, the US IRS’s Taxpayer Compliance measurement programme (a random audit programme in the IRS) was able to provide a broad-based and internally consistent longitudinal profile of the compliance characteristics of the vast majority of US taxpayers. While taxpayer compliance measurement programme (TCMP) studies relied on intensive examinations of every taxpayer, the NRP developed a case building approach that first determined if a return was accurately filed and if not, to determine the issues that needed determination. The NRP approach was a new method of measuring taxpayer compliance.316 In the UK, yield is measured to show whether the revenue body is fulfilling its commitments under the Public Service Agreement with the UK Treasury. Both the ‘direct’ yield achieved from audit activity and the ‘indirect’ yield (the continuing effect of the compliance activity) is taken into account. Finally, random audits can serve as a general deterrent to evasion, if no other means exist to distinguish compliant from non-compliant returns.

315 OECD paper on Compliance Risk Management: Managing and Improving Tax Compliance, October 2004
316 OECD Paper on Compliance Risk Management- Use of Random Audit Programmes, September 2004
TP audit

The US IRS had released a TP Audit roadmap in February 2014 that provides IRS employees with audit techniques and tools to assist in the planning, execution and resolution of TP examinations. The Transfer Pricing Operations of the IRS Large Business and International Division prepared the roadmap, and shared it with the public in order to provide insights into what taxpayers can expect during a transfer pricing examination. This roadmap is not a template and IRS examiners are expected to use their judgment in applying the roadmap’s guidelines.

In Germany, the tax administration selects cases by two means:

a) Cases are automatically pre-selected because of attributes such as size (sales, amount of wages, etc) or because they have been audited in the past already. These pre-selected cases are then reviewed at a high level by the responsible tax audit department. The department decides, after the desktop review, whether the case looks relevant, given the audit resources.

b) Cases can be nominated by the tax office in charge for tax assessments. The audit trigger can be any observation (for example variation in profits, media coverage on business restructurings). These suggestions are also reviewed by the audit department. A tax audit can also be initiated when mutual agreement procedure (MAP) or advance pricing agreement (APA) procedures are applied for by the taxpayer or a foreign counterpart.

In France, transfer prices are audited as part of a formal tax audit on all issues. There are no rules as to which companies come under investigation. Major companies are audited every three to four years. Nowadays, almost all sectors are audited, including wholly French-owned entities and subsidiaries of non-France based groups.

In the Australian ATO, every taxpayer who engages in international transactions with connected parties for an aggregate amount greater than AUD 2 million is required to submit an international dealings schedule (IDS) with their income tax return, detailing the nature and value of these transactions. The ATO uses information from the IDS to assess a taxpayer’s transfer pricing risk and select taxpayers for review.

The ATO uses a risk differentiation framework (RDF) to assess tax risk and determine an appropriate risk management response. In using this framework, the ATO considers the likelihood of non-compliance (i.e., having a tax outcome that the ATO does not agree with) and the consequences of that non-compliance (e.g., in terms of dollars, precedent). If the likelihood and consequences of non-compliance are considered to be high, the ATO will target the taxpayer for a review or audit. Conversely, if the risk assessment by the ATO is determined to be low, the taxpayer will be monitored periodically.

The ATO typically uses an approach known as client risk review (CRR) when undertaking a risk assessment of potential material tax issues, including transfer pricing. The ATO will examine information such as the taxpayer’s IDS, compliance history, latest collections, news
or media articles and other publicly available information. A CRR is a review of one or more historical income years for which a tax return has been lodged. When transfer pricing is identified as a significant risk, the CRR may proceed to a formal Transfer Pricing Record Review (TPRR).

As part of a TPRR, and in deciding whether to proceed beyond a TPRR to a TP audit, the ATO considers the quality of a taxpayer’s processes and documentation, and whether the taxpayer’s results are commercially realistic.

In conducting TPRRs, the ATO sometimes uses publicly available data from the Australian Bureau of Statistics (ABS) in order to form an opinion on the commercial realism of a taxpayer’s financial performance, relative to the performance of the market segment as a whole. The ATO’s use of ABS data is limited to this situation and not used in comparability analyses because the data includes details of companies engaged in controlled transactions, and the categories may be wide enough to include companies that might be functionally dissimilar.

Taxpayers will receive a risk rating at the completion of the risk review. A higher risk rating does not necessarily mean that the company will be selected for audit, but with such a risk rating, the taxpayer is likely, at a minimum, to be placed on a watching brief. If an audit happens, inter alia, the ATO will carry out an inspection of the taxpayer’s premises and interview key operational personnel.

**Risk management systems for better audit**

The basis for effective audit strategies is reliable risk identification and workload selection. Improved capabilities or improved processes in these areas are likely to bring about considerable effectiveness gains. The Canadian CRA has redesigned compliance systems in order to improve the business intelligence capability of compliance programmes. This has led to improved risk management and workload selection and consequently, improvements to audit quality in terms of fairness and integrity as well as in terms of its ability to protect the revenue base and lower the burden placed on honest taxpayers. In Switzerland, the pre-selection process for risk-based audits has been amended in order to improve case selection. The idea is to select more cases than needed and let audit staff do a short analysis of each case to assess the risks involved before accepting or rejecting the selection. The short analysis provides valuable feedback that is used to improve future selection – for instance, by correcting wrong information in databases or updating outdated information. As a result of the amended process, the number of unproductive audits has decreased. This is illustrative of how selection processes can be improved through systematic feedback mechanisms.

With modern compliance risk management strategies, more emphasis is placed on identifying and responding to aggregate risks as opposed to individual cases. The Finnish Tax Administration is implementing new risk management procedures designed to achieve a more
optimal allocation of audit resources. It is expected that the initiative will result in more uniform selection and more effective use of resources. \(^{317}\)

