THE INCOME TAX COMPLIANCE COST OF INDIAN CORPORATIONS

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FOREWORD

This is one of three related studies on income tax compliance costs carried out by the NIPFP for the Planning Commission. The other two studies are on the relation between compliance cost and compliance with respect to the personal income tax in India, and the compliance cost of the personal income tax in India.

As with the companion studies, the study is based on a small sample of 45 companies because of very poor survey response. Consequently, estimates in the study are subject to a wide margin of error which the authors have been careful to point out. The study estimates the social compliance costs of the corporation tax, or the value of resources used to comply with the income tax law to lie between 5.6 and 14.5 per cent of corporation tax revenues. These costs are typical by international standards, if the compliance costs in reality happen to be near the lower limit of the range of estimates but a cause for concern if the upper limit reflects the true position. The authors identify delays in payment of refunds and uncertainty associated with ambiguity and complexity of tax provisions as also frequent changes in the tax code as major factors contributing to the compliance cost of companies. Besides streamlining of refunds and reform of the budget process and the "notification raj", the study also identifies over 20 specific high compliance cost areas for remedial action, covering both legal structure and administrative procedures, which should be useful to those entrusted with reforming the corporation tax.

Benefits from reform of the corporation tax to lower compliance costs will accrue mainly to the general public and small businesses rather than to large corporations. This is because, the net cost to companies, given the tax deductibility of expenditure on compliance and cash flow benefits, is estimated by the study at between minus 0.7 and plus 0.6 percent of corporation tax collections. Negative costs are faced mainly by large companies since compliance costs are found in the study to vary inversely with size.

Among other useful contributions of the study is the careful documentation and analysis of bribes and the impact of corruption on company compliance costs. Besides policy makers, the study should also be of interest to academics because of the new ground broken in recognising illegal compliance costs and in attempting to assess the psychic costs to company owners and managers of policy instability and tax code complexity and ambiguity.

The study team consisted of the Principal Consultant for the project Arindam Das-Gupta (Visiting Professor, Indira Gandhi Institute of Development Research, Mumbai), Surendra Prakash Singh (Commissioner of Income Tax), Dheeraj Bhatnagar (Joint Commissioner of Income Tax) both Consultants for the project and Saumen Chattopadhyay (Senior Economist, NIPFP). As with the companion studies, Arindam Das-Gupta is the principal author of the present report. Research support was provided at different times by Arindam Bandyopadhyay, Jeeta Mohanty, Sachchidananda Mukhopadhyay and Parthasarathi Pal. Chattopadhyay and Das-Gupta were chiefly responsible for the analysis and for report writing. Thanks are due to Professor R. Radhakrishna, Director, Indira Gandhi Institute of Development Research, for generously permitting Das-Gupta, to travel for and work on the study as needed.

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The Institute does not bear any responsibility for the views expressed in the study. That responsibility belongs primarily to the authors.

Amaresh Bagchi
Emeritus Professor and Director In Charge, NIPFP
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The responsibility for remaining errors is ours.

Summary

This is the first study of compliance costs of income taxation of companies in India.

To assess the costs of taxation, “the total sacrifice imposed upon the populace – total collection costs, administrative and compliance costs" should be examined. Income tax compliance costs of companies are costs they incur in meeting their obligations under income tax law and in planning to save taxes. Opportunity costs such as in the case of delayed tax refunds are also included.

Important distinctions need to be made between social costs, gross and net private costs and between mandatory costs and voluntary costs which give rise to tax saving. Gross private costs include expenditure incurred by companies on employees, on tax advice and other non-labour expenses, including both legal expenses and illegal expenses such as bribes.

Estimates in the study are for the year 2000-01, and are based on 45 companies throughout India which responded to a postal questionnaire survey in August-September 2001. The response rate to the survey, at 1.15 percent, was disappointing and results, being based on a small sample, should be viewed as tentative and subject to a margin of error.

Gross compliance costs of company income taxation in India for 2000-01 are estimated to lie between 5.6 and 14.5 percent of corporation tax revenues. The estimates are incomplete as an estimate of bribe costs is omitted as are an estimate of cash flow benefits of tax deductors. Comparing these costs to estimates in other studies, these are typical by international standards if compliance costs are near the lower limit of the range of estimates but a cause for concern if the upper limit reflects the true position. On the other hand tax deductibility of legal expenses and cash flow benefits arising from the timing difference between taxable income and payment of tax result in net compliance costs to companies of between *minus* 0.7 and plus 0.6 percent of corporation tax revenue, though these rise to around 2 percent when opportunity costs are included.

