Chapter – II
REFORM OF TAX ADMINISTRATION

It is widely accepted that a significant portion of potential tax revenue is not collected because of poor tax administration and high tax evasion in India. The question is whether the complexity of the tax structure or high tax rates have led to a high incidence of tax evasion, or if lax tax administration by itself has been unable to fulfill the revenue objectives implied by the tax structure. In practice, it is likely that both tax policy and tax administration have mutually affected each other.

It is widely recognized that tax policy and tax administrations are intrinsically linked. In this interrelationship, however, tax policy formulation is generally seen to precede tax administration. This is because only when a tax structure is legislated does tax administration come to play its role in the implementation of the law. In developing countries, however, the direction of the link may not be quite so apparent. Indeed, it is said that in developing countries tax administration is tax policy[1]. This would imply that, however fine the design of the tax structure might be in a representative developing country, it is the interpretation and implementation of the law that counts. These elements reflect the need for adequate capacity of the tax administration in place to implement the law[2].

At the same time, experience reveals that a particular tax administration mechanism could alter the original intention of tax policy and structure. Possible modes include large taxpayer units that continue to be emphasized in the long run at the cost of the overall universe of taxpayers, tax deduction at source used as a final withholding, purely financial, as opposed to physical, control as an administrative device in a rudimentary environment, and the use of distortionary or simplistic taxes purely on grounds of easy administration.

In many developing countries, tax laws may be quite well designed and detailed. But unless the accompanying tax administration is able to handle those laws in terms of having the appropriate staff to interpret and implement them, the field-level reality of the actual incidence of the tax system may be quite different from the original objectives[3]. The taxes may be passed on to those on whom

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[1] Bird, Richard M. and Milka Casanegra (1992), Improving Tax Reform in Developing Countries, International Monetary Fund, Washington D.C.

[2] Faria, Angelo and Zutu Yucelik (1995), 'The Interrelationship between Tax Policy and Tax Administration' in Parthasarathi Shome (ed.), Tax Policy Handbook, International Monetary Fund, Washington D.C.

[3] Faria, Angelo and Zutu Yucelik (1995), 'The Interrelationship between Tax Policy and Tax Administration' in Parthasarathi Shome (ed.), Tax Policy Handbook, International Monetary Fund, Washington D.C.

they are not meant to fall, and the distribution of the burden may turn out to be indiscriminate. Lawyers find it easy to litigate tax matters because of the difficulties in interpreting complex tax laws and, accountants, ploughing through a myriad pages of the tax code, successfully advise clients in careful tax planning such that their tax burden is minimized. This implies that, in the long run, it has to be ensured that tax administration instruments facilitate, rather than ignore or hinder, the implementation of tax policy goals.

2.1 ROLE OF THE TAX ADMINISTRATION

If "tax administration is tax policy", as is widely recognised, it is imperative to identify the role of the tax administration, so that responsibility and accountability is clearly established. The existence of a tax administration is a necessity, even in the most law – abiding society. Where there is full compliance, the role of the tax administration would be restricted to the provision of facilities for citizen to discharge their responsibility. In case there is non-compliance, it will have to play the role of a policeman. Since it cannot play the role of a policeman to all taxpayers, its action must provide sufficient deterrence so as to induce voluntary compliance.

Collection of taxes are merely transfer of resources from the large masses of taxpayers to the Government. The resources used in the collection of taxes are a dead-weight loss[4] unless the benefit flowing from the expenditure policy exceeds the dead – weight loss. Hence, it is necessary to use minimum resources in the collection of taxes. Therefore, the fundamental role of tax administration is, in order of priority:-

1. To render quality taxpayer services to encourage voluntary compliance of tax laws; and
2. To detect and penalise non-compliance.

The extent of success of the tax administration in its role would be reflected in higher revenue growth. These functions of the tax administration comprise the following seperable component activities :

1. Taxpayers' education and services
2. Collection of information
3. Collation of information
4. Dissemination of information
5. Storage and retrieval of information
6. Verification (appraisal/assessment of information)
7. Collection of taxes
8. Taxpayers' grievances redressal system
9. Accountability

2.2 TAXPAYER SERVICE

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[4] This is exclusive of the dead – weight loss on account of distortionary impact of taxes.

Traditionally, the role of the tax administration has been to enforce the tax laws and provide at least minimal taxpayer service. This was understandable in the context of a small potential taxpayer base and the then prevalent practice of administrative assessment. Over time, as the taxpayer base expanded and the scheme of self-assessment introduced, it became necessary for the tax administration to also facilitate compliance through the provision of quality taxpayer service. In most developing countries this shift in role focus is suspiciously viewed as abandonment of its traditional role of enforcement and softening of the tax administration. Most employees unable to reconcile to their new role continue to resist this shift in the role perception from an enforcement officer to a facilitator.

Tax evaders in most countries, particularly developing countries, can be classified into two categories. The first category relates to those who fail to comply because of information asymmetry (lack of information) and the tax administration's failure to provide this information. Recourse to private sources (tax practitioners) for information entails a relatively high compliance burden. These evaders are sitting ducks for the tax administration and entail a high administrative burden if pursued individually. The second category relates to those who refuse to comply because of deficiencies in the taxpayers information system and supporting institutional setup. Therefore, theses also exist because of information asymmetry (lack of information with taxpayers). The compliance burden in this category is relatively low. The first category constitutes the majority of tax evaders but account for a relatively small proportion of taxes evaded. The existence of the first category of evaders creates a general climate of non-compliance. Tax evasion being contagious it spreads widely. Since the second category is hard to nab and the first category is a sitting duck, the tax administration tends to prey on the first category for easy success. The second category continues to thrive under the umbrella of the first category. It is, therefore, efficient for the tax administration to provide quality taxpayer service and reduce the size of the first category. The limited resources hitherto deployed

in the pursuit of the first category could be substantially released and redeployed to the task of tackling the second category. Hence, taxpayer service must be seen as complimentary to enforcement and not a substitute as is commonly understood in most developing countries – the mind set amidst tax officials in India is no different. Provision of quality taxpayer service is an integral part of the enforcement strategy of any tax administration.

