

Effectiveness of Tax Deduction at Source (TDS) in India

S.S. Murugan¹ and Dr. S. Sekar²

¹Research Scholar, Department of Finance Management, Bharathidasan University, Trichirapalli, INDIA

²Principal, Meenakshi Ramasamy Arts and Science College, Thathanur, Ariyalur, INDIA

¹Corresponding Author: mururathinam@gmail.com

ABSTRACT

To Study and analyses all the purposes for which TDS in India was introduced to ensure whether they are properly achieved for collection of more revenues to Govt. Also study major types of tax system in the world. Study whether Adam smith's all the four Canon of Taxation are satisfied by TDS mechanism and to what extent with reasons there for. To conclude, considering major tax collection mechanism, whether TDS mechanism is effective or not.

Keywords-- TDS, India, Tax

I. INTRODUCTION

The purpose of introduction of Tax Deduction at Source is

- (1) To prevent Tax Evasion
- (2) Widen the assessee base
- (3) Regular flow of Tax revenue

To prevent Tax Evasion

It is the illegal evasion of taxes by individuals, corporations, and trusts. Tax evasion often entails taxpayers deliberately misrepresenting the true state of their affairs to the tax authorities to reduce their tax liability and includes dishonest tax reporting, such as declaring less income, profits or gains than the amounts actually earned, or overstating deductions.

One measure of the extent of tax evasion is the amount of unreported income, which is the difference between the amount of income that should be reported to the tax authorities and the actual amount reported.

These are some of the ways in which people may avoid/evade taxes.

Failing to Pay the Due

This is the simplest way in which someone may evade taxes. They simply won't pay it to the government, not even when the dues are called for. A person engaged in this sort of tax evasion won't, willingly or unwillingly, pay the tax before or after the due date.

Smuggling

When certain goods move from one location to another, across international or state borders, a tax or charge may be payable in order to move the goods. However, some individuals may move these goods in

surreptitious ways in order to avoid paying those taxes that evading the tax altogether.

Submitting False Tax Returns

In some cases, when an individual files taxes, they may submit false or incorrect information in order to either lessen the tax that they are supposed to pay or not pay it at all. This is also tax evasion since the complete information is not provided and they may actually be paying less than what they should.

Inaccurate Financial Statements

The taxes that are payable by an individual or an organisation may be decided on the financial dealing that have taken place during the assessment year. If false financial documents or accounts books are submitted, ones that show incomes less than what was actually earned, the tax may come down.

Using Fake Documents to Claim Exemption

The government may have provided certain exemptions and privileges to certain strata or members of society in order to ensure they have a bit more financial freedom to progress. In some cases, members who actually don't qualify for such privileges will get documents created to support their claim of being a part of that group thus claiming exemptions where they are not suited.

Not Reporting Income

It could be said that this is one of the most common methods of tax evasion. In this case, individual just won't report any income that they receive during a financial year. Not having reported any income, they don't pay any tax thus successfully evading tax all together. The simplest example of this would be a landlord who has kept tenants but has not informed the authorities that he has rented the house and is actually receiving an income from it.

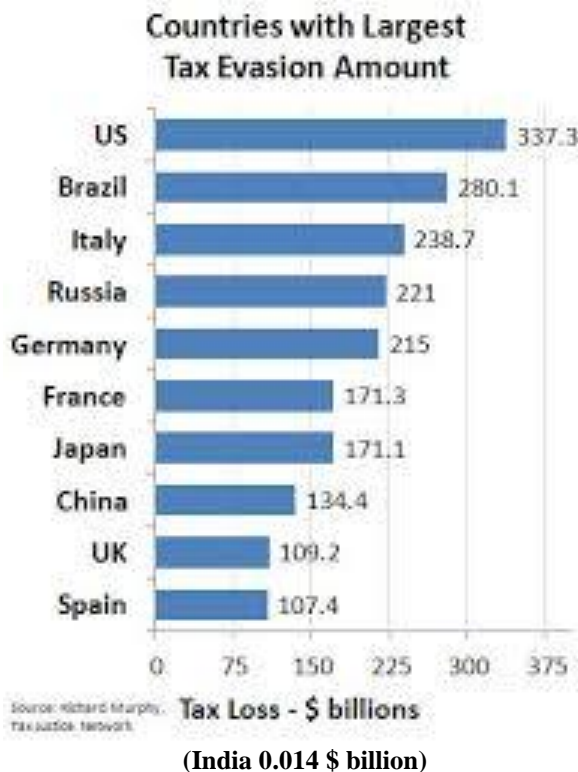
Bribery

There may be a situation where there a certain amount due in taxes which the individual may not be willing to pay. In such a case he or she may actually offer a bribe to officials to not make them pay the tax and to make it 'disappear'.

Storing Wealth Outside the Country

We have all heard tales of Swiss bank accounts. Offshore accounts are accounts maintained outside the country and information about the dealing in these accounts

is not disclosed to the income tax department thereby evading any and all taxes due on that wealth.