Tardy refunds, the budget process and the frequency of administrative notifications result in tax instability. This and tax ambiguity and complexity are major contributors to compliance costs. Besides these, over 20 specific high compliance cost areas, covering both legal provisions and administrative procedures, have been identified in the study.

Both gross and net compliance costs are regressive.

Other important findings about compliance costs are as follows:

- Sixty-two percent of companies confirm benefits from compliance requirements as income statements and balance sheets are better prepared, while over 50 percent of companies find audit requirements useful in detecting dishonest employees.
- Twelve sample companies reported payment of excess taxes since tax evasion penalty are not leviable under Indian law if taxes assessed have already been paid. That is, many companies, avoid risk by overpaying taxes, preferring to lose interest on the overpaid taxes.
- Additional information asked during scrutiny assessment, followed by accounting requirements are the major activities contributing to compliance costs.
- The small share of expenses on employees (24.7 percent) does not accord with international experience, but is plausible in a low wage economy like India's.
- Seventy percent of companies use outside tax advisors to prepare returns, with small companies being somewhat more dependent on external assistance.
- External costs account for around 39 percent of the total legal costs of sample companies.
- Compulsory external financial audit is the main source of fees of external professionals from companies. Other important sources are litigation and providing assistance to company employees.
- Crude estimates of voluntary costs suggest that they lie between 19 and 43 percent of total compliance cost with greater weight being given to the lower end of the range.

- The average sample company had 10 to 11 assessment years locked in disputes for tax or penalty. Adding the time taken for scrutiny assessments, the number of open assessment years of a typical company is 12 to 14. Statistical analysis suggests that a one year increase in the number of disputed assessment years raises legal compliance costs by 5.7 percent .
- The average times taken to close an assessment varies from 2 years if no tax dispute arises to over 20 years if a dispute goes to the Supreme Court.
- Although there is wide variation in the use of concessions to reduce tax liability, tax savings achieved by the sample companies average over 200 percent of taxes paid.
- Incorrect application of tax laws by tax officials burden taxpayers who have their tax assessments revisited. From CAG audit data, the most serious problem is with valuation of closing stocks of companies followed by underassessment of tax. Both of these are areas where assessing officers have high discretion.
- Nearly a third of companies expressing an opinion felt that they had been harassed by income tax officials.
- Porous tax laws or lax enforcement, permitting illegal competition via tax evasion, have a strong statistical association with underreporting.
- Over 50 percent of Indian companies are estimated to pay bribes to income tax officials. Though bribes do not appear to add significantly to compliance costs, bribes are likely to be a major income source for corrupt officials.
- The usual bribe to obtain a speedy refund is reported to be around 10 percent of the refund due.
- Additional psychic costs are associated with bribes due to their uncertain quantum and, in case of services expected in return, the 25 percent chance that "contracted" services will not be delivered.
- Bribes may be a cause of tax evasion, since companies cannot report bribe payments in their accounts. There is a strong statistical association between corruption and tax evasion.

The study attempts to assess the costs of tax uncertainty, complexity and ambiguity, and also fiscal attitudes while recognizing that opinions are those of company officials responding to the survey and not necessarily company owners.

- Average psychic costs are about 50 percent of objective legal compliance costs of sample respondents and, while variable, are less so than legal compliance costs.
- Among component costs, ambiguity of tax laws has the highest psychic cost as also the lowest variability. Costs of tax complexity and instability are both around 4 to 5 percent of taxes paid.
- Psychic costs are regressive.
- There is a fairly uniform belief that government expenditure benefits to companies are around 20 percent of taxes paid. Even so, respondents feel that the corporation tax should only be somewhat reduced rather than greatly reduced.
- Seventy-eight percent of respondents are satisfied with or neutral towards the Income Tax Department.
- In an earlier survey, only 10 percent of respondents felt that income tax administration was a major obstacle to doing business, though high taxes are perceived by 35 percent as a major obstacle. Under 5 percent of reported facing major difficulties with income tax authorities.

Methodological problems with estimates of compliance cost in this study include qualitative rather than quantitative questions about in-house cost components; assumed rather than the actual opportunity cost of funds to value cash flow benefits; no application of shadow values to estimate social compliance costs; and, as in earlier studies; possible bias due to incorrect apportionment of fixed costs and the value of time of company management.