Taxpayer service, typically refers to the provision of information and material by the tax administration to the general mass of taxpayers so as to facilitate compliance with the tax law. A cross country survey of taxpayer service indicates that the relatively more successful tax administrations provide relatively high levels of taxpayer service. Inspite of the mindset in favour of enforcement,

the Income Tax Department indeed provides a range of services to facilitate compliance. These services include pamphlets, brochures, booklets, web–based information and return forms. In some Metropoliton centres, an Interactive Voice Response System is operational. The recent introduced scheme of Suvidha and Sampark are all extensions of the taxpayer service programme. However, these are just beginnings and are clearly not enough. The present scope of taxpayer service in India is too narrow to encourage voluntary compliance. The evolution of the package of taxpayer services in India is accidental – the entire programme seems to have evolved in an ad hoc manner rather then as a strategy to promote voluntary compliance. The Task Force was informed that this was primarily due to inadequate financial resources for taxpayer service. The expenditure set apart for tax payer service is woefully small (less than 2 per cent of its annual budget). The existing taxpayer service programme is also handicapped by the absence of professionals trained for planning and executing focused media campaigns.

Given the best international practice in the area of taxpayer service and the future programme for widening the tax base through voluntary compliance, the Task Force recommends the following measures to expand the present scope of the taxpayer service programme:-

(i) The income tax department must expand, qualitatively and quantitatively, the present scope of taxpayer service. These should, *inter alia*, include the introduction of a telephonic system (by voice message) to remind taxpayers of important dates and the provision of pre-formatted programmed floppy diskettes through retail outlets.

(ii) The expenditure on taxpayer service must be increased from the present level of about one percent of the total expenditure on tax administration to at least five percent. In this regard, an important start should be made by the establishment of taxpayers' clinic in different part of the country to enable taxpayers to walk in for assistance. The Task Force feels that better treatment of existing taxpayers has an important role in encouraging those outside the tax net to become taxpaying citizens.

(iii) The department should provide easy access to taxpayers through Internet and e-mail and extend facilities such as tele-filing and tele-refunds. It should design special programmes for retired people, low-income taxpayers, who cannot afford expensive services of tax consultants and other such groups with special needs.

2.3 Taxpayer Identification and Registration

The process of tax enforcement begins with the identification of taxpayers. This is an extremely formidable task particularly where the unorganized sector predominates. An effective taxpayer information system and monitoring alone

can help achieve this task. The establishment of an effective taxpayer information system, is crucially dependent upon a unique identification numbering system such that the information relating to various indicators of wealth and expenditure and financial transactions could be collected and collated.

Income tax Act[5] provides for allotment of a Permanent Account Number (having ten alphanumeric characters). Every persons who fulfils any of the following conditions has to compulsory apply to the Assessing Officer for the allotment for permanent account number:-

1) If his total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the maximum amount which is not chargeable to income-tax; or
2) Carrying on any business or profession whose total sales, turnover or gross receipts are or is likely to exceed five lakh rupees in any previous year; or
3) A charitable trust or institution;
4) any other person desiring to own a PAN ; and
5) any other person by whom tax is payable.

The PAN is required to be quoted by a person

(a) In all his return to, or correspondence with any income tax authority.
(b) In all challans for the payment of any sum due under the income tax act
(c) in all documents pertaining to foreign transactions ;
(d) sale or purchase of any immovable property valued at five lakh rupees or more ;
(e) sale or purchase of motor vehicle or vehicle(does not include two-wheeled vehicles);
(f) a time deposit exceeding fifty thousand rupees with a banking company;
(g) a deposit exceeding fifty thousand rupees in any account with post office saving bank;
(h) a contract of a value exceeding one lakh rupees for sale or purchase of securities;
(i) opening an account with the bank;
(j) making an application for installation of telephone connection including a cellular telephone connection;
(k) payment of hotels and restaurants for an amount exceeding twenty five thousand at any one time;
(l) payment in cash for purchase of bank drafts or pay orders or bankers cheque from a bank for an amount aggregating fifty thousand rupees or more during any one day;

[5] Section 139A

(m) deposit in cash aggregating fifty thousand or more with a bank during any one day;
(n) payment in case in connection with travel to any foreign country for an amount exceeding twenty five thousand rupees at any one time.

Given the ongoing and new initiatives by the Ministry of Home Affairs for issuing a Citizen Identification Number and by the Ministry of Labour for issuing a Social Security Number, the Task Force feels that the use of PAN can effectively integrate, on the lines of the US Social Security Number system, multiple tasks of tax and commercial enforcement, targeting government subvention, improving governance and enhance national security, both at the Central and State level. We recommend that:

(i) The PAN should be extended to cover all citizens and therefore serve as a Citizen identification number. This will obviate the need for the Home and Labour Ministries to issue new numbers.
(ii) Given the manifold increase in the coverage of PAN, the responsibility for issuing should be transferred to an independent agency outside the income tax department. However, the income tax department should have online access to the database for tax enforcement like any other agency.
(iii) The requirement of quoting PAN may be expanded to cover most financial transactions.

2.4 Collection of Information

For administrative purposes, information for taxpayer for identification can be grouped broadly in three heads : (i) Taxpayer's Declaration, (ii) Information Returns and (iii) Field Survey

(i) **Taxpayer's Declaration :** Under the system of self-assessment, the taxpayer forms the basic source of information. The taxpayer provides information to the tax administration through returns and accompanying documents. These returns contain valuable information on the taxpayer and his activities. All this information can potentially be used to help gauge the taxes due from the taxpayer. However, the Task Force was apprised that tax administration was unable to digitize the information since the staff in the income tax department, despite training in computer skills, is at the lower end of the learning curve. More than 2.5 crores of tax returns were pending for processing for lack of adequate skilled manpower.