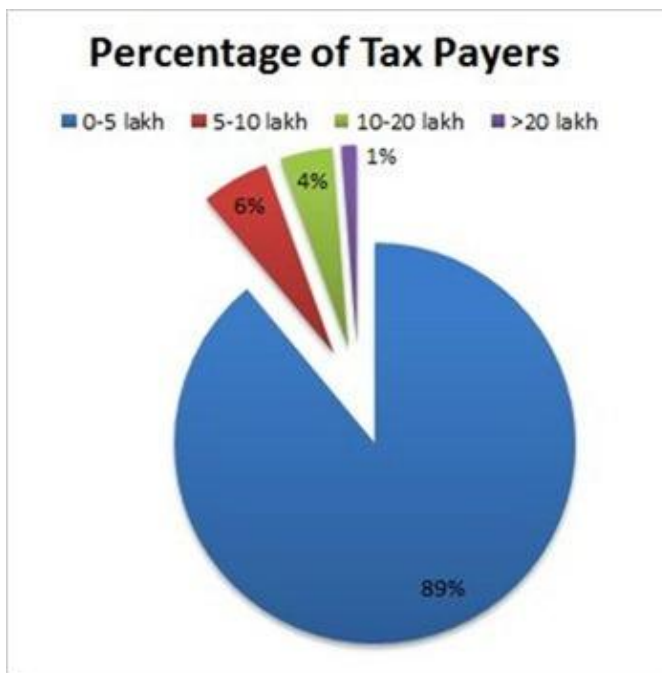
Widen the Assesse Base

It means enhancement of existing assesse base. That is including new assessee who are not paying tax so far.

Out of our total population of 136.87 Crores, only 1% are paying income tax.

For such 1 % of Tax payers, taxable income groups are as follows: (Rs. in Lakhs)

Upto 5	05-10	10-20	20<
89%	6%	4%	1%



Level of Evasion and Punishment

Tax evasion is a crime in almost all developed countries, and the guilty party is liable to fines and/or imprisonment. In Switzerland, many acts that would amount to criminal tax evasion in other countries are treated as civil matters. Dishonestly misreporting income in a tax return is not necessarily considered a crime. Such matters are handled in the Swiss tax courts, not the criminal courts

How TDS prevent Tax Evasion:

TDS is applicable only on income of assessee to be received from external source

TDS is not effective in preventing Tax Evasion because of the followings:

- (1) Only internal income is shown at reduced level and/or expenses are inflated for the purpose of Tax Evasion, Hence, it is very difficult or rare to hide income from external source for Tax evasion.
- (2) Govt. shows huge amount of tax collected under TDS. as one of the source of income rather than treating TDS as method of collection.
- (3) Moreover, there is no system to know how much amount TDS collected are availed/ adjusted by assessee in their tax return. It shows that Govt. has no mechanism to link such unclaimed/un adjusted TDS& refund the same to assessee.

The finance ministry's effort to widen the tax base and bring tax evaders under the net is a welcome move, but it would also require more efficient and transparent functioning of the taxman.

For example, The Central Processing Centre (CPC) of CBDT had carried out an automatic scrutiny which result in identification of new income tax assessee and significant increase in Tax Revenue.

But, under TDS only existing assessee are covered, by this procedure and no new assessee are identified/added.

Regular Flow of Tax Revenue

Income tax is collected through-

Tax Deducted at Source (TDS)
Advance Tax under Self-assessment
Regular Assessment Tax

Out of total collection of Income tax, nearly 40 % are through TDS and remaining 60 % through advance tax & Regular assessment. Percentage of collection as Advance tax to Total Tax collection are keeps on increasing Under self-assessment, advance tax is to be paid on quarterly basis. TDS is collected throughout the year and remitted on monthly basis. TDS in addition to advance tax. Advance tax is percentage of tax paid based estimated tax liability of assessee for the current financial year were as TDS is paid as specified percentage on income actually earned.

As advance tax is paid by the assessee themselves, relevant TDS amount may adjusted before remittance of it.

In absence of TDS, to some extent Advance tax may be increased. But, role of TDS in tax collection is very significant.

Hence, to some extent, there is additional flow of regular tax revenue to Govt. through TDS.

II. THREE TYPES OF TAX SYSTEMS

1. Progressive Tax System

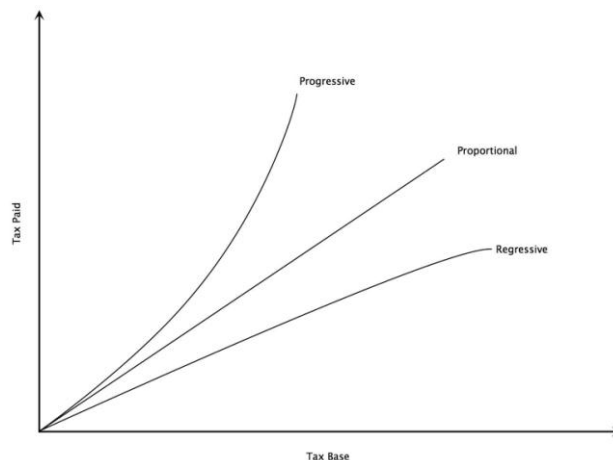
In a progressive tax rate system, higher income individuals pay a higher proportion of tax with a rise in income. In this case, the marginal tax rate would be higher than the average tax rate. A progressive tax is cited as a method to reduce inequality in society. Most economies around the world use a progressive tax to assess taxes for individual income.

