

## The costs of poor quality tax assessments

The annual Economic Survey 2017-18 has put the ever-increasing pile of tax litigation in the spotlight. It points out that the total tax (both direct and indirect) in dispute at appellate tribunals, high courts and the Supreme Court is approximately Rs7.58 trillion (equivalent to 4.7% of the gross domestic product) in 280,000 cases. It would be useful to remember that the indirect tax litigation numbers pertain to the pre-goods and services tax (GST) era, so commercial tax disputes pursued by/against the state governments are not included here.

The most significant takeaway from the chapter in the Survey could well be the low success rate of the tax departments at all levels, ranging from 13% to 27% for direct taxes and 11% to 46% for indirect taxes.

This has significant economic implications. From a taxpayer's perspective, this means uncertainty in applying the law, and incurring legal and working capital costs on account of taxes wrongly collected. From a public finance perspective, since government accounts for tax collections on a cash basis and most disputed taxes are collected in advance, it ends up paying interest at 6% per annum when it refunds/adjusts taxes wrongly collected if the dispute is decided in favour of the taxpayer. The Comptroller and Auditor General (CAG) has, in its report released in December 2017, pointed out the cost to the exchequer of about Rs58,000 crore over nine years due to such practices. The disclosure of such amounts in the budget statements needs improvement.

Much has been said about how the tax departments need to be more judicious in appealing cases. But the root cause of the problem—tax administration—hasn't got as much attention. The deeper problem is the quality of tax assessments. CAG's December 2017 report on income-tax assessments says: "There is persistent and pervasive irregularities in respect of corporation tax and income tax assessments cases over the years. Recurrence of such irregularities, despite being pointed out repeatedly in the earlier Audit Reports points to structural weaknesses on the part of Department as well as the absence of appropriate institutional mechanisms to address this."

Most assessments are carried out in a routine fashion, without understanding business complexities and ground realities. Most of the time, they are carried out keeping immediate tax collections in mind. These are then easily struck down by appellate bodies. This leads to two kinds of problems: one, where genuine compliant taxpayers have to face hardship; and two, where tax dodgers or those who take shelter in the grey areas of law or complex structuring are either not picked up or pursued to their logical end. The reasons for this could be many: political economy, not knowing what information to ask for, not getting sufficient response, or lack of capacity.

In the 2018-19 Union Budget, a new scheme of assessment has been proposed "so as to impart greater efficiency, transparency and accountability" where technology will be used to the extent feasible to interface between taxpayer and tax officers and team-based assessments, with dynamic jurisdiction and specialization, will be introduced. Pooling resources will help the tax department do justice to complex tax assessments. An electronic interface for assessments has also been introduced recently. This is expected to reduce hardship to compliant and small-time taxpayers. However, when the tax officer proposes to take an adverse view and the taxpayer requests a personal hearing, the electronic mode can be dispensed with. Given the wide discretion available to tax officers, it would not be surprising if this exception quickly became the norm. This becomes even more relevant with tax officers now being able to use the wide discretionary powers granted to them under anti-avoidance rules.

Hopefully, the economic surveys in future will continue to track these metrics and give details

beyond the overall success rate. We currently don't know the success rate for cases based on the value of tax disputes or the type of taxpayers or cases. For instance, is the success rate for cases where tax holidays are in dispute lower than it is for search and seizure cases? While a low success rate is probably good news for taxpayers, the public would like to see a high success rate in the case of tax dodgers.

There can be no simple solution to such a complex problem. It needs to be tackled on many fronts. Using technology is a good first step. This would also help the Central Board of Direct Taxes (CBDT) analyse trends in behaviour of both tax officers and taxpayers, and frame more specific solutions. Balancing the wide discretionary powers given to tax officers with regulations (and not merely technology) that require them to strictly follow procedures in assessment could be another solution. Then there is the problematic institutional design where the CBDT's performance is measured by tax collection, while it is also expected to balance taxpayer rights and is held responsible for policy-level reforms. This can only be solved through structural changes. The responsibility of tax collection must be separated from that of evaluation, framing of laws, research and policy reform—with the latter divisions reporting directly to the Union finance ministry.

These are not new ideas. As is often said: "Everything has been said before, but since nobody listens we have to keep going back and beginning all over again."

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