(ii) **Information Returns :** This is a more widely used device to collect information. Information returns are declarations filed with a tax administration by persons required to report details of their financial dealings with other taxpayers. Information returns often require listing of all transactions of a certain kind e.g., payments of corporate dividends or transactions beyond a magnitude of other kinds with other taxpayers

during a certain period. A wide variety of source of information can be imagined which could be reached by the tax administration through the device of information returns.

Under the extent procedure, the Central Information Branch functioning under the Director general (Investigation) within the Directorate of Income Tax (Investigation), spread all over the country, collects from predetermined sources information relating financial transactions from various external and internal sources. Sources of information to be tapped in a financial year, are laid down by the CBDT in its instruction No. 1943 dated August 22, 1997. The Director General of Income Tax (Investigation) is empowered to revise the ceilings of the monetary limits fixed by the Board for collection of information. Currently, about 37 broad categories of external and internal sources are listed in the long-term action plan for information collection, formulated by the CBDT. Section 133B (power to call for information) and 131 (power regarding discovery, production of evidence, etc.) constitute the main legal base for the process. Under Section 133(6) of the Income Tax Act, firms, companies, dealers, brokers, agents, banks, etc., can be called upon to provide the name and address of persons engaged in transactions with them. The information so collected is collated and then disseminated by the CIB to the assessing officers for verification in the respective cases.

The process starts with the collection of information, mainly from external sources. However, there are several hurdles in this area. First, the flow of information is not automatic in the sense that the CIB first issues letters to various agencies, calling for information under sub-section (6) of Section 133 of the Income Tax Act. Though the instruction identifies the sources of information to be tapped during the year, the specific identifies the sources of information to be tapped during the year, the specific firms, dealers, brokers, banks, companies, etc., required to be tapped for this purpose are left to the discretion of the officer in the field formation, with the result that the coverage of most sources tapped in incomplete. Secondly, even where information is called for under Section 133(6), not all agencies respond promptly. In such cases summons under Section 131 are issued. Even then, many agencies try to stall or even resist communication of information. Refusal to part with information by banks and some other financial institutions is a case in point. This strains CIB's resources and delays verification and dissemination of information. Thirdly, because of limited manpower and infrastructure – including, importantly, the lack of automation and also the long delays in furnishing information, the CIB is not able to collect information from even the major external sources every year. The inability to collect annually comprehensive information from all or at least the major sources dilutes the efficacy of CIB verifications

Under the Income tax Act, deduction at source is required to be made from specified categories of payment like salaries, interest, commission etc. The deductor is required to file with the TDS circle in the Department annual returns relating to deduction of tax at source. These information returns also form one of the important sources of information.

(iii) **Information and evidence collected by the Department during the course of investigation :** In addition to information from taxpayer's return and other information returns, a large volume of information also get collected during assessment, searches and seizures and survey operations.

In view of the extant method of collection of information and constraints in digitizing the volume of information received by the tax administration, **the Task Force recommends:**

1. **Income Tax Act should be amended to provide for submission of 'annual information return'. For this purpose, a proper format of the return also needs to be prescribed. As a result the flow of information will be continuous and the discretionary power with the CIB to collect information will be eliminated.**

2. **Such annual return of information should be mandatorily required to be submitted on electronic format.**

3. **Many of the Departments involved in transactions specified in Rule 114B do not have any mechanism for obtaining the PAN of the concerned person. It is, therefore, necessary that the proforma used by them for their departmental purposes e.g.. the application form for transfer of motor license, should carry necessary column requiring the applicant to disclose his Permanent Account Number (PAN).**

4. **The Department should set up a structure for Electronic Data Interchange (EDI) with some of the major departments and organisations involved in the transactions specified in Rule 114B, such as, Banks, Stock Exchanges, Telephone Companies, Regional Transport Authority etc.**

2.5 Verification & Processing of Tax Returns

Income tax assessment system in India comprises of 'Intimation' of tax/refund on returned income (Section 143(1)(a); 'limited scrutiny' (Section 143) introduced by the Fincance Act, 2002 with effect from 1st June, 2002 to disallow inadmissible loss, exemption, deduction, allowance, or relief claimed in the turn; 'full scrutiny' (section 143).

'Intimation' of tax or refund on the basis of returned income is to be routinely generated and sent to the tax payer once computerization is in place. Processing of the return of income by the integrated computerized system will ensure that the refund generated is after adjustment of the outstanding arrears if any against the assessee. Till then, manual verification and adjustment of the outstanding demand against the assessee will be necessary before the refund is issued to him. Unfortunately, despite training in computer skills, the staff in the income tax department is at the lower end of the learning curve and inhouse clearing of the backlog in a short period is not possible. As a result, more than 2.5 crores of tax returns remain unprocessed. A large number of these would be refund cases contributing to the grievance against non-issue of refunds. Against this background, **the Task Force recommends that :-**

1. **In line with our view that the tax department should concentrate on its core functions, the department should be allowed to outsource data entry work and clear the backlog of returns (which number 2.5 crores) by end-February 2003.**

2. **All returns must be processed within four months of receipt. For this purpose, it would be necessary for the department to either hire additional personnel on a temporary basis during the peak period for filing returns, or, outsource data entry work, as is done routinely by national tax administrations all over the world.**

The cost of hiring additional personnel or outsourcing data entry work would be far less in comparison to the benefit from reduced interest burden on refunds and taxpayer satisfaction.

The process of selection of cases for audit (scrutiny) is the most important element of the enforcement strategy of any tax administration. It is this process of selective verification of the volume of information received by the tax administration which establishes deterrence. The Task Force was appraised about the negative aspects of the existing discretion-based system of selection of case. The department should progressively develop a mechanism for risk assessment, which forms a scientific (and, therefore, objective) basis for identifying cases of potential tax evasion for in-depth scrutiny. In the interim, we recommend the identification of cases through a random non-discretionary centralised method deploying the PAN database. The current practice of issuing guidelines for selection of cases for scrutiny, which eventually finds its way to the public must be dispensed with.