2. Proportional Tax System

In a proportional tax rate system, everyone pays the same proportion of his or her income as tax. The tax rate does not change with an increase or decrease in income. Here, the average tax rate is equal to the marginal tax rate. This system exists in Latvia and Russia, and is considered to be more 'fair' and easier to manage for everyone. Some states in the U.S. like Colorado, Utah and Michigan impose a proportional income tax for individuals.

3. Regressive Tax System

A regressive tax is a tax which results in a decrease in the tax rate as the amount subject to taxation increases. In a regressive tax rate system, the individuals with lower income pay a higher proportion of his or her income as tax. Here, the marginal tax rate is lower than the average tax rate. Any tax with a cap above which no taxes are paid are regressive taxes.



Whether Indian TDS mechanism Satisfies Principles or canons of Taxation?

- 1) Equality
- 2) Certainty
- 3) Convenience
- 4) Economy

Equality

The first canon or principle of a good tax system emphasized by Adam Smith is of equality. According to the canon of equality, every person should pay to the Government according to his ability to pay.

However, modern economists interpret equality or ability to pay differently from Adam Smith that is progressive income tax, that is, the rate of tax increases as income rises.

But, TDS rates are flat percentage from 1 % to 30 % depending upon the nature of transaction irrespective of the volume of income on which TDS is deducted.

%	Sec.	Nature of transaction
1	194D 194IA	Payment to LIC, Transfer of Immovable property
2	194 I	Rent of Plant & Machinery
5	194 D 194 G 194IB 194LD	Payment of Insurance premium Comm. On sale of lottery tickets Rent Interest on few Bonds & Govt securities
10	193 194, 194A	Interest on securities & debentures Dividend, Interest on other than securities, etc.,
20	194F	Repurchase of units of Mutual funds
30	194B 194BB	Winning from lottery/puzzle//game Winning from horse race

Hence, TDS does not satisfy canon of Equality.

Certainty

The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid ought all to be clear and plain to the contributor and to every other person.

Sometime, applicability of TDS may not clear. This question arises when there is a conflict with respect to a particular transaction falls under “contract for sale” or “contract for work/service”. Contract for sale involves transfer of property in goods for consideration for which TDS provisions are not applicable. In contrast Contract for work/service involves adding some value to the property by doing some workmanship or performance of an express task or service and is subject to TD. However certain aspects require professional judgment.

Some of the peculiar examples are presented:

Nature of Transaction	Applicability of TDS
Subscription to Journals	No
Advertisement in Journals	Yes
Membership fee to certain organizations	No
Training fee	Yes
Software procured in CD form	No
Payment for customized software	Yes

Next one is identification of appropriate TDS section to know rate of TDS, it depends upon so many factors like-

Nature of work or routine or normal, composite contract or different, deductor is resident Indian or non-resident, corporate or non-corporate, eligible for no deduction/nil deduction etc.

TDS does not fully satisfy this principle because many cases whether TDS is applicable to particular person and/or which rate applicable are not clear. To some extent, lack of clarity in respect of applicability TDS to particular person and also applicable rates.

Convenience

According to the third canon of Adam Smith, sum of tax, time and/manner of payment of a tax should not only be certain but the time and manner of its payment should also be convenient to the contributor.

For TDS these are certain, but payment is not convenient to all detectors especially to small etectors.

Economy

If the collection costs of a tax are more than the total revenue yielded by it, it is not worthwhile to levy it. But in TDS mechanism, tax collection, remittance, filing of returns, issue of certificates all are done by assesses only on behalf of Govt., cost of collection of TDS is very low, however those detectors of TDS are suffering a lot due to

lack of clarity and simplicity in TDS collection, remittance and filing rules/procedure.

Therefore, even for achieving economy in the tax collection, the tax rules must be as much simple as possible and TDS detectors who doing on behalf of Govt. should not be suffered.

III. CONCLUSION

All purposes for which TDS was introduced are not fulfilled

Purpose of TDS	Status of fulfillment
1.Prevent Tax evasion	Not fulfilled
2.Widen the assesse base	Not fulfilled
3. Regular flow of tax revenue.	To some extend fulfilled

TDS mechanism does not satisfy all the cannon of taxation.

Canon of Taxation	Status of TDS
1.Equality	Not satisfied
2.Certainty	Not satisfied
3.Convenience	To some extend satisfied
4.Economy	Not satisfied

Total Direct Tax collections for the year 2018-19 (up to Dec-18) is ₹8.74lakhs Crores which is 14.1% higher than the Budget Estimate for the Financial year 2018-19. TDS contributes nearly 42% (Rs. 3.69Lakhs Crores) to the gross direct taxes collections that emphasizes its ever-growing importance in the total volume of direct taxes collection in the country.

The purpose of introduction of TDS is good, but, it is not effective Hence, Certain modifications in the TDS mechanism and procedures may be done to enable the TDS to become an effective and smooth one.

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