

## **Tax Rate Changes and its Impact on Tax Burden Leading to Tax Evasion Practices – With Reference to the Individual Taxpayers in India**

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**ABSTRACT:** Tax evasion is the major destruction for any country's economy. It plays a significant role in the developing country's economy. Due to tax evasion practices the citizens of the country are getting poor infrastructure facilities. The ending results of tax evasion to the Government is revenue loss, which cause a serious damage and deficit of revenue which leads to lack of public expenditure. The study examines factors that influencing tax evasion practices in India. The survey was conducted with primary data from 110 respondents with five points rating scaled questionnaire. The outcomes of the study reveals that the low quality of service to the public in return for the tax significantly impact the tax evasion practices in India. Furthermore, high impact on tax evasion on variables such as tax system, transparency, fairness and accountability. High level of corruption is also one of the major factors for the tax evasion practices in India. The study recommends necessary steps to be taken in view of the transparency, accountability and corruption in order to gain the public morale and minimize the tax evasion practices in India.

**Keywords:** Accountability, Tax rates, Tax evasion and Transparency

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### **I. INTRODUCTION**

Taxation is a compulsory levy on income to support the Government in Nation building such as infrastructure facilities, creating employment opportunities, supporting the economical growth etc. Tax also defined as a charge imposed by the Government upon property, individuals or transactions to raise the money for public purposes (Akinyomi & Tasie, 2011; Enahoro & Olabisi, 2012). Tax rates are increasing due to the poor economic development and high inflation in the financial market. Due to this reason prices of the commodities are increased and other monetary commitments are rising for the individuals. Due to the heavy burden of tax rates the individuals are practicing more tax evasion activities. Tax evasion is defined as "Dishonest taxpayers try to reduce their taxes by concealing income, inflation of expenses, falsification of accounts and willful violation of the provisions of the Income-tax Act. Such unethical practices often create problems for the tax evaders". Tax evasion is a global scourge. The black economy as estimated, by some experts has reached 10% of the GDP in the advanced countries and 70% in the developing countries and it is getting worse.

Tax evasion is usually confronted in two ways: audits and harsh sanctions. But, as the rising tide of tax evasion suggests, these mechanisms amount only to a cat game and mouse problem — and the mice, are winning in the game. Thus the amount of tax evasion, which is used for the economical and social development, is also used for the anti social activities. All this creates black money and social evils in the society. Tax evasion is a crime in all the major countries and the guilty parties are subject to imprisonment or fines or sometimes imposed both the penalties. When taxpayers try to discover loopholes with the intention to pay a smaller amount of tax even in the principle lawful, their actions are against the spirit of the law and this is regarded as a noncompliance (Wenzel, 2002; Bhuiyan 2012)

### **II. OBJECTIVES**

The study mainly focuses on the Tax evasion practices in India and its route causes. Further more the article attempts to highlight the tax burden on the individuals on the tax rate change, which leads to tax evasion practices. The study also focuses on the route causes for the tax evasion practices other than the tax rate changes. The paper also attempts to assess the remedies of tax evasion practices and a light focus on the tax system in practice.

### **III. STATEMENT OF PROBLEM**

Taxation is one of the major sources of revenue to the Government. Direct taxes play a significant role in supporting the economy of the country. Majority of the Government projects are purely depending on the collected tax. However, the tax evasion practices also shows an increasing trend in the last one decade. This

shows that the tax evasion practices are highly evident in India. Tax evasion is not a new phenomena as they have been existing for long time; however, they have taken new dimensions in recent times (Eschborn, 2010). According to Asada (2010) tax evasion represents some of the perplexing problems facing the Indian economy. Individual taxpayers are trying to escape from the tax bracket by hiding their income or falsify their report in order to get the less tax burden. Meanwhile, taxation is one of the means of revenue generation of any government to meet the needs of its citizens (Abiola & Asiweh, 2012). The resulting of tax revenue loss may cause a serious damage to the proper performance of the public sector, threatening its capability to finance public expenditure (Chiumya, 2006). Therefore, there is the need to ascertain the factors that are influencing the tax evasion practices in India.