Once a case is selected for scrutiny, it should be fully investigated, covering investments , accretion to assets , expenses incurred , savings, transactions entered and profits made, turnover etc. The scrutiny assessment will then serve its purpose of deterrence against tax evasion and contribute to revenue realisation. The present practise in scrutiny assessments is mostly to make statutory disallowances of exemptions, deductions and other claims made in the return to achieve zero error assessments from the point of audit

objections. 100% policing is not possible. Therefore, the number of cases selected for effective scrutiny should be on the basis of available man power, their number and capability .

Penalty proceedings for concealment of income are required to be initiated in the course of assessment proceedings (Section 271(1) of the I-T Act). The order imposing the penalty can be passed within six months from the end of the month in which the order of the Appellate Tribunal against the order of the assessment is received. The order of assessment and order of the first and second appellate authority against order of assessment take about seven years. So, the order of penalty for concealment of income is passed after seven years. Thereafter, the order of penalty goes through appeals which takes another five years. Thus, under the existing system, the imposition of penalty for concealment takes more than a decade. Firstly, penalty for concealment is successful in very few cases, secondly it materialises very late. The reason for this situation is that penalty proceedings are treated separate proceedings from assessment proceedings, though the same material is considered in both the proceedings. It would be advisable to pass order of penalty for concealment alongwith order of assessment. Section 275 may be suitably amended to make it obligatory for the assessing officer to pass the order of penalty for concealment along with the order of assessment. This would ensure deterrent impact of scrutiny assessment and penalty on tax evasion. This would reduce multiple proceedings and litigation.

2.6 Computerisation of the Tax Administration

The assessment of most modern taxes requires the ability to marshall the numerous pieces of information needed to determine the base of the tax and the rate to be applied. With many taxpayers, the level of information that needs to be processed and – for tasks that need centralized coordination – the magnitude of the coordination problem increase rapidly and possibly faster than the number of taxpayers. Either taxes requiring less information must be adopted or the information processing and coordination capacity of the tax administration must be improved.

Radical improvement in tax administration calls for a transformation of organization and methods. Modern information technology greatly facilitates such transformation. The availability, cost, and accessibility of modern computers make them ideal for the large-scale information processing and coordination problems facing tax administrations. Benefits to taxpayers from computerization, through such advanced systems as electronic filing, electronic data interchange and computerized taxpayer assistance can also be immense in terms of lowered compliance costs and time saving. Nonetheless, it is critical to have a clear strategy and to consider a number of important aspects of the problem when considering the introduction of technology to upgrade the information handling capacity of any tax administration.

The Task Force cannot over emphasise that effective tax reform must harness Information Technology (IT). The tax department is no different from most businesses. World-class customer service is critical when "all of India is its customer and Parliament its Board of Directors". While the CBDT has to be commended for the effort it has expended and the action it has initiated for computerisation of taxpayer records, the business processes, systems and facilities have not kept pace with the growing demand on tax administration. The Task Force firmly believes that the tax department should be allowed to concentrate on its core functions – an increasing emphasis on assessment and enforcement duties, rather than logistics and support services – which will surely lead to increased effectiveness of the tax administration. In this context, rapid and progressive outsourcing of many tasks of the tax department is not only feasible, given the significant pool of talent in the Indian software industry, but it is also desirable. In order to make IT infrastructure commensurate with the requisite processing tasks, the Task Force would like to explicitly put on record that implementation of this enhanced integration-software requires considerable investment in upgrading associated IT hardware and sufficient access to high-capacity bandwidth for implementing the network.

The process of systemic modernisation of tax administration cannot be further delayed. To empower the tax administration in executing its core function, the Task Force studied the existing depository system of the National Stock Depository Limited (NSDL) and concluded that it offered a scalable system to meet the requirements stated above. As this proven and tested infrastructure already exists, it can readily be adapted to offer a world-class, state-of-the-art IT architecture to rapidly empower the tax administration. Our study suggests that if action is initiated by the middle of November 2002, the system could be operational and available on-line by the beginning of the 2003-04 fiscal year.

To speed up the process of modernisation, the Task Force therefore recommends the following:

(a) The Government should establish a national Tax Information Network (TIN) on a build, operate and transfer basis. This will comprise of a world class (common carrier) network system and have access to state-of-the-art IT infrastructure. A requisite in-built feature of the system is that it should be scalable to offer ease of access across tax administration and taxpayers. The network that is envisaged will facilitate transactions, akin to securities markets, and establish secure and seamless logistics of tax collection through integration of primary information, record keeping, dissemination and retrieval. It should be a repository of information, with a database of all tax payments and refunds. Data mining software associated with such relational databases will allow a quick and systematic identification of non-compliance and abuses, thereby helping to

improve compliance. The existing facilities of the National Securities Depository Ltd. (NSDL) can be relatively quickly deployed to make a systemic improvement in processes and reduce transaction cost.

(b) TIN will receive, on behalf of the tax administration, all TDS returns and other information returns for digitisation. The information would be received either online, or through magnetic media or in printed format. The digitised information will be downloaded by the National Computer Centre / Regional Computer Centres of the income tax department for further processing.

(c) TIN will also receive online information about collection of taxes from the banks. The information could be downloaded by the income tax department as and when required.

(d) The taxpayer will have the facility of accessing the TIN system through a secure and confidential Permanent Account Number (PAN) based identification to ascertain tax payments credited to his/her account and the status of returns and refunds.

The TIN will therefore serve as a gateway to the National Computer Centre of the Income Tax Department. It will help overcome the paucity of technical manpower and inadequate technical infrastructure.