**Table 12A.2: Australian Taxation Office’s risk identification process:**

<table>
<thead>
<tr>
<th>Element</th>
<th>Stage of Process</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Risk Identification</strong></td>
<td>1. Identify risk – identify list of outputs and work roles associated with the work of the audit stream, and identify risk for each output</td>
</tr>
<tr>
<td><strong>Apply ATO risk matrix</strong></td>
<td>2. Assess the impact of the risk and assign a risk rating</td>
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<tr>
<td></td>
<td>3. Assess mitigation factors (for example, work processes, systems, etc.)</td>
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<tr>
<td></td>
<td>4. Re-assess impact to determine actual risk</td>
</tr>
<tr>
<td></td>
<td>5. Conduct cross-stream validation</td>
</tr>
<tr>
<td><strong>Options/Responses to risk and potential capability assessment process</strong></td>
<td>6. Design an assessment and/or assurance response</td>
</tr>
<tr>
<td></td>
<td>• Identify risk critical capabilities for high-risk roles</td>
</tr>
<tr>
<td></td>
<td>• Match critical capabilities to appropriate response for high-risk roles</td>
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<tr>
<td></td>
<td>• Match non-critical capabilities to core common specific capabilities</td>
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<td></td>
<td>• Select appropriate assessment from options</td>
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<td>7. Use capability intelligence for feedback analysis and risk review</td>
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The process adopted by the ATO in risk identification has been enumerated in Table 12A.2. Under this Risk Differentiation Framework (RDF), \(^{318}\) large taxpayers – those companies with turnover in excess of Australian $250 million – are profiled so as to assign risk ratings relative to the level of perceived tax risk for each taxpayer. These risk ratings subsequently determine the type and level of intensity of the ATO’s inquiries into that taxpayer, and whether the taxpayer will be subject to continuous reviews, continuous monitoring, periodic reviews or period monitoring. \(^{319}\) The framework contains four risk categories – higher risk taxpayers, key taxpayers, medium risk taxpayers and lower risk taxpayers. The factors that determine the risk rating assigned to a taxpayer include past compliance behaviour, business performance relative to tax outcomes, significant transactions, intelligence from foreign revenue authorities, intelligence from Australian government agencies, and the risks associated with the introduction of new laws.

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\(^{317}\) OECD Paper on *Working smarter in structuring the administration, in compliance, and through legislation*, January 2012


\(^{319}\) Typically, larger entities are more likely to be assigned a higher risk rating if there is high likelihood of non-compliance. Smaller entities may be considered of higher consequence if they are deemed to be a market leader, for example, the first to the market with innovative financial products or structures.
7) Deterrence

There are both direct and indirect effects of compliance activities undertaken by tax administrations. Direct effects refer to the collection of additional revenue from taxpayers who are subject to audit and enforcement actions. Indirect effects refer to “spillover” effects when audit or enforcement activity on one set of taxpayers has positive effects on the compliance behaviour of the rest of the taxpayer population in response to heightened enforcement or audit activity. As a tool of enforcement, tax audits are thought to have both direct and deterrent effects on taxpayers. The direct effect is simply the difference between the tax liability as determined by an examiner and the amount voluntarily reported by the taxpayer. In contrast, the deterrent effect is an increase in voluntarily reported tax liability due to the existence of a programme of taxpayer audits. Several studies aimed at quantifying the magnitude of deterrent effects have reported ambiguous results. A factor contributing to the lack of research on this topic is the theoretical view that taxpayers behave as if the audit selection process were completely random. With this assumption, each taxpayer’s decision to evade tax is reduced to a simple calculation of maximum utility that depends only on the fraction of taxpayers audited each year and the penalty for evasion.

A tax administration can design its audit activities in a more effective way by understanding the way deterrence works in practice. To understand the likely effect of an audit on future compliance behaviour, the New Zealand Inland Revenue Department commissioned telephone interviews among 300 recently audited businesses. Fifty-four per cent of the interviewed businesses stated that they had done or would do things differently in the future in order to meet their tax obligations. This suggests that audits can improve compliance among businesses. The central issue here is not whether deterrence works or not but how and when deterrent measures could be applied effectively and when not. The challenge for a tax administration is to utilise a strategy that creates positive effects at both the individual level (i.e., among those who have been audited), and on a general level (i.e., for those taxpayers who have not been subject to the enforcement activity) at the same time. This means that tax administrations do not only need to perform audits in an effective manner and among the right taxpayers, but also inform the public about these actions in an effective way.

Deterrence is based on the concept that the risk of detection and punishment will improve compliance behaviour. There are generally legal limitations on the level of detail that can be put into the public domain. However, within those limits, the key elements in such a communications strategy include publishing fairly comprehensive details of the results of audit activities in their annual performance and/or statistical reports. For example, the US IRS publishes in its annual statistical publication, the ‘IRS Data Book’, the aggregated results (i.e., numbers of taxpayers examined, tax assessed, and tax refunded) of all tax audit activities by detailed taxpayer size classification criteria and type of audit. Apart from that, communication

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strategies are also seen to include publicising convictions for tax evasion, which acts as a deterrent to the potentially non-compliant.

Similarly, the component of transparency that constitutes the strongest incentive for tax compliance is the publicity given to prosecution and conviction of tax evaders. In 1996, the US IRS Criminal Investigation Division (CID), employing about 5,000 persons of the total IRS staff complement, referred 3,600 cases for prosecution to the Department of Justice (DoJ).\textsuperscript{321} Publicity regarding tax fraud is handled by the latter department, via the office of the US Attorney in the district, where a given case is prosecuted. It normally issues a press release when a tax evader is indicted, once he or she is convicted, and again when the evader is sentenced. The Division's Policy and Information Division compiles a volume of monthly news clippings from around the country, bearing on prosecution of tax evasion. The significant magnitude of general deterrence results implied that media played a large role in criminal investigation cases.\textsuperscript{322}

\textbf{Netherlands' Tax accounts project}

In late 2000 and early 2001, the Fiscal Intelligence and Investigation Service/Economic Investigation Service of the NTCA obtained information on thousands of Netherlands nationals who, collectively, held a huge amount of capital in foreign bank accounts. This information resulted in what was called ‘The Accounts Project’. The primary objective of the project was to deal with the account holders identified \textit{en masse} or intensively. It also hoped to achieve the greatest possible indirect knock-on effect – voluntary disclosure by as many as possible of those persons who held a foreign bank account but who had not yet been identified.

The Accounts Project had brought that effect about mainly through media publicity. The NTCA actively sought publicity by setting up a website and placing an advertisement to publicise the voluntary disclosure scheme that allowed taxpayers to declare (and pay tax plus interest on) previously undeclared foreign bank balances without being fined. There was considerable contact with journalists concerning the project.

This study examined the content of media reports on the Accounts Project published in national and regional dailies during the period November 2001 to September 2002 and related this content to the influx of taxpayers making voluntary disclosures. Of all the elements in the media reporting on the Accounts Project, normative messages appear to have had, by far, the greatest positive influence on the number of such new taxpayers. This applies both for prescribed norms – it is wrong not to declare a foreign bank account, and perceived norms – a lot of other people have already voluntarily declared their foreign accounts.