#### **IV. RESEARCH QUESTIONS**

The following research questions have been developed mainly based on the review of literatures on the tax avoidance and evasion:

- i. What is the influence of low quality of the service in return for tax payment on tax evasion in India?
- ii. What is the influence of tax system and perception of fairness on tax evasion in India?
- iii. What is the influence of low transparency on tax evasion in India?
- iv. What is the influence of high level of corruption on tax evasion in India?

#### **V. LIMITATIONS**

The data collected is restricted with the limited respondents of 110 through out India from the different Individual earning groups. The study also conducted with the support of published sources of different authorized websites and journals. The context is limited to Indian Tax System. Therefore, the reliability of the conclusion and analysis is depending on the reliability of the respondent's loyal answers and information published.

#### **VI. HYPOTHESIS**

In order to be able to test the significance of the relationship that exists between the identified factors and tax evasion practices, the following hypotheses have been formulated:

**H<sub>0</sub>**: Reduction in tax rates do not have any influence on the tax evasion practices in India.

**H<sub>01</sub>**: Lack of transparency on the tax budget and the revenue generation from the direct taxes does not influence the tax evasion practices.

**H<sub>02</sub>**: Tax system and perception on fairness do not influence on the tax evasion practices in India.

#### **VII. RESEARCH METHODOLOGY**

The study adopts a survey research design. Five point rating scaled questionnaire starting from strongly agree, agree, neutral, disagree and strongly disagree were used to collect data from the 110 respondents randomly selected from the different earning groups of individuals in India. However, 109 respondents returned and usable. The questionnaire was designed in such a way that every question in the questionnaire was related to the research questions.

#### **VIII. BACKGROUND OF THE STUDY**

According to the study conducted by **Boylan and Sprinkle (2001)** they tried to explore the behavioral determinants of the tax evasion. He used experiment technique in order to acquire the desired objectives such as to identify the factors that motivate the tax compliance and characteristics of noncompliance taxpayers.

According to **Uadiale et al. (2010)** conducted study in Nigeria while examining the relationship between the personal income tax evasion and cultural factors like religiosity, trust in government, and legal enforcement. Study found a positive impact on personal income tax of trust in government and legal enforcement. However, no significant relationship is found between the religious variables and tax evasion in Nigeria.

According to **Lefebvre et al. (2011)** in Netherlands, France and Belgium (Flanders and Wallonia) while examining the behavior of people, he compared the behavior of the people regarding, the welfare dodging and tax evasion. Results indicated that the people adopt less evaded behavior in tax treatment than in welfare treatment; and people evade more tax in Netherlands and France

According to **Gary Becker and Richard Posner (2012)**, Increasing income taxes can reduce the amount of work and increase the amount of tax evasions practices. But when the issue is increasing the marginal the income tax rates, the likelihood of a significant effect on work depends critically not only on the amount of the increase but also on where the margin is set.

According to **JB Maverick (2015)**, Its possible for tax rate changes, either up or down, to have the effect of increasing the consumer spending or decreasing the spending and increasing the savings. This will lead

to the tax evasion practices. The ultimate determinant of the overall effects of the tax rate changes primarily depends on the consensus attitude of the consumers as to whether they are better off spending or saving in light of the interest rate change. An increase in tax rates may lead consumers to decrease the savings since they pay high rates of taxes, which also reflect in tax evasion practices. An increase in tax rates is often accompanied by a corresponding increase in inflation, so the consumers may be influenced to spend more if they believe the purchasing power of their currency will be eroded by the inflation. This concludes in tax evasion practices.

The previous study conducted on the tax burden and tax evasion practices resulted only on certain factors such as savings, spending attitude, morality on work and behavior. However, the past literature was limited to focus on other factors such as transparency, tax system and fairness towards the taxpayer. This study mainly focuses on the other factors, which were not considered for the tax evasion practices such as lack of transparency on tax budget and revenue generation from the direct tax collections. Furthermore, the study focuses on the tax system and its fairness on tax evasion practices.