2.7 Collection of Taxes and their Accounting

Currently, payment of taxes can be made only at the specified branches of designated public sector banks in a given city. The taxpayer is required to fill up the right challan depending upon the major and minor head of the payment i.e. whether it is a payment against Corporation tax or Income-tax and whether it is by way of self assessment tax, advance tax, regular tax or TDS etc. The challan together with corresponding amount of cash or cheque is presented before the authorised branch of the designated bank. In case of cheque payment the banks give the receipted copy of challan only after the cheque is cleared. This, usually, takes 2-3 days. Branches of each designated banks send the challans of their various branches in a city/region to a Nodal branch from where these come together with a scroll to the Computer Centre/Central Treasury Units (CTUs) while another set goes to concerned Zonal Account Office (ZAO). The banks are entitled to a service charges of 11.18 paise per hundred rupees of tax deposited with them. Besides, they enjoy a float period of 15 days after which they transfer the tax deposited with them to the Reserve Bank of India (RBI). The procedure of reconciliation of taxes paid between Banks, Department's Computer Centres, Central Treasury Units and the Zonal Account Office is, entirely manual – based on paper copies of the challans and scrolls.

Since only a limited number of public sector banks are designated for collection of taxes and these, in turn, have authorised only a few of their branches for giving this facility, the choice before taxpayer is very limited. In a

very large number of cases, the taxpayers have to deposit taxes in a bank/branch in which they do not have their own bank account. This entails extra time of 2-3 days in clearance of the cheques due to which the taxpayer has to visit bank again after 2-3 days for collecting the paid copy of challan.

The service charges of 11.18 paise per hundred rupees is not related to the cost of service or the cost of transaction but is related to the amount of tax paid in one challan. This is a historical legacy, and entirely, illogical. In addition, since the banks are simply collecting together the counterfoils of challans under a daily/weekly scroll and forwarding them to the Central Treasury Unit (CTU) / Zonal Account Office (ZAO) via their nodal banks, there is hardly any value added to justify the service charges of 11.18 paise per hundred rupees, in addition to the benefit of retaining the tax money for 15 days.

There are numerous instances of mistakes in challans and scrolls. There are even cases where the name of taxpayer is not mentioned on the challan.

Since the Tax Accounting System in the Department has been fully computerised, it becomes necessary to transcribe the data on the challans after they are received in the Department. This involves a huge and an increasing data of work. Delays in this affects reporting of tax collection and the forecast of mechanism of budget collection to the Government.

In view of our recommendation for the establishment of a TIN, we recommend a revised procedure for collection of taxes and their accounting. The new procedure will be as follows:-

(a) A taxpayer will be required to fill up only one copy of the challan while making payment of taxes in the bank. The present requirement of filling up four copies of challan for payment of any tax will be given up.

(b) The banks will be networked to the TIN and receive payments online. The banks will be required to issue a computerised receipt to the taxpayer instantaneously. The date of presentation of a cheque will be treated as the date of payment. If a cheque bounes, the bank will reverse the receipt, online, and the department would then be expected to prosecute the delinquent taxpayer.

(c) With instant accounting of tax collection, the requirement of enclosing a copy of the challan as evidence of tax payment, along with the annual return of income could be done away.

(d) Since the TIN will digitise all the TDS returns, the requirement to file TDS certificates along with the return of income will also be dispensed with.

(e) At present, taxes are collected through approximately 10,500 bank branches. Since the proposed procedure requires banks to receive online payment, those banks that do not have

adequate infrastructure for establishing online connectivity will be debarred from collecting taxes. Accordingly, the Government, in consultation with the Reserve Bank of India, should also consider paying higher charges for services rendered by banks.

The process outlined above will facilitate real-time accounting of TDS, Advance Tax and Self-Assessment Tax, and help the tax administration to swiftly identify non-compliance. Furthermore, the new procedure of tax accounting will facilitate electronic filing of tax returns.

2.8 Refund

The failure of the tax administration to issue refunds continues to be a major source of public grievance. This is partly due to its inability to promptly process the returns, whose numbers have increased substantially in the last three years, and partly due to the cumbersome process for issuing of refunds[6]. Therefore, we recommend the following:

(a) The existing cumbersome and manually-operated procedures for issue of refunds must be replaced by a more efficient IT-based system. Under the new system the department will prepare a separate file of all refunds daily which will be downloaded by a payment intermediary, i.e., a designated bank.

(b) The designated bank will be authorised to issue computerised refunds as is the current practice for issuing dividend and interest warrants by companies.

(c) The designated bank will be required to transmit the information relating to the issue of refunds to the TIN, which will also allow a taxpayer to verify the status of his/her refund claim.

2.9 SEARCH AND SEIZURE

Income tax department, in public perception , is identified with 'raids'. That is its identity. That is its most visible enforcement activity . Raid is conducted with the help and in the presence of police force. The search and seizure activity is immediately reported in the press, highlighting "big names" and big amounts of undisclosed income. It also provides publicity to the concerned officer.

The objective of the search is to ascertain facts and collect evidence of concealed income and to give a message that tax evasion will not go undetected or unpunished. But, in the course of the search as they are conducted, the main

[6] For detail procedure for Issue of Refund, reference may be made to DOMS Circular No.:54, dated 16/12/87 and Circular No.: 58, dated 08/02/98.

objective of the search team is to obtain a declaration of undisclosed income from the person searched. It confirms success of the raid. Further investigations are slowed down or abandoned. Often such declarations are obtained under pressure. They are retracted in subsequent proceedings. After the raid, the officers of the investigation in charge of the raid, call to their office the persons searched to understand from them the seized accounts and documents. They record further statements. Mostly, the objective of this exercise is to obtain declaration of undisclosed income.