Issues not addressed in the survey include the duration of delay in receiving refunds; the division of organizational responsibilities for tax related work in companies; actual advance tax instalments paid; and the value of festival gifts given to income tax officials.

Problems with the representativeness of the sample include a stratified random design that degenerated into a convenience sample; a single public sector company responding to the survey (presented as a case study); over-representation of large firms; and loss making and zero profit companies being underrepresented.

Reform suggestions include:

- Tackling the problem of delayed refunds by streamlining refund procedures and associated administrative corruption.
- Improving taxpayer services for business.
- Reducing discretionary powers of income tax officials, increasing individual accountability and reducing occasions for direct contact with taxpayers.
- Improving tax enforcement.
- Regular after the fact reviews of a sample of appeal cases to guard against alleged corruption by appellate officials.
- Reducing the costs of the policy environment by reforming the budget process and the process of issue of administrative notifications.
- Improved the drafting of the Income Tax Act.
- Strengthening advance rulings and extending their scope.
- Scrapping selected concessions, especially where they are not matched by commensurate social benefits.
- Harmonising central and state tax provisions.
- Reform of 22 legal and procedural "hot spots" which add to compliance costs, identified in the study. Detailed examination by the Income Tax Department of these high compliance cost areas and simplification where possible is suggested.

1. Introduction

1.1 Objective and scope

The objective of this study is to measure the cost of compliance with the income tax of Indian corporations and ascertain how these costs compare internationally. Sources of compliance costs and their break-up in terms of different compliance activities are also studied. Within sources, both legal and illegal compliance costs are studied. The determinants of compliance costs in terms of firm characteristics and the importance of mandatory obligations as against voluntary tax planning activity is also studied. An attempt is also made to quantify "psychic" costs of compliance arising from policy uncertainty and tax law complexity and ambiguity.

In the next two sections of this chapter compliance costs are defined and international evidence on compliance costs is reviewed. The information base for compliance cost estimates and the methodology employed to estimate compliance costs are discussed in Chapter 2. Estimates of the tax compliance cost of companies in India, for the study sample and for all Indian companies are in Chapter 3. The chapter also contains an evaluation of the representativeness and adequacy of the study sample. The association of compliance costs with characteristics of surveyed firms and components of compliance costs are then examined, in Chapter 4. Chapter 5 reports on opinions of surveyed respondents regarding high compliance cost or "hot spot" tax code provisions and administrative procedures. Chapter 6 reports on additional scrutiny of compliance costs associated with government inefficiency and corruption, while psychic costs associated with the policy environment are examined in Chapter 7. Three case studies, including of a large and established, Indian owned, manufacturing company and of a large public sector company are presented in Chapter 8. In Chapter 9, conclusions of the study are summarised and reform suggestions are made.

1.2 Defining and measuring the compliance cost of companies

Overall costs of a tax system include “welfare costs, opportunity costs, psychic costs, social costs and so on.”[1] To assess the total impact of taxes on society, “the total sacrifice imposed upon the populace – total collection costs, administrative and compliance costs, should be looked into”[2]. Slemrod and Yitzhaki (1996) identify compliance costs as one of the **five component costs of taxation**. The others are administrative costs, deadweight efficiency loss from taxation, the excess burden of tax evasion and avoidance costs. This set of costs can, in principle, be identified by considering situations with and without taxation. Taxes themselves are merely a transfer of purchasing power from the non-government sector to the government sector. Costs that arise in effecting this transfer are what the Slemrod-Yitzhaki analysis points to. Compliance **costs of taxpayers** are not the only costs. All agents involved in facilitating this transfer of funds from the private sector to the government exchequer incur costs. For example, **third party costs** include costs of employers responsible for tax deduction at source. Financial institutions collecting taxes also incur compliance costs.

In defining compliance costs of taxation, **in this study**, *all* costs due to the tax system borne by taxpayers and third parties other than cost arising from economic distortions and equity violations are included. In other words both genuine compliance costs and avoidance costs are included here as they are hard to distinguish in practice. Though costs of non-compliance, including costs associated with tax evasion, are also included in the definition adopted, in this study no specific information is available on costs due to tax evasion.[3]

[1] See Evans and Walpole (1997).
[2] See Mikesell (1986).
[3] However, some information is available on costs incurred to forestall accusations of tax evasion. See Chapters 4 and 8.