### IX. ANALYSIS AND INTERPRETATION

Chi-square test with 5% level of significance is employed in testing the hypotheses. The decision rule is to reject the null hypothesis if the calculated value is greater than the critical value and accept if otherwise. Chi-square is calculated with the help of the following formula.

$$X^2 = \sum \frac{(O_{ij} - E_{ij})^2}{E_{ij}}$$

Where  $O_{ij}$  = represents observed frequency;  $E_{ij}$  = represents expected frequency

$$E = \frac{\text{Number of respondents}}{\text{Number of rating scale}} = 109/5 = 21.8(E)$$

Number of rating scale

Level of significant = 0.05; Formula for degree of freedom = n-1; Therefore, the degree of freedom  $df = 5-1 = 4$ . Thus, the value of  $x^2$  from that 4-degree of freedom at 5% significance is 9.488.

#### Tests and Outcomes

The responses of the respondents are tested as follows:

**H<sub>0</sub>**. Reduction in Tax rates do not have influence on the tax evasion practices in India.

S.No.	Degree of Acceptance	No. of responses	% of Responses
1	Strongly agree	35	32.11
2	Agree	42	38.53
3	Neutral	15	13.76
4	Disagree	17	15.59
5	Strongly disagree	-	0.00
<b>Total</b>		109	100

The survey analysis of responses to statement number one reveals that most of the respondents (70.64%) agreed that the Reduction in tax rates do not have any influence on the tax evasion practices in India. Further more, in order to confirm the existence of the relationship between the Reduction in tax rates and tax evasion in India; the hypothesis is then tested below.

O (Observation)	E (Expected outcomes)	O-E	(O-E) <sup>2</sup>	(O-E) <sup>2</sup> /E
35	21.8	13.2	174.24	7.99266055
42	21.8	20.2	408.04	18.71743119
15	21.8	-6.8	46.24	2.121100917
17	21.8	-4.8	23.04	1.056880734
-	21.8	-21.8	475.24	21.8
<b>x<sup>2</sup></b>				<b>51.68807339</b>

The results of hypothesis one indicate an  $x^2$  value of 51.68, which is greater than the critical value of 9.488. Therefore, the null hypothesis rejected. Thus, we conclude that the reduction in tax rates does significant influence on tax evasion practices in India.

**H<sub>01</sub>**. Lack of transparency on the tax budget and the revenue generation from the direct taxes does not influence the tax evasion practices.

S.No.	Degree of Acceptance	No. of responses	% of Responses
1	Strongly agree	8	7.33
2	Agree	69	63.30
3	Neutral	27	24.77
4	Disagree	1	0.91
5	Strongly disagree	4	3.66
<b>Total</b>		109	100

The survey analysis of responses to the statement number one reveals that most of the respondents (70.63%) agree that the Lack of transparency on the tax budget and the revenue generation from the direct taxes does not influence the tax evasion practices. Further more, in order to confirm the existence of relationship between the transparency and tax evasion in India; the hypothesis is then tested below.

O (Observation)	E (Expected outcomes)	O-E	(O-E) <sup>2</sup>	(O-E) <sup>2</sup> /E
8	21.8	-13.8	190.44	8.735779817
69	21.8	47.2	2227.84	102.1944954
27	21.8	5.2	27.04	1.240366972
1	21.8	-20.8	432.64	19.84587156
4	21.8	-17.8	316.84	14.53394495
<b>x<sup>2</sup></b>				<b>146.5504587</b>

The results of hypothesis one indicate an  $x^2$  value of 146.55, which is greater than the critical value of 9.488. Therefore, the null hypothesis rejected. Thus, we conclude that the Lack of transparency on the tax budget and the revenue generation from the direct taxes influence the tax evasion practices.