The officer, in charge of the raid, prepares a report on seized material in about 60 days, giving their own appraisal of the search and seizure, without any accountability for what he says or omits to say in the report. This report is the basis for assessment in the searched case. The assessing officer does not independently investigate the case. He neither has time nor inclination for doing so. The assessment is one sided, high pitched, completed in a hurry when it is getting barred by limitation, ignoring the contentions of the assessee. About half the arrears are accounted for by Search & Seizure assessments. When the case goes through first and second appeal, the additions are knocked off.

In a search case there is no “real” investigation. As a result, the assessment does not stand the test of judicial scrutiny in appeals. There is nominal revenue gain from the searched case. Overall, the contribution of searched cases to total revenue collection is less than 1% .

In view of the scheme of block assessment and settlement by Settlement Commission, the person searched is not required to pay any interest or penalty and is never subjected to prosecution in respect of the income he had concealed and which was detected as a result of search and seizure action by the department. He gets away by paying tax @60% as against normal rate of 30% or 35%. As a result the deterrence effect of a search is also doubtful.

Today, in the income tax department the most sought after posting for most of the officers in any grade is to the search and seizure wing. The officers employ all stratagem to obtain posting to search and seizure wing . The reason is not that the search and seizure work provides high visibility with sense of being in power, without accountability for acts or omissions but the main reason is that it is profitable. The department gives handsome rewards to members of search team based on seizures and revenue realisations. Only officers posted to search and seizure wing have received good amounts of reward. This practice has contributed to obtaining forced confessions of undisclosed income and seizure of money, jewellery, stock or other assets though recorded in accounts or acquired from disclosed sources of income.

To sum up, Income tax raids in India are the most visible activity of the department. In public perception the identity of the Income tax department is ‘raids’ . Search and seizure has become substitute for all investigations and an

end in itself. Search and seizure does not serve as deterrence against tax evasion. It has become a routine exercise. There is no meaningful investigation prior to, during or after the search. The concealed income declared as a result of search is widely publicized, but in judicial proceedings the additions made on that basis are not sustained. Search and seizure cases contribute less than 1% to the total revenue realizations. Search and seizure case does not suffer interest, penalty or prosecution. The social and economic cost of search and seizure activity is very high.

Search and seizure has a limited role, in the income tax proceedings. Search and seizure is not a substitute for investigation. It is only a tool for investigation. It is not an end in itself . Search and seizure cannot be a way of life for any civilized society. Search and seizure should be used in rare of rarest cases, when it is a must and where alternative measures of investigation have failed . And once it is used , it should have its full impact as a deterrent. The tax evader should suffer the penal consequence of interest, penalty and prosecution in respect of the concealed income detected as a result of the search.

Based on the aforesaid considerations, the Task Force recommends the following :-

a) Special procedure for assessment of search cases in chapter XIV B (Block Assessment) which provides for tax @60% and exonerates the concealed income detected as a result of search from penal consequences of interest penalty and prosecution, be omitted. When concealment is detected and established, it should suffer full penal consequence of interest, penalty and prosecution.

b) Power of Settlement Commission to grant immunity from interest, penalty and prosecution may be restricted to cases other than those where the assessee admits of tax evasion consequent to search and seizure action taken by the department in his case.

c) The scheme of rewarding officers engaged in search and seizure activity be abolished.

d) Often in the course of search and seizure, stocks are either seized, deemed seized or put under order of attachment or prohibition. This hampers business, without any gain to revenue. Commerce Ministry has unveiled new export-Import Policy (2002-2007). At para 2.42.1 it states “No seizure of stock shall be made by any agency so as to disrupt the manufacturing activity and delivery schedule of export goods. In exception case, the concerned agency may seize the stock on the basis of prima facie evidence. However, such seizure should be lifted within 7 days.” In line with this policy of the government, in the course of search and seizure under the Income tax Act, the stocks may only be

inventorised but not seized. This can be done by issuing administrative instruction.

2.10 Income tax Clearance Certificates

A person leaving India by land, sea or air is required to obtain from the Competent Authority a certificate that he has no liabilities under the direct tax laws or that he has made satisfactory arrangement for payment of his existing liabilities as also for payment of the tax that may become payable by him. The persons requiring income tax clearance are those:

(i) not domiciled in India provided they have stayed in India over a period of 120m days. Generally a person holding a foreign passport is considered as not domiciled in India;

(ii) domiciled in India at the time of departure but-
   (a) intends to leave India as an Emigrant or
   (b) intends to leave India on a work permit for employment or occupation abroad or
   (c) in respect of whom income tax authority considers that a clearance is necessary.

Case 1 was intended to facilitate collection of taxes from foreigners in respect of income that they may have earned during their stay in India. Case 2 was also intended to ensure that residents do not leave India without discharging their tax liabilities. However over time the machinery for issuing such clearances has degenerated often leading to complaints of harassment and unethical behavior. Infact. International travel guides advise foreign tourist to budget for a certain sum to obtain such clearances. This is indeed an inhibiting factor for foreign tourists to visit India and spend long periods. It is also learnt from a cross section of officers and staff in the Department that they have yet to come across any case where such a clearance has facilitated recovery of taxes.

India has a network of treaties for avoidance of double taxation. These treaties do not provide for any bilateral arrangement for assistance in tax recovery by one country from the residents of another country. It is now learnt that OECD has proposed the incorporation of such an arrangement in all treaties and therefore India will have to renegotiate for this purpose.

The Group on Tax Policy and Tax Administration set up by the Planning Commission under the chairmanship of Dr. Parthasarathi Shome has recommended that the requirement to obtain tax clearance by foreign tourists must be dispensed with immediately. The Task Force also discussed this issue and endorsed the view of the Group.

It is therefore recommended that the present requirement of obtaining a tax clearance certificate before leaving the country must be abolished. However

in order to protect the interest of revenue, we can continue to allow the income tax authorities to notify the immigration/custom authorities to prevent any particular person from leaving the country if such person is considered to be a proclaimed offender. As a result only a handful of notified persons will be subjected to the process of tax clearance as against the present practice of requiring all and sundry to comply with the requirement of obtaining tax clearance before leaving the country.