In addition to normative messages, reports about the possible ways of making a voluntary disclosure had a beneficial effect. Again, the number of disclosures increased a few weeks after the reports appeared.

A very large proportion of the media reports dealt with the risks of detection and the consequences for those suspected of holding undeclared foreign accounts. However, these elements in reports did not appear to have much direct influence on the number of new taxpayers making voluntary disclosures.\(^{323}\)

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Use of third party data in DG (Audit), CBEC

Third party data is used for (a) identification of all taxpayers who are liable to pay tax, but do not pay and (b) to ensure that taxpayers discharge their tax liability properly.

Information from Reserve Bank of India (RBI)/authorised banks for handling foreign exchange

As part of an exercise undertaken by the DG Audit to verify whether the service tax had been correctly paid on services sourced from outside India, transaction wise data relating to foreign remittances for selected purposes was collected from authorised foreign exchange dealers. Banks, which are authorised dealers of Foreign Exchange, maintain transaction-wise details of amount remitted outside the country. These details include the purpose for which the amount is remitted. There are 36 Purpose Codes that attract service tax liability. This data was used to identify potential taxpayers. It was found that there was a gap between the service tax payable and actually collected. In many cases, the remitters of foreign exchange who appeared liable to pay service tax were not even registered with service tax. ACES data available on service tax registrants and service tax payments was used for this purpose. Investigations have so far resulted in huge recovery.

Information from Income Tax

The CBDT maintains data pertaining to deductions effected for various purposes under specific heads.

- Insurance Commission Section 194 D
- Commission on Brokerage Section 194 H
- Rent for use of Property Section 194 I
- Payment to Service Providers Section 194 J
- Payment to Work Contractors Section 194 C

This data is useful for co-relating the service tax liability and income shown to the CBDT.

Information from the Central Board of Film Certification (CBFC)

The CBFC provides the details of films produced and owners of copyright, which is useful for identification of service providers. The list of all films produced and their owners with PAN number was obtained and data in ACES was matched to identify potential service tax payers. Many non-registrants were identified in this exercise and service tax was recovered.
Information from Ministry of Information and Broadcasting and Telecom Regulatory Authority of India

Annual reports published by Telecom Regulatory Authority of India (TRAI) and the website of Ministry of Information and Broadcasting contain details of television stations, radio stations and cable operators, which is useful for identifying service providers. By using the information available on the website, details of all service providers obtained and the PAN details were matched with ACES database. A large number of non-registrants were identified across the country and action for recovery of service tax taken.

Information from Civic Agencies

The information about civil contractors with authorities like the Delhi Development Authority can assist in identifying service providers, particularly in the construction sector. Details of service providers were procured from the civic authorities in Mumbai and Delhi, and their permanent account numbers (PANs) were matched with the ACES database. A large number of non-registrants who were required to register with service tax were identified and action taken for recovery of service tax.

Information from State VAT department

Information exchange between centre and state VAT departments have huge potential to detect non-compliance. A project between the CBEC, CBDT and Maharashtra VAT department called ‘Tax 360’ has unearthed huge evasion of duty by taxpayers.

Information from other Ministries:

Details of services provided by the Home Ministry by deploying the Central Industrial Security Force (CISF) for security of public installations like refineries, airports etc., and remunerations received were obtained from Home Ministry and service tax liability on such remunerations was recovered.
Appendix XII.3

Undergraduate Tax awareness course objective

This course is proposed to be introduced at the undergraduate level in Indian universities, preferably in the first year. After going through this course the learner should be able to:

- Gain knowledge about the principles of taxation and the applicability of tax laws
- Understand that public and development expenditures are met out of tax revenues
- Realise the government’s tax objectives in the right perspective
- Fulfil his or her tax duties and
- Build a system of mutual trust between government and citizens (taxpayers).

Course Structure

- Principles of taxation: direct and indirect taxes
- Fiscal policy of government of India: Provision of public good and externalities\(^{324}\)
- Assignment principles of tax in India
- Basic understanding of the Government of India budget\(^{325}\)
- Public and development expenditure met out of tax revenues, granting of subsidies and provision of infrastructure
- Simple and transparent taxation system
- Accountability of tax administration towards taxpayers
- Legal implications of and risks involved in non-compliance of tax obligations

Expected Outcomes

Introducing this course at the undergraduate level will enable the Government of India to achieve the following:

- Inculcating the right attitude towards tax compliance
- Long-term cultural shift in compliance
- Creation of pressure groups by catching future taxpayers young
- Bring about leaders of change

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\(^{324}\) Public Finance chapter 3 from the recent economic survey GOI available at \(http:indiacredit.nic.in/es2013-14/echap-03.pdf\)

\(^{325}\) Key to the budget document available at \(http://indiabudget.nic.in/ub2011-12/keybud/keybud2011.pdf\)
Paying Taxes Voluntarily: A Primer

I. Why should you pay taxes?

You often wonder why you should pay any taxes. Some people think that taxes are paid only by the rich. Some people think that if they do not pay due taxes, nobody will notice. Some people wonder why taxes should be paid, since there is little that one gets in return. You may be surprised by the answers to all of these questions. All of us pay taxes all the time. The services that we get in return are significant and valuable. But you also come across many opportunities for not paying your taxes. A shopkeeper may tempt you not to pay the due tax on a purchase if you choose not to take a proper receipt. A house-owner may show reluctance to give a rent receipt where you may be a tenant. Tax evasion and tax avoidance makes tax authorities aggressive and forces them to make complex provisions in law to plug loopholes. Over time, the tax system becomes extremely complex and difficult to comply with. Interaction between taxpayers and tax authorities often leads to corruption and generation of black money, which has many harmful effects on the economy. It is best if each side, namely, the taxpayer, the policy makers, the spending departments, and tax authorities appreciate their relative roles and their place in the common endeavour towards building a better society and a stronger Indian economy. As a taxpayer, you have a key role to play in this common endeavour. It is illegal not to pay one’s due taxes; by voluntarily paying your due taxes, you contribute to the common good.

We pay taxes all the time, sometimes without realising it

Rich or poor, knowingly or without being aware, reluctantly or willingly, all of us are paying taxes all the time. As we step out of the house to purchase fruits or vegetables, without realising it, the price that is to be paid is likely to contain a tax component. Fruits or vegetables may be in the exempt list of indirect taxes charged by the government. However, if diesel has been used to transport it from the place of production to the market, a tax might have been paid on that diesel, which would already be part of the price. Many taxes are embedded in the prices of goods and services that we purchase. These are called indirect taxes.