For businesses, **sources** of tax compliance costs in most earlier studies[4] have been subdivided into **in-house personnel costs, other in-house costs** and **external costs** associated with retaining the services of tax, accounting and legal professionals. In-house costs may be incurred both by tax departments as well as by other departments.[5] External costs also include bribes and gifts to government officials, though, in this study, these are separately considered. "Third party costs", such as tax collection cost of banks and costs of others required to provide information to tax authorities are also included. Though this is not as serious a problem for companies as it is for individuals and other taxable entities, costs of non-filing for companies choosing not to file returns are also, in principle, included.

In measuring these costs, there is possibly no alternative to taxpayer surveys. **Respondent bias** and **non-response bias** has been warned against by Wallschutzky & Gibson (1993), depending on the prevailing situation during the survey period. Pre-budget and post-budget timing, economic recessions and difficulties with tax authorities may affect both willingness to respond to surveys and estimates provided.

There are also **psychic costs** including mental stress suffered by the internal staff or tax advisors.[6] Possibly more important are costs imposed on society by business uncertainty due to frequent changes in tax provisions and tax administration procedures. These costs are only partly reflected in measurable compliance costs. Costs of a complex tax code and a related but distinct aspect, ambiguity in tax provisions or discretionary elements in both the tax code and administration powers, are likely to be more completely reflected in measurable costs.[7]

As will be clear, costs as defined for this study include **mandatory** elements and **voluntary** and **quasi-voluntary costs**. Voluntary costs are mainly associated with tax planning or avoidance to reduce tax liabilities. The distinction between voluntary and mandatory costs has been taken note of in several studies.[8]

The major **activities generating compliance costs** of companies include maintaining books of account, complying with tax return filing obligations, obtaining taxpayer identification numbers, clearances and permissions where required by law, tax avoidance or tax planning to reduce tax liability, tax audits (or scrutinies as they are called in India), appeals, court references and tax prosecutions. Also included are costs of discharging statutory tax withholding obligations (tax deduction at source or TDS in Indian parlance). A problem faced by many earlier studies is that the extent to which some activities, such as accounting, are undertaken for tax compliance as opposed to other reasons is hard to ascertain. Of these, a major difficulty is in apportionment of capital costs. Time costs of owners, directors and proprietors have also been found to be difficult to estimate in earlier studies. Compliance costs of the income tax may also be difficult to separate from costs for other taxes.[9,10] As a result, internal costs estimates are subject to a margin of error.[11]

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4 See section 1.3 below and Annex 1.1.

5 That costs outside tax departments can be significant has been documented by Gunz, McNaughton and Wensley (1995) and Porter (1999). The former focuses specifically on costs of tax incentives for R and D which they find to be largely borne by research staff.

6 These are sometimes referred to as non-economic costs though the reason for this is unclear. For a discussion see, for example, Pope and Fayle (1991).

7 More discussion is in one of two companion reports, Chattopadhyay and Das-Gupta (2002). Estimates of these costs for companies are in Chapter 7.

8 Further discussion is in Chattopadhyay and Das-Gupta (2002).

9 Good discussions are in Sandford, Hardwick and Godwin (1989), and Pope and Fayle (1991).

10 As discussed in Chapter 8, it is likely that estimates in this study are largely for the corporate income tax and not for all taxes paid by corporations.

11 For example, compliance cost estimates for corporations in the USA in Slemrod and Venkatesh (2002) are almost 10 times as high as those in Slemrod and Blumenthal (1996). However, part of the reason is a difference in samples.

In terms of **objects of expenditure**, wages, salaries and allowances, stationery and supplies, rents and other overheads, computer hardware and software costs and travel are some of the major items. Costs of acquiring tax knowledge, training costs, and membership fess paid to representative bodies and lobbying for taxation matters are other cost items.

A distinction must be made between **gross compliance costs** and **net compliance costs**. The discussion above pertains to the former. Net compliance costs are the difference between gross compliance costs and the value of **benefits from compliance activities**. The **tax deductibility of compliance cost expenditure** is also taken into account in computing net costs.[12] The major benefit is from the augmented cash flow arising from tax becoming liable and remittance of tax. This is true both for TDS agents and also for the corporation tax itself. Estimates of these cash flow benefits are sensitive to the opportunity cost of funds assumed, as also to assumptions made about the timing of cash accruals and disbursements.[13] Benefits also arise from better record keeping and improved management control, though these are difficult to quantify.