In terms of the policy of the Government of India patronage in the form of grant of license, government contracts, permits, etc should be extended only to honest tax payers. All the Ministries, their attached and subordinate offices, public sector undertakings, ordnance factories, Directorate General of Supplies and Disposals and Central Public Works Department strictly ensure that those who fail to discharge their tax obligations do not get any patronage from them. The concerned Department/Agencies, before granting the contract insist on the production of Income Tax clearance certificate from the Assessing officer to the effect that the concerned person has paid his taxes unless stayed by the competent authority; he has cooperated with the department in the completion of assessments by filing return of income and complying with the notices and in the past three years, he has not been penalized or prosecuted for tax defaults.These days it is learnt that some banks have also been insisting on income tax clearance certificate before granting loans.

Application for the tax clearance is required to be made to the Assessing officer having jurisdiction over his case in a specific form. This form brings out the state of tax compliance by the concerned person. On receipt of the form, the Assessing Officer verifies from his records the facts stated therein. He looks into the position regarding payment of taxes, assessee's cooperation in completing assessment and whether he was penalized or prosecuted. Thereafter, the certificate of tax clearance is recorded by the Assessing Officer on the Application form.

The certificate is valid for one year. Application for fresh certificate can be made one month prior to the date on which the validity of the previous certificate is due to expire. Those firms of repute who have clean tax records are by Government notification exempted from the production of income tax clearance certificate. Such exemption certificate is issued on the recommendation of the Commissioner.

The existing system of issuing income tax clearance certificate has become a source of harassment and encourages rent-seeking behavior. A taxpayer is required to visit the income tax office a number of times. Thereby increasing the interface with the department, which must be avoided to the extent possible. It is not necessary that we should enforce compliance with the tax laws by denying "patronage". The tax laws provide for adequate penalties and prosecution for this purpose.

In view of the above, it is recommended that the system of issuing Income Tax Clearance Certificates to contractors and others should be eliminated forthwith. However, to help in enhancing effective tax enforcement, all government agencies should be required to obtain the PAN of entities participating in tenders, being designated as vendors to the government, etc. and
Periodically submit (pre– specified) relevant information to the tax administration.

Dispute Resolution:

Under the current scheme of dispute resolution, the taxpayer has the option to either seek administrative redressal or judicial remedy. The Income tax Act specifies the categories of orders in respect of which a judicial remedy can be availed. There are several orders for which there is no judicial remedy and the administrative redressal mechanism is ineffective. This results in considerable dissatisfaction amongst taxpayers. **The Task Force therefore recommends that the Income tax Act should be amended to provide that all orders/intimation imposing any additional burden should be made appealable.**

A cross section of taxpayers lamented the absence of administrative response to their grievances particularly to those relating to issue of refunds (mostly women and senior citizens), rectification appeal effects etc. It was suggested that the office of Ombudsman along the lines in the banking sector may be setup which will help redress taxpayer grievances. Accordingly, the Task Force also recommends creating the institution of Ombudsman in the top ten-taxpaying cities and all state capitals on the lines of similar institutions existing in the banking sector. This institution will provide an independent system to assure that tax problems, which have not been resolved through normal channels, are promptly and fairly handled. It will also identify issues that increase burden or create problem for tax payers, and bring those issues to the attention of the Central Board of Direct Taxes (CBDT). The Ombudsman will also enquire into, should a complaint be filed, the practices and performance of all classes of tax professionals. Where necessary it will also make appropriate legislative proposals. This institution will be independent of the local tax office. Its goal will be to protect individual taxpayer rights and to reduce taxpayer burden. A consolidated annual report of the Ombudsman system will be tabled in Parliament.

Accountability

The ability of the tax administration to perform its role effectively and efficiently is in turn determined by its ability to coordinate and adapt over time the

organisational structure and its resources. The organisational structure should follow from the organisations' objectives and conditions prevailing in the country. Until recently, the organisational structures of many tax administrations were not based on any overarching rationale, but instead had either emerged as a result of historical accident & bureaucratic inertia or had evolved in an ad-hoc manner. In the last few years, however, there has been a worldwide interest in reforming the organisational structure of tax departments.

One of the important general organisational issues relate to the placement of the tax administration in relation to the Ministry of Finance. While traditionally the tax administration has been placed within the Ministry of Finance, tax administrations are increasingly attracted to the Canadian model where the tax administration is placed outside the Ministry of Finance and therefore enjoys full autonomy. Since the Finance Ministry is responsible, as of now, for the preparation and execution of the government budget, the Task Force recommends that it must continue to have authority over both revenue collection and expenditure to fulfill that responsibility. Analogously, CBDT, which is responsible for administering the direct tax laws, must have the requisite autonomy if it has to be made more accountable.

Deeply concerned about the lack of any meaningful accountability of the tax administration, the Task Force recommends the following:

(a) The control of the Central Government over the tax administration must be formally reduced through a Memorandum of Understanding (MoU) between the Central Board of Direct Taxes and the Central Government (we understand that there is already a Cabinet decision to this effect). The Central Board of Revenue Act provides that the two boards (CBDT and CBEC) must function subject to the control of the Central Government, but the mechanism and the extent of control remains unspecified even after forty years.

(b) The MoU must, *inter alia*, specify the financial commitment of the Central Government for tax administration.

(c) The MoU must provide for full financial autonomy and control over deployment of human resources to the CBDT. The Central Government should only specify the general guidelines for financial expenditure and deployment of human resources.

(d) The MoU should be for a period of five years specifying the observable performance indicators for the CBDT and the financial resources that would be made available to the CBDT on a year-to-year basis.

(e) It must also specify, in financial terms, and in a manner to be decided later, the levels of penalty (reward) for under-performance (exceeding targets).

(f) The CBDT should have exclusive power for designing the enforcement strategy, subject to the condition that it is non-discriminatory and transparent.