There are, of course, more direct taxes that are clearly visible. A salaried employee will be paying an income tax, which may get deducted from his income every month. Every year he will be filing an income tax return. A company will be asked to pay a corporate income tax. A property owner will be asked to pay a property tax. Direct taxes are paid by individuals and companies. Indirect taxes are collected through dealers registered with the tax authorities although the tax is eventually paid by the consumers of goods and services. As you read the newspaper, not only will you be intrigued by the tax cases going on in the courts of law but you yourself will be paying an electricity duty for the light under which you may be reading the newspaper. The list of taxes is long. There are central taxes such as personal income tax, corporate income tax, central excise duty, customs duty, and service tax. There are state taxes such as sales tax and value added tax, stamp and registration duties, state excise duties, motor vehicle tax and entertainment tax. There are taxes charged by municipalities like the property tax. Even local rural bodies like the panchayats have powers of taxation.
We also enjoy the benefits of services provided by governments, sometimes without appreciating it.

As you step out of the house, you would unavoidably walk on a road built by the state government, who finances it by taxes that you have paid. You might take a bus to your college of university and pay a price for the bus ticket, which is much less than the cost of providing that transport service. You would then be benefited by a subsidy, also financed by tax revenues. When you decide to go abroad to pursue higher studies, the government will issue a passport so that you are allowed entry in a foreign country. That service is also run by the government and the expenditure that the government incurs for providing that service is financed by tax revenues. Just as there are many taxes, there are also many services that governments provide. The central government provides services like defence, system of justice, and the currency system. It builds national highways and nurtures universities and institutions of higher education like the Indian Institutes of Technology (IITs). State governments also provide many services. They build state level highways, facilitate setting up of industries, run hospitals and schools and colleges, and build irrigation canals.

If you are a citizen living in an urban area, three tiers of governments are responsible for your welfare and well-being – the central government, the government of the state where your city is located and the municipal body that provides you civic or local services. Your elected representatives have been entrusted with the responsibility of forming that government, formulate policies and provide administration with the help of administrators. If you are a citizen living in a rural area, there would be, according to our constitutional scheme, five tiers of government entrusted with the responsibility for your welfare and well-being. Starting with the tier of government closest to you and moving upwards, you would have a gram panchayat, a block or anchal panchayat and a district committee or panchayat, a state government, and then at the apex of this vertical structure, the central government. All the elected members of panchayats, state legislature, and the Parliament and the appointed officials of the executive are meant to serve you. In terms of economics, you are the principal and they are the agents entrusted with the responsibility of meeting your needs and carrying out your wishes. But they need resources to perform those duties.

Tax is a compulsory payment by law

Taxation is by definition a compulsory payment. It is compulsory by law. There is no one-to-one link between the tax that you pay and the service that you receive. The law has been made because of the special nature of goods and services provided by the government that are financed by tax revenues. The nature of these goods and services is such that they cannot be sold or financed in the same way as private goods that are bought and sold in the market place. When we go to the market, we pay a price according to the quantity we purchase and the type of goods we buy. Whatever we purchase, we have the full right to enjoy the benefits of that exclusively if we so desire.

The book that we buy from a bookstore or the meal that we have ordered in a restaurant need not be shared with anyone else. But many services that governments provide are different in
nature. In their case, the one-to-one ownership once purchased cannot be applied. These are special economic goods called ‘public goods’. It is difficult to finance them adequately except through taxation, which has to be levied on principles that are different from market principles. In the market, if you do not pay the price, you go without the good. It is your choice. In the case of public goods, if you do not pay the price, you would still enjoy the benefit of the good, because such goods are meant for collective consumption and one individual cannot be isolated from enjoying that service. Since you know that, you may not be willing to pay anything voluntarily. If everybody is allowed that choice, no tax would be raised, and the public good cannot be financed at all. Hence, tax has to be made a compulsory payment.

Need for taxes: case of public goods

Governments finance a category of goods, extremely critical for meeting the combined or joint needs of all citizens in the country that would not be provided unless these are paid for by taxes. Such goods are called public goods. Examples of such goods are defence, general administration, and administration of justice. If you are asked what price you are willing to pay for the country’s defence, you might say that this is a service not for you alone but for everybody. If everybody pays something, you might also pay something. But let others pay first. The difficulty is that it is very difficult to charge people according to their preferences, as one would in a normal market. It is not possible to divide defence into each citizen’s separate defence nor is it possible to charge them according to how much they are individually willing to spend for the country’s defence.

Left to be paid by individuals according to what might please them, such goods will either be not provided or under-provided. These goods have then to be paid for by taxes, which is a payment that is compulsory and not voluntary. Voluntary payments often fail for such goods when people mistakenly think that since everybody has to contribute only a little, your contribution is going to be small and nobody would notice if you did not contribute. A good example of this wisdom is contained in one of the Akbar-Birbal stories recounted in Box 1. There are two characteristics of services that are jointly consumed where normal market principles do not work. These characteristics, in technical terms used by economists, are called ‘non-rivalry and non-excludability’, which are defined in Box 2.

**Box 1: Akbar-Birbal and the filling up of pond with milk**

Once, Akbar and Birbal were travelling together talking about how trustworthy Akbar’s subjects were to him. They came across an empty pond. Birbal asked, “If you were to ask your subjects to fill this pond with milk, will they respond voluntarily because of their loyalty to you?” Akbar was confident of their loyalty. Birbal said that this could only be tested if they were each asked to contribute a glass of milk but let them be told that this will have to be done during the night. Each came bringing a glass. Next morning the pond was full of water. There was not a drop of milk. Each person thought that if he were to put a glass of water, nobody could tell since the pond would be full of milk since my neighbours are in any case going to bring their glass of milk. Since everybody thought in the same way, the result was no milk but only water.
Box 2: Defining a public good
Public goods have two special characteristics. In technical terms, these are called non-excludability and non-rivalry in consumption. Non-excludability means that any single individual cannot be effectively excluded from the consumption of the public good. Non-rivalry means that the consumption of a public good by one individual does not reduce the quantity available for consumption by another individual. Examples of public goods include national security, judicial system, and lighthouses.