Since most monetary compliance costs are deductible, **private costs** are typically less than the **social costs**. To arrive at social or real resource costs, tax deductions for compliance expenditure must be added back to gross private costs and bribes, which are inter-agent transfers, must be netted out.

1.3 Conclusions from earlier compliance cost studies of companies

In all, around 50 studies of compliance costs of companies in around 20 different countries have been conducted since the 1960s. Studies on which information could be gathered are reported on in Annex 1.1. The studies vary widely in their scope, coverage and methodology adopted. Compared to these studies, the scope of the current study is broader in that illegal compliance costs and psychic compliance costs are included, however imperfectly. Indian studies include Export Import Bank of India (1998) on the compliance cost of Indian exporters with export and customs procedures and Sridharan (1999) on business compliance costs in India with Central customs and excise duties. However, their estimates, to the extent that they deal with similar costs, differ widely. Furthermore, they do not cover the income tax, which is the focus of this study. A brief review of important qualitative findings and numerical compliance cost estimates of earlier studies is now presented.

Table 1.1 Regressivity of Compliance Costs in Three Countries
(compliance costs as a % of turnover)

Turnover category	United Kingdom (1986-87)	Australia (1986-87)	Malaysia (1994)
Low	0.77 – 0.07	1.72	0.596
Medium	0.03	1.71	0.452
High	0.01	0.242 – 0.035	0.321

Notes: (a) £0-0.999 mn; £1-9.999 mn; £10 mn and over.
(b) A$ 0 – 5 mn; A$ 5 – 20mn; over A $20mn.
(c) £ 1 = A$ 2.34 in 1987.
Sources: UK and Australia: Pope and Fayle (1991). Malaysia: Ariff et. al. (1995).

The major conclusions from earlier studies are (a) that compliance costs incurred by corporations are **large relative to tax administration costs**[14] and (b) that compliance costs are **regressive** regardless of the measure of size adopted (Table 1.1).[15,16] In fact net compliance costs of large

12 See Binh, et. al. (2000).
13 A discussion of this issue is in Pope and Fayle (1991).
14 Though there are some exceptions: See Annex 1.1.
15 Common size measures include employee strength, value of assets – total or fixed, turnover or sales, and different measures of profits.
16 Costs as a percentage of tax revenue should be treated with caution as tax revenue may change with tax reform without

corporations have been found to be negative for corporations in Australia.[17] Slemrod and Blumenthal (1996) find from statistical analysis of large US corporations for the year 1992 that "a 10 percent increase in size is associated with an increase in compliance costs of between 4.1 percent and 6.1percent", depending on the measure of size used.

Though it is widely believed that **simplification** could improve compliance by lowering compliance costs, evidence available does not provide unambiguous evidence of this in all cases, though as pointed out below, there is evidence of this in specific situations. For example, Slemrod and Blumenthal (1996) found that compliance costs increased after the major "tax simplifications" introduced by the Tax Reform Act in the USA. Bardsley (1997) argues that risk averse taxpayers could try to avoid uncertainty created by an incomplete, "simplified", tax code and hence could incur greater compliance costs. He suggests that, at the aggregate level, a reduction in uncertainty which reduces compliance costs can have an expansionary impact on output and employment. However, in the USA, the Annual Minimum Tax (AMT) was associated with compliance costs that were higher by 11.5 percent for those subject to AMT but costs that were as much as 136 percent higher for companies *not* subject to AMT (Slemrod and Venkatesh, 2002). Mills (1996) suggests that because of complexity, compliance costs may fall because non-filing may rise, there may be increased non-reporting of certain categories of incomes and third, certain deductions and business activities may be foregone.[18] Consequently, **tax simplification and reducing compliance costs should be treated as possibly distinct and in certain cases, even conflicting objectives**. Furthermore, Blumenthal and Slemrod (1996) point to a trade off between simplicity and other objectives such as fairness and growth facilitation.[19]

Compliance costs also vary by activity, by sector, by region and by country. For example, Blumenthal and Slemrod (1996) estimated that compliance with foreign source income reporting and taxes contributed 40 percent of the total compliance cost of large US corporations in 1992, disproportionately higher than the aggregate share of foreign operations by all size measures. Foreign tax credit computations and information reporting on controlled foreign corporations were found to be the two most burdensome requirements of the US corporation tax. Regression analysis by Slemrod and Venkatesh (2002) led them to infer that US companies with international operations had compliance costs 143 percent higher than other US companies. Similarly, being publicly held caused compliance cost of companies to increase by 26 percent. Erard (1995) finds that costs of large Canadian corporations tend to have a positive association with foreign operations, activity in the mining and oil and gas sectors. Erard (1997a) provides evidence that small and medium Canadian firms possibly have higher costs in the province of Quebec.