The Task Force was also concerned with the absence of any well-publicised rule for appointing as CBDT Members / Chairman and, therefore, recommends transparent procedures. Lack of transparency in appointments to senior positions in the tax administration can engender uncertainty and demoralise the tax bureaucracy. Therefore, it is recommended that the Central Government must formulate appropriate rules for appointments to the Board.

The Task Force also observed that the turnover of Members and Chairman of the Board was too high. Therefore, the rules for appointment of Members must provide for selection on criteria of merit cum seniority from amongst those who have a minimum period of two years of service before retirement as on the date on which the vacancy arises. Further, an officer once appointed as member of the Board should be debarred from any appointment either in the ITAT or Settlement Commission. Similarly, the Chairman, CBDT should be selected on criterion of merit cum seniority and once appointed should have a minimum tenure of two years.

The Task Force also noted that the standards of accountability at the field formation level were considerably diluted since, *inter alia,* the performance targets, particularly those related to revenue collection, were unrealistic and thrust upon them. The field formations were either resigned to the failure of the targets or resorted to questionable practices to meet revenue targets divorced from underlying economic trends. The Task Force was informed that very often officers were (informally) directed to hold back refunds to boost revenue collection. Accordingly, it is strongly recommended that the revenue targets should be based on underlying economic trends.

It must be appreciated that the ultimate accountability of the tax administration is to the Citizens. With a view to enhancing accountability of (and transparency in) tax administration, the CBDT must publish an annual report of its own, along the lines of the UPSC / CVC that is tabled in Parliament and put on its Website. The annual report must separately provide for performance achievements of each Chief Commissioner / Commissioner. In addition, the quarterly progress of achievement must be displayed on the Website, so that taxpayers have an opportunity to respond. While defining a stricter accountability structure, however, care must be taken to eschew an excessive and regimented accountability system which over-burdens AOs with an onerous and fragmented oversight that ultimately only serves to reduce its overall effectiveness.

Delegation of Financial Powers

The Central Board of Direct Taxes was created out of the Central Board of Revenue in early Sixties. Ever since it has functioned as a part of Department Revenue.

In those days, the Income tax department had only a few offices and not a a very large number of employees. Decision – making was a leisurely activity. The tax laws were simple and remained unchanged for long periods of time. This situation continued for almost three decades, with only incremental changes.

Things, however, began to change very rapidly in early nineties. The number of taxpayers increased sharply. Induction of technology was no longer a choice but a necessity.

Decision-making has now ceased to be a luxury. Very quick decisions are necessary on all issues of tax policy as well as management. Most decisions today have to be in hard real time as even soft real time may be late. Delays in decision making impose a great burden on the effectiveness of the tax administration.

In the context of the rapidly changing environment, CBDT has to attend to several functions critical to efficient functioning of Income Tax Department. It has to prepare about 55,000 personnel for induction of technology and provide world class services to more than 2 crore taxpayers. The technology induction initiative involves reorientation of entire manpower and training them in new skills, extensive communication with taxpayers and public at large and constant review and updating of technology. It is only appropriate that at this critical juncture the CBDT is given necessary and sufficient authority to manage the affairs of the Income Tax department. Powers over the use of resources (both financial and human) must be commensurate with responsibility. A comprehensive technology induction initiative requires comprehensive authority for its implementation.

In this backdrop, it will not be out of place to mention that it is a declared policy of the Government to encourage Ministries to delegate powers to subordinate offices. As a matter of fact, Government of India decision number 7 under Rule 13 of Delegation of Financial Rules, 1978 mentions not only of suitable delegation to match requirements of subordinate offices, it also stipulates a three-yearly review of the delegated powers. Unfortunately, CBDT has continued to function without any financial authority to guide and control affairs of Income Tax offices across the country. The task Force was of the view that the position must be immediately rectified.Therefore, CBDT should be notified as a ‘Department of Central Government’ as defined in sub-rule (d) of rule 3 of Delegation of Financial Rules, 1978. Furthermore, CBDT should be authorised to remit the tax collections to the Central Government net of its

expenditure budget [and also be allowed to carry forward surpluses]. Consequently, it will have full control over its finances and therefore better placed to design and give effect to the medium term and long term enforcement strategy. For its part, CBDT must publish an annual financial report (statement), which will enable the government to assess the cost of tax collection.

Human Resource Management

The absence of control over human resources has further undermined accountability. Therefore, we recommend that the Central Government should delegate to CBDT full authority and responsibility regarding staff of the income tax department and its secretariat. This would include decisions on recruitment, deployment, designing incentive schemes, discipline matters, performance management & appraisal, employee relations, training & development, and other matters related to human resource management. Reciprocally, the CBDT should design a system of performance targets. The CBDT should, however, exercise such delegated powers in a transparent manner within the framework of rules and guidelines framed for this purpose. Such rules and guidelines should be framed with the approval of the government.

Infrastructures

The Task Force was aghast at the physical environment prevailing in most tax offices. We were also told by professionals that office space, work conditions and basic conveniences for staff, as well as storage facilities for tax records, are grossly inadequate. Facilities for taxpayers are even worse. The office layout is inimical to modernisation and induction of information technology. To institute these changes:

(a) A Task Force should be constituted to standardize the requirement of a modern occupant-friendly office (with modern methods of storage and retrieval of records). The Task Force should furnish its report, including financial estimates, by 31st December 2002.

(b) Based on the report of the Task Force the CBDT should request Chief Commissioners to identify the shortcomings in their offices by 1st April 2003 and send forward a proposal to CBDT.

(c) By 1st August 2003 a model Commissionerate including the offices at the range, circle and ward levels should be established in each zone.

(d) CBDT should seek the requisite financial sanction to replicate the model offices by either upgrading existing offices or, where necessary, by purchasing new premises, etc. The entire exercise should be time bound so that by January 2005 modern offices are in place in all Commissionerate.