Taxation is helpful to finance subsidies: case of merit goods
There is another set of services to which government must contribute because, left to themselves, people will not fund enough of the provision of such a service to meet the needs of the society. Education is a good example of such a good. A poor family may think that her child is better off working and contributing to the family’s income. Why waste time on going to school? But if many children do not get enough education, their productivity in their adult life may be much less than if they had received adequate education and training. Their total contribution to the country’s economy over a lifetime would be much more when time and resources are spent in first educating and skilling them than it would be if they earn as uneducated and unskilled workers from their childhood. But parents may not fully understand this or their economic circumstances may force them to ask their children to forego education because it is very costly. On the other hand, left to earn low income or remain unemployed, they may become criminals and cost a lot to the rest of the society. There may also be faulty social or cultural values that lead families to under-educate their children. Education of the girl child in India has long suffered from this malaise. For some, it might the accepted practice in the caste or village they belong to. Some might think that if the girl child is uneducated, she will be more submissive and it would be easy to marry her off. Some parents may think that family income is limited and it is better to focus the limited resources on the boys because in any case the girl will eventually go away after she comes of age and gets married. All of this reflects faulty thinking and society as a whole cannot permit this. Every child has to be educated to become better equipped to realise her full potential. It is her right. But even from the narrower viewpoint of the individual’s life time contribution to the country’s income and output, the country will be much better off if all children independent of their gender are educated to their full potential so that they can earn for themselves and contribute fully to the country’s income. In this case, if the family is not adequately inclined to educate their children to their full potential, society will have to intervene and impose a ‘social preference’ over the family’s preference. Such goods of services are called ‘merit’ services. Box 3 gives the technical definition of merit services. Health is another good example of a merit service.

Box 3: Defining Merit goods
Merit goods are goods whose consumption can be justified from a social viewpoint. Merit goods are such that the social benefit is often more than the sum of individual benefits. When this is clearly the case, the concerned good or service is characterised by ‘positive externalities’. Education and health services are considered to be prime examples of merit goods. Inoculation against a contagious disease benefits not only the person inoculated but also his neighbours who would have a reduced risk of catching the disease. Clearly, there is a positive externality.
In the case of merit goods, it is often argued by economists that the level of consumption of the goods would be less than is desirable for society if the choice is left to free market forces to be done on the basis of individual preferences. In order to further promote its consumption, some intervention needs to be done in the form of subsidies, which would reduce market prices and hence, promote more consumption. These subsidies need to be financed by taxation. The desire to provide universal education can be justified on this ground. In laying the foundations of modern India, Gandhiji was one of the first to recognise the value of education for society.

**Taxation can be good for you and your family: case of demerit goods**

In the case of merit goods, subsidising the purchase of such goods is justified. The case of demerit goods is the opposite of merit goods where taxation is good for the individual. Good examples of demerit goods are alcohol and tobacco. Both are bad if they become habits. Many families are ruined if the family head or any other member becomes addicted to alcohol or tobacco. Governments try to discourage these either by prohibiting these or taxing these relatively heavily compared to other goods. Taxation is good in these cases because it increases the price and discourages consumption.

**Taxation is good for society: case of protecting environment**

Just like there are positive externalities, there are also negative externalities. Environmental pollution is a good example of negative externalities. Examples of pollution are atmospheric pollution, soil pollution, water pollution, and noise pollution. Pollution caused by the consumption of one individual or industry leads to a poorer quality of environment for other individuals or for the society as a whole. One method of discouraging polluting activities is to levy a tax on the polluting activity.

**Box 5: The Tragedy of Commons**

There is an insightful theory in economics called “*The tragedy of the commons*”. It says that individuals, acting independently and rationally, according to each one’s self-interest, behave contrary to the whole group's long-term best interests by depleting resources commonly owned by the group or society. Examples of such commonly owned resources are atmosphere, oceans, rivers, public parks and, in general, all earth’s natural resources. The basic idea conveyed in the notion of ‘tragedy of commons’, first formally analysed by an ecologist [Hardin, 1968 published in the well-known journal ‘Science’] is that if individual members in a group, acting in rational self-interest, used common resources for their own gain and with no regard for others, all resources would be degraded and eventually depleted. By recognising resources as ‘commons’, we can develop strategies to better use and preserve our natural resources. This requires intervention by governments that are nothing but representatives of the group of individuals comprising a country by regulation, taxation and subsidies.

Since environment itself is a common resource (see, Box 5) consisting of the atmosphere, water and land resources, environmental taxation or green taxation provides a powerful tool to oversee the management of the environment. In India, the importance of managing the environment has been recognised in our constitution in Article 21 and other related provisions. Green taxes are levied on energy products like petroleum, diesel, and coal and in general, on polluting inputs or outputs.
There are two main mechanisms by which governments can affect the behaviour of polluters so that our environment can be kept acceptably clean. One is regulation and the other is fiscal incentives like subsidies and disincentives like taxation. Taxes reduce the use of natural resources and pollution by making them more expensive.

**In India, the Government has to play a key role in promoting economic development**

As a citizen of a developing country, we look to the government to drive economic development, so that we can get employment, earn incomes and lead a fruitful and satisfying life. The government has to build roads, run railways, build and run schools, colleges and universities, build hospitals and make sure that the services of health, education, and transport are all provided to us at reasonable prices. Governments also invest in infrastructure, irrigation, power, and other economic activities. Governments may also run its own industries. Many of these services or activities can be provided or undertaken by the private sector also but the supply may not be adequate and sometimes, the prices charged may be too high.

Government has to plan for the growth of the economy such that the fast rising population of young people can get productive employment. It has to make sure that there is a balance in economic development across different parts and regions of the country and also ensure income inequalities do not become excessive. It has to make sure that poverty is eliminated in the country within a reasonable time. In order to meet these responsibilities, massive resources, which are primarily raised through taxes, are required.

Taxation affects savings in the economy and, therefore, investment and growth in significant ways. Taxation is nothing but a transfer of resources from individuals and companies into the hands of the government. Economists say that a good tax system is one where there are only a limited number of taxes, tax rates are low, tax laws are simple and easy to comply with. If there are high tax rates, these are only for goods that are considered ‘bad’ for one’s health or welfare such as tobacco or alcoholic products. On the other hand, a bad system would have too many taxes, excessively high tax rates, very complex laws, and similar tax rates whether or not the goods are bad for your health or whose consumption causes damage to the environment. We need to have a good tax system not only for its own sake; a country with a good system attracts a lot of foreign investment, which can be very important if domestic savings are not enough to provide sufficient growth and employment to our growing and young population.