Table 1.2 Computational Costs and Planning Costs of Australian Businesses, 1986-87
(percentage of turnover)

Turnover range (A$ million)	Computational costs	Planning costs
Less than 5	0.43	2.16
5 – 20	0.20	2.74
20 – 50	0.078	0.211
50 – 100	0.086	0.228
Greater than 100	0.023	0.013

Notes: Details of statistical problems are in the source paper.
Source: Pope and Fayle (1991).

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there being any change in the compliance requirements (Sandford and Hasseldine, 1996).

17 See Binh et. al. (2000) and Walpole et. al. (1999).

18 Further evidence of this is in Slemrod and Venkatesh (2002).

19 Further discussion of simplification and tax complexity and additional references are in Chattopadhyay and Das-Gupta (2002).

In terms of sources, internal costs account for the bulk of costs. Of these, personnel costs predominate. For example, Slemrod and Blumenthal (1996) find for large US corporations, that of the 85 percent of internal costs, 55 percent are personnel costs the other and 30 percent being non-personnel costs. Furthermore, of internal costs, 70 percent is attributable to the tax department and 30 percent to other departments. External costs were found by Slemrod and Venkatesh (2002) to be more regressive for companies in the USA than total costs, with a (partial) elasticity of 0.25-0.28 with respect to total assets.

Regarding PAYE (Pay-as-you-earn or TDS), Pope, Fayle and Chen (1993) state that “In terms of operating costs [after adding an estimate of administrative costs to compliance costs], the Australian and UK estimates of employer’s PAYE are remarkably similar, at around 2.6 percent of tax revenue.” Furthermore, for Australian businesses, cash flow benefits for the employer’s PAYE were estimated at 1.9 percent of tax revenue.

In terms of their impact on revenues, there is some support for a negative association between voluntary or tax planning costs and tax revenue (Mills, 1996). This is not necessarily the case, however, for mandatory costs.

International evidence of company compliance costs is presented in Table 1.3. Further details and a more exhaustive listing of studies are, as mentioned, in Annex 1.1. Estimates of compliance costs are not strictly comparable due to very different tax systems and serious differences in methods adopted.[20] Nevertheless, as a percentage of tax revenue, compliance cost estimates for the corporation income tax range between 0.36 percent and 28 percent in Table 1.3.

1.4. International evidence on the compliance cost of companies

Table 1.3 Recent Evidence of Tax Compliance Costs of Corporations
(percentages of tax revenue of relevant tax)

Country	Year	Corporation tax/ Income tax	Pay as you earn (PAYE)	Other Business taxes	Total Compliance costs	Admin-istrative Costs
Australia[1]	1994-95	6.8 17.1 (S)	1.3 2.5 (S)	8.0 11.9 (S)		
Canada[2]	(a) 1996 (b) c. 1994	4.6-4.9				
Fed. Rep. of Germany[3]	1984-85				9.5	2.35
Hong Kong[4]	1987	1.5				
Israel[5]	1987	2.2	See note			0.007
Malaysia[6]	1994	0.36				
Netherlands[7]	c. 1994	4.0	See note			
New Zealand[8]	1989-90		1.3	6.3	3.9	0.8
Norway[9]	1987	8.8				7.0
Sweden[10]	1993	(1.7[7])	0.34	2.6		0.65
UK[11]	1996	2.2	1.9	3.7		
USA[12]	2000	26.9-28.0				
USA[13]	1992	3.2				
RANGE	**---**	**0.36-28.0**	**0.34-1.9**	**2.6-8.0**	**---**	**---**

Notes and sources:

1. Evans et. al. (1997) reported in Binh (2000). Estimates for business taxpayers: "Corporation tax " actually income tax on

[20] Further discussion is in Chattopadhyay and Das-Gupta (2002) and references cited there.