**H<sub>02</sub>:** Tax system and perception on fairness do not influence on the tax evasion practices in India.

S.No.	Degree of Acceptance	No. of responses	% of Responses
1	Strongly agree	37	33.94
2	Agree	25	22.93
3	Neutral	30	27.52
4	Disagree	13	11.92
5	Strongly disagree	4	3.66
<b>Total</b>		109	100

The survey analysis of the responses to the statement number one reveals that most of the respondents (56.87%) agreed that the Tax system and perception on fairness do not influence on the tax evasion practices in India. Further more, in order to confirm the existence of the relationship between the tax system on fairness and tax evasion in India; the hypothesis is then tested below.

O (Observation)	E (Expected outcomes)	O-E	(O-E) <sup>2</sup>	(O-E) <sup>2</sup> /E
37	21.8	15.2	231.04	10.59816514
25	21.8	3.2	10.24	0.469724771
30	21.8	8.2	67.24	3.08440367
13	21.8	-8.8	77.44	3.552293578
4	21.8	-17.8	316.84	14.53394495
<b>X<sup>2</sup></b>				<b>32.23853211</b>

The results of hypothesis one indicate an  $x^2$  value of 32.23, which is greater than the critical value of 9.488. Therefore, the null hypothesis rejected. Thus we conclude that the Tax system and perception on fairness influence the tax evasion practices in India.

## X. OUTCOMES

The outcome of the analysis exposes that the Lack of transparency on the tax budget significantly influences the tax evasion practices in India. This shows that the individual earning group people are evading the tax due to the lack of information on the utilization of their tax funds by the Government. Individual earning groups are expecting the Government to make a transparency in their tax budget, which provides the way to know their tax funds are utilized. However, the Indian Tax budget is purely based on the tax collection, the lack of transparency on the tax spending is one the major cause for the individuals to lose interest in paying the taxes. Moreover, the inadequate facilities provided to the taxpayers and poor infrastructure facilities will also lead them to evade the taxes. Furthermore, the results also expose that due to the increasing of tax rates in every budget discourages the individuals to evade the taxes in India. The tax rates are increasing every year, however the slab rates are also increasing every year based on the income level. But the proportion of slab rates are not in line with the tax rates which increases with the income level of the individuals. This discourages the individuals in paying the taxes and more tax evasion practices are evident. In addition, the study also exposed the high level of corruption in all levels, perception of individuals on the lack of fairness are some of the other factors encourages tax evasion practices in India.

The study further exposed on the Tax system in India in relation with the tax evasion practices. Individual's perception towards getting caught on non payment of taxes, perception towards the tax system and the penalties imposing on individuals are some of the factors which encourages the tax evasion practices in India.

## **XI. SUGGESTIONS**

It is important to take remedial measures in order to overcome the tax evasion practices in India. The findings of the study have been focused on the three aspects such as tax moral, tax evasion and tax system. It is strongly recommended to have the wider transparency, accountability and anti corruption activities in the tax system. In addition, Government should also strive to ensure the surety of the tax amounts utilized for the public cause and infrastructure development of the country. It is also recommended more public awareness campaigns and programmes related to tax implications would reduce the tax evasion practices and generate more revenue to the Government. The audited accounts of Government departments should be made available for the public either under the Right to Information Act or by any other means in order to secure the public trust in the context of tax. It is strongly recommended to reduce the tax burden of individuals tax rates to be reduced and additional surcharges on taxes to be abolished. This will reduce the tax burden of individuals indirectly and it discourages the tax evasion practices in India.

## **XII. CONCLUSION**

Income tax is the major source of revenue to the Government in order to enrich the infrastructure facilities in the country. However, the marginal increase in the tax rates will be a burden and attitude of individuals towards the tax system is having high impact on the tax evasion practices. The government has to come with some reforms on stabilizing the tax system and changes in the tax rates to be taken place at long intervals. This will ensure a better understanding of the individuals about the tax system and its utilization for nation building.

In dealing with tax rates, the Government should consider the changes in such a way that the income level of the individuals increased and subsidies in different sectors to be encouraged.

The observations are broadly accepted and different study views show that the tax rate changes have the impact on the tax evasion practices. However, it is necessary to bring a permanent tax reforms in tax rate changes to ensure the tax evasion practices are minimised and driven them to contribute towards the nation building.

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