**Who collects taxes?**

In India, since we are a federal country, we have governments at three levels. At the apex, there is the central government. The next tier is that of state government and governments of union territories. The third tier consists of local governments consisting of urban and rural local bodies. Since we chose to be a federal country with multiple tiers of government, our constitution makers made sure that each tier or level of government was given reasonable taxation powers so that it has both the responsibility and autonomy to at least partly raise its own resources. Diagram 1 depicts the structure of the Government of India.
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Taxation powers have been given in our constitution mainly to the central and state governments. This has been illustrated in Table 1.

### Table 1: Main central and state taxes

<table>
<thead>
<tr>
<th>Central Taxes</th>
<th>State Taxes</th>
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<tr>
<td><strong>Personal Income tax</strong></td>
<td>Land revenue and agricultural income tax</td>
</tr>
<tr>
<td><strong>Corporate income tax</strong></td>
<td>Sales tax/State VAT</td>
</tr>
<tr>
<td><strong>Union excise duties</strong></td>
<td>Stamp duty and registration fees</td>
</tr>
<tr>
<td><strong>Import (Customs) duties</strong></td>
<td>State excise duties</td>
</tr>
<tr>
<td><strong>Service tax</strong></td>
<td>Motor vehicle tax</td>
</tr>
<tr>
<td></td>
<td>Entertainment tax</td>
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<tr>
<td></td>
<td>Electricity duty</td>
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*Source: Based on Schedule VII of the Constitution of India*

The list of taxes is actually much longer. There are also a number of cesses and surcharges that the central and state governments levy on top of these taxes. By two constitutional amendments
in the early nineties, namely, the 73rd and 74th amendments, local bodies in India have also been given constitutional recognition. While the basic power of taxation belongs to the state government, they can by legislation pass on some of the taxation powers to local governments. Some of the taxes that are usually given to local bodies include property tax, entry tax, goods and passenger tax and local bodies tax.

II: What kind of government do you deserve?

If you were a law abiding and responsible citizen of India, you would take payment of taxes a part of your duty. While payment of tax is a responsibility, it also confers on you an important right. It is your right to ensure that you get the right kind of government.

Principal and agent: reversal of roles

Government is not abstract. It consists of a set of people. You have elected members to Parliament and state legislatures and municipal bodies and panchayati raj institutions with the expectation that they would make the best kind of policies for you. These bodies perform their functions by appointing a number of officials, who together constitute the executive (also referred to as the bureaucracy). By following certain rules of appointment, a judiciary has also been put in place to provide a system to deliver justice and resolve different kinds of conflicts according to law. We govern ourselves by law that emanates from and remain consistent with the Constitution of India. All members of Parliament and other elected bodies, members of the executive and the judiciary are meant to represent you and to serve you as the common citizen of the country. They are all your agents and you are the principal. They exist in their roles only because you have put them there.

The difficulty is that these roles often mistakenly get reversed. Ministers and members of Parliament find themselves with a lot of power and privileges. You do not deserve a government where your role as the principal has been reversed and your agent has become your master. It is your right to ask for a government where elected members of Parliament, the bureaucracy and judiciary act with that objective in focus.

Transparent, non-corrupt government

As a law-abiding, voluntarily tax-paying citizen, you have the right to ask for a transparent government that consists of people who are neither corrupt nor corruptible. When laws including tax laws are simple and straightforward, powers are decentralised and there is transparency and sharing of information with the public on what the policies are and why they have been made in one way rather than another, corruption does not flourish. You deserve and you can ask for a transparent government.

Standards of service

You are entitled to a reasonable and acceptable level of services that governments, be they central, state, or local, provide. You deserve to walk, cycle, or drive on a road that is smooth and well-paved and not marked by potholes, traffic on which is well managed, and, when
maintenance and repairs on some patch of road is required, it happens automatically. If you fall ill, you should be able to go to a government hospital and get appropriate treatment at reasonable costs. Your experience in reality may still be quite different. If the organs of government are not able to provide services that they are expected to provide at an acceptable standard, there is a government failure.

As a law-abiding tax-paying citizen, you deserve better. But this is not a good enough reason for you to consider that taxes should not be paid. Not only would you violate law and undermine your responsibility but you would also lose the moral right to demand better services. The fact that you have voluntarily paid your taxes gives you tremendous moral power to ask for and get the governments to perform according to your expectations and the expectations of your fellow citizens.

Tax evasion and black money

You frequently hear the word ‘black money’ in newspapers, media debates, and debates in Parliament and state legislatures. Tax evasion is the main reason for the generation of black money. The incentive to evade taxes arises from a combination of factors. The fact is that it is possible to evade taxes and get away with it because the tax administrators have limited resources to ensure that everybody pays the correct tax liability. Often, black money gets generated because of collusion between the tax administrators and taxpayers. Tax laws happen to be so complex that it is difficult to make sure that all provisions have been properly complied with. You may need to spend resources such as taking the help of a chartered accountant or tax experts to file your returns properly. Thus, limited resources with the tax administration, collusion between tax administrators and taxpayers, complex tax laws and high tax rates are some of the reasons for tax evasion. Black money damages the prospects of an economy in a number of ways. In particular, it drives prices up and forces investment to go in certain sectors where black money can be easily absorbed such as the realty sector.

Simple tax systems with reasonable tax rates

You deserve a tax system that is simple and straightforward, easy to comply with, a system where you do not have to depend on too many external experts to file your tax returns or deal with tax officials excessively.

Fiscal responsibility and inter-generational equity

If you put resources in the hands of the government, be it the central or state government, you will be correct in expecting that the government will exercise the required fiscal discipline in spending these resources. With considerable resources flowing into the hands of the government from tax as well as non-tax sources, governments develop the necessary base to also borrow from the market. But any expenditure incurred on the basis of borrowing raises important problems of sustainability and inter-generational equity. Borrowing can be spent on current consumption or for creation of assets. Any debt as a result of current borrowing must be serviced and eventually paid from future tax flows. In this sense, borrowing, which is also
called the fiscal deficit, always leaves a liability for future generations. It is only to be expected that such liability should be accompanied by the creation of assets so that there are both liabilities and assets for future generations.

**Efficiency and public expenditure management**

Resource allocation is based on the principle that budgetary allocations should reflect strategic priorities and that could be done by spending money on the "right" things, and spending it efficiently so that the country gets value for money.

**III: Relationship between the taxpayer and tax administration**

**Role of the tax administration**

Levying of taxes requires a legal framework. No tax can be levied without the authority of law. The tax administration implements and enforces tax laws. But this does not imply that all regulatory details to enable levying of taxes should be included in the law. These details of implementing rules and regulations are delegated to the tax administration. Such delegation to the tax administration does not mean that it has power to reduce tax obligations under the law. While tax law ensures responsiveness of potential revenue to overall economic growth, tax base and tax rates, the tax administration seeks to secure potential tax revenues effectively and efficiently.

**Mutual trust**

The core business of any tax administration is levying and collecting taxes imposed by law. But the relationship between taxpayers and the tax administration must go beyond transactional exchanges and must involve strong emotional ties and loyalties based on trust.

**Helping taxpayers comply**

Improving taxpayer service by educating and assisting taxpayers is an integral part of the functions of a responsible and responsive tax administration.

**Tax evasion and tax avoidance**

While tax compliance is important, taxpayers sometimes do not follow the spirit or the underlying purpose of the tax law but only the letter of the law. Taxpayers explore the loopholes in tax laws if they are not clear or have ambiguities. These legal loopholes or ambiguities in law are exploited by taxpayers for tax planning. Such tax planning, often termed as tax avoidance, is different from tax evasion, which refers to illegal practices to escape taxation. An example of tax avoidance can be strategic tax planning where financial affairs are arranged in such an order to minimise tax liabilities by using tax deductions and taking advantage of tax credits. In tax evasion, taxable income, profits liable to tax or other taxable activities are concealed, the amount and/or the source of income are misrepresented, or tax reducing factors such as deductions, exemptions or credits are deliberately overstated. Both tax avoidance and
tax evasion have revenue-reducing effects, thereby creating a compliance gap, *i.e.*, a gap between the taxes collected and the theoretical tax due.

**IV. Cultivating voluntary tax payment habits**

**Taxation is compulsory, but it is best paid voluntarily**

We all know that taxes are compulsory payments. Our constitution has given powers to the central government, to each state government and to urban and rural local bodies to collect taxes according to the provisions of law that Parliament and legislatures make. Not paying taxes is illegal. Non-payment of tax, if it is due, can lead to fines and penalties. Serious lapses can lead to more serious punishment. The best strategy for each individual, as an individual and as a member of society, is to pay taxes voluntarily and in a timely manner. This makes matters easy for you as an individual since you do not have to think of the law catching up with you.

**Best habits for voluntary tax payment**

Here is a list some desirable habits to develop to become an ideal taxpayer:

i) **Keep a calendar of important tax-related dates:** For any type of tax relevant for you, there would be some important dates. Prepare, keep, and update a calendar of relevant dates for each of the taxes that you are liable to pay. This way you can avoid a last minute rush.

ii) **Learn to take and give receipts:** Whenever you buy and sell anything, you should inculcate the habit of taking and giving receipts. Often, the shopkeeper will tell you two prices: one with tax and one without tax and leave the moral choice of paying or not paying the tax to you. Not only must you insist on taking a proper receipt, you must ensure that the tax element is listed separately both in your receipt and his receipt.

iii) **Learn to keep records:** Keeping and filing of documents and records would make your tax-paying life very easy. Develop the habit to keep records like your monthly salary slip, bank account details, receipts of all purchases and sales, receipts of tax deposits.

A country’s real strength is the aggregation of the moral fibre and values of its people. Being voluntarily tax compliant is a necessary component of this strength, which can ensure common good and shared prosperity.
ANNEXURES
<table>
<thead>
<tr>
<th>Date</th>
<th>Meeting Description</th>
</tr>
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<tbody>
<tr>
<td>09.09.2014</td>
<td>Meeting with ICRIER team on compliance cost</td>
</tr>
<tr>
<td>10.10.2014</td>
<td>Meeting with the expert committee to frame course material on “Paying Taxes Voluntarily: A Primer” for the under-graduate students</td>
</tr>
<tr>
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<td>Meeting of Focus groups on impact assessment, expanding the base and compliance management</td>
</tr>
<tr>
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<td>Meeting with the officers of DG (Audit), CBEC</td>
</tr>
<tr>
<td>17.10.2014</td>
<td>Meeting with the officers of DG, Central Excise Intelligence, CBEC</td>
</tr>
<tr>
<td>17.10.2014</td>
<td>Meeting with the officers of DG (Systems), CBDT</td>
</tr>
<tr>
<td>21.10.2014</td>
<td>Meeting of Focus groups on enforcing better tax compliance</td>
</tr>
<tr>
<td>07.11.2014</td>
<td>Review of the material developed for the under-graduate students</td>
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</table>
**Annexure - I**

**TARC meetings with stakeholders**

<table>
<thead>
<tr>
<th>Date</th>
<th>Name of the Stakeholder</th>
</tr>
</thead>
<tbody>
<tr>
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</tr>
<tr>
<td>17.10.2014</td>
<td>Meeting with ICRIER team on sampling and survey methods</td>
</tr>
<tr>
<td>21.10.2014</td>
<td>Meeting of Focus groups on enforcing better tax compliance</td>
</tr>
<tr>
<td>07.11.2014</td>
<td>Review of the material developed for the under-graduate students by the expert committee</td>
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</table>
## Annexure -II

### Composition of Focus groups

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Topic</th>
<th>Focus Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>To review the existing mechanism and recommend capacity building</td>
<td>Ms. Mansi Kedia, ICRIER</td>
</tr>
<tr>
<td></td>
<td>measures for preparing impact assessment statements on taxpayers compliance cost of new policy and administrative measures of the tax departments</td>
<td>Ms. Neetika Kaushal, ICRIER</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sri Sunil Chopra, ex I-T</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sri Gautam Ray, ex CCE</td>
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<td></td>
<td></td>
<td>Sri S P Singh, Deloitte</td>
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<td></td>
<td></td>
<td>Sri Gautam Bhattacharya, CCE</td>
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<td></td>
<td></td>
<td>Sri Bipin Sapra, E &amp; Y</td>
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<td></td>
<td></td>
<td>Sri Tukaram Munde, Addl Commissioner, VAT, Mumbai</td>
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<tr>
<td>2.</td>
<td>To review the existing mechanism and recommend measures for deepening</td>
<td>Sri Sunil Chopra, ex I-T</td>
</tr>
<tr>
<td></td>
<td>and widening of tax base and taxpayer base</td>
<td>Sri Gautam Ray, ex CCE</td>
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<tr>
<td></td>
<td></td>
<td>Sri S P Singh, Deloitte</td>
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<tr>
<td></td>
<td></td>
<td>Sri Gautam Bhattacharya, CCE</td>
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<td></td>
<td></td>
<td>Sri Bipin Sapra, E &amp; Y</td>
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<td></td>
<td></td>
<td>Sri Tukaram Munde, Addl Commissioner, VAT, Mumbai</td>
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<tr>
<td>3.</td>
<td>To review the existing mechanism and recommend a system to enforce</td>
<td>Sri Sunil Chopra, ex I-T</td>
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<tr>
<td></td>
<td>better tax compliance – by size, segment and nature of taxes and</td>
<td>Sri C. Mathur, ex CCE</td>
</tr>
<tr>
<td></td>
<td>taxpayers, that should cover methods to encourage voluntary tax</td>
<td>Sri Gautam Ray, ex CCE</td>
</tr>
<tr>
<td></td>
<td>compliance</td>
<td>Sri R K Bajaj, ex I-T</td>
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<tr>
<td></td>
<td></td>
<td><strong>Expert Group for consultations on encouraging voluntary compliance</strong></td>
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<tr>
<td></td>
<td></td>
<td>a) Prof. D. K. Srivastava, ex-Director, Madras School of Economics</td>
</tr>
<tr>
<td></td>
<td></td>
<td>b) Dr. Manjulika Srivastava, Professor of Distance Education, STRIDE,</td>
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<td>IGNOU</td>
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<td></td>
<td></td>
<td>c) Dr. Surajit Deb, Reader, Ram Lal Anand College, University of Delhi</td>
</tr>
</tbody>
</table>

Note: I-T: Income Tax Department

CCE: Custom & Central Excise Department
### TARC meetings

<table>
<thead>
<tr>
<th>Date of the meetings</th>
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<tbody>
<tr>
<td>26th September, 2014</td>
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<td>15th October, 2014</td>
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<td>16th October, 2014</td>
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<td>17th October, 2014</td>
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<td>21st October, 2014</td>
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<td>27th October, 2014</td>
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<tr>
<td>24th November, 2014</td>
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<td>25th November, 2014</td>
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Chapter XIV

Annexure - IV

Gazette Notification constituting TARC

MINISTRY OF FINANCE
(Department of Revenue)
NOTIFICATION

New Delhi, the 21st August, 2013

F.No.A.50050/47/2013-Ad.I. — The Government in its Budget, 2013-14, had, inter-alia, announced the setting up of a Tax Administration Reform Commission (TARC) with a view to reviewing the application of Tax Policies and Tax Laws in the context of global best practices and recommend measures for reforms required in Tax Administration to enhance its effectiveness and efficiency. Accordingly, it has been decided to constitute the Tax Administration Reform Commission with the following composition:

<table>
<thead>
<tr>
<th>i)</th>
<th>Dr. Parthasarathi Shome</th>
<th>Chairman</th>
</tr>
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<tbody>
<tr>
<td>ii)</td>
<td>Shri Y. G. Parande</td>
<td>Full-time Members</td>
</tr>
<tr>
<td>iii)</td>
<td>Ms. Sunita Kaila</td>
<td>Part-time Members</td>
</tr>
<tr>
<td>iv)</td>
<td>Shri M. K. Zutshi</td>
<td></td>
</tr>
<tr>
<td>v)</td>
<td>Shri S.S.N. Moorthy</td>
<td></td>
</tr>
<tr>
<td>vi)</td>
<td>Shri M.R. Diwakar</td>
<td></td>
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<td>vii)</td>
<td>Shri S. Mahalingam</td>
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</tbody>
</table>

2. The Commission will have a fixed tenure of 18 months from the date of its constitution and work as an advisory body to the Ministry of Finance. The Commission will give its first set of recommendations with six months of its constitution and thereafter submit periodic reports after every three months.

3. The Terms of Reference of the Commission will be as follows:

   a) To review the existing mechanism and recommend appropriate organizational structure for tax governance with special reference to deployment of workforce commensurate with functional requirements, capacity building, vigilance administration, responsibility of human resources, key performance indicators, assessment, grading and promotion systems, and structures to promote quality decision making at the highest policy levels.
b) To review the existing business processes of tax governance including the use of information and communication technology and recommend measures tax governance best suited to Indian context.

c) To review the existing mechanism of dispute resolution, covering time and compliance cost and recommend measures for strengthening the same. This includes domestic and international taxation.

d) To review the existing mechanism and recommend capacity building measures for preparing impact assessment statements on taxpayers compliance cost of new policy and administrative measures of the tax Departments.

e) To review the existing mechanism and recommend measures for deepening and widening of tax base and taxpayer base.

f) To review the existing mechanism and recommend a system to enforce better tax compliance – by size, segment and nature of taxes and taxpayers, that should cover methods to encourage voluntary tax compliance.

g) To review existing mechanism and recommend measures for improved taxpayer services and taxpayers education programme. This includes mechanism for grievance redressal, simplified and timely disbursal of duty drawback, export incentives, rectification procedures and refunds etc.

h) To review the existing mechanism and recommend measures for “Capacity building” in emerging areas of Customs administration relating to Border Control, National Security, International Data Exchange and securing of supply chains.

i) To review the existing mechanism and recommend measures for strengthening of Database and inter-agency information sharing, not only between Central Board of Direct Taxes (CBDT) and Central Board of Excise and Customs (CBEC) but also with the banking and financial sector, Central Economic Intelligence Bureau (CEIB), Financial Intelligence Unit (FIU), Enforcement Directorate etc. and use of tools for utilization of such information to ensure compliance.

j) To review the existing mechanism and recommend appropriate means including staff resources for forecasting, analyzing and monitoring of revenue targets.

k) To review the existing policy and recommend measures for research inputs to tax governance.

l) To review the existing mechanism and recommend measures to enhance predictive analysis to detect and prevent tax/economic offences.

m) Any other issue which the government may specify during the tenure of the Commission.
4. The Commission will be supported by a Secretariat consisting of a Secretary at the level of Joint Secretary to the Government of India and other officials and support staff. They will be appointed on deputation/contract basis.

5. The Commission will be provided information and quantitative data of Central Board of Direct Taxes/Central Board of Excise and Customs to enable it to do statistical analysis for making recommendations.

6. The Headquarters of the Commission will be in Delhi.

M. L. MEENA
Joint Secretary