businesses. S: Social compliance costs (deductible taxes and cash flow benefits added to private compliance costs). Private compliance costs are negative for large businesses.
2. (a) Plamondon and Zussman (1996). Includes sales tax, CIT, payroll taxes, excise taxes for small and medium business. (b) Erard (1997). Only for top 500 non-financial firms. Opinion survey of compliance costs of small and medium business is reported in Erard (1997a).
3. Tauber (1983) and Tiebel (1984).
4. Harris (1989).
5. Freidkes and Gavish (1989). PAYE costs are 5 NIS per month per pay slip.
6. Ariff et. al. (1995).
7. Allers (1995). Imhof and Snijder (1981) (cited in Imhof ,1989) provide 1980 cash estimates of per form costs.
8. Sandford and Hasseldine (1992) .
9. Nicolaissen (1989).
10. Malmer (1994) and Malmer (1995). "Corporation tax" is actually income tax, including for individuals.
11. Hudson and Godwin (2000), Collard and Godwin (1999). Cash flow benefits exceeded compliance costs for firms with over 1000 employees. Corporation tax compliance costs (net of cash flow benefits) and VAT from Sandford, Godwin and Hardwick (1989) for 1986-87.13.
12. USA: Slemrod and Venkatesh (2002). Small and medium businesses. The sample contains several "pass through entities" which do not pay any tax. Without these, costs would be "significantly lower".
Blumenthal and Slemrod (1992). Large businesses.

2. Estimation of Compliance Costs: Methodology

2.1 The information base on company compliance costs

To gather information on compliance costs, the study employed a mailed survey supplemented by case studies. To this was added information on sources of costs from pre-survey focus group meetings. Secondary data sources were also used, as described below.

2.1.1 Questionnaire design

Specific design issues were discussed with experienced researchers in the field during the study design phase.[21] Since there is a strong suspicion that illegal compliance costs are important in India, coverage of these costs was felt to be important and included in the questionnaire. In order to elicit frank responses to these questions, the questionnaire was anonymous and not serially numbered or otherwise identified, despite this making follow-up contact with non-respondents impossible.

Total compliance costs of a company can be divided into external costs or fees paid to tax advisors and internal or in-house costs. Illegal external costs include bribes paid to tax department staff. In the questionnaire used for this study, activities by companies to comply with the corporate income tax are divided into several categories.[22] Major activities are keeping records, filing tax returns, scrutiny, appeals and litigation, obtaining clearances, and tax research and tax planning. Of these categories, though respondents are asked for cash estimates of fees paid to tax advisors for each activity, for in-house costs, only an opinion scale, ranging from "very important" to "unimportant" is used, following feed-back in pre-survey focus group meetings. As a result, the study sacrifices a clear identification of the relative contribution of mandatory and voluntary in-house costs. In-house costs are however, classified by expenditure objects such as wages and salaries, computers and data processing, and travel and conveyance. In the absence of explicit accounting of compliance costs under a separate head of account, the study, like most other studies of compliance costs, relies on respondent's estimates of compliance costs.[23]

The questionnaire also asks respondents to identify high compliance cost tax provisions and administrative procedures via opinion scales as well as via their estimates of the proportion of compliance costs contributed by these activities.

Total legal compliance costs are computed as the sum of advisor costs and in-house costs.

Other sources of compliance costs covered in the questionnaire are bribe costs and psychic costs. Bribe costs are covered via a "Yes/No/No Comment" question as well as a question seeking numerical bribe estimates. However, these questions asked about the behaviour of "similar companies" rather than the company's own activity, to further encourage frank responses. Bribe costs, when added to legal costs, give an estimate of total or gross compliance costs. Psychic costs are assessed by questions designed to elicit respondents' "willingness to pay", which are discussed further in a later chapter. However, psychic cost estimates are not added to the main compliance cost estimates as this may result in partial double counting.

To enable measurement of compliance costs in comparison with indicators of size, companies were asked about their tax payment, their profit before taxes, book value of assets, sales or turnover, and employee strength.

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21 See Annex 3.1 for a summary.

22 The questionnaire as well as the covering letter sent with it are in Annex 3.2.

23 As discussed in the previous chapter, the apportionment of fixed and time costs leads to possible bias in attribution of certain cost categories to costs specifically incurred for tax compliance. This is true, for example, for wages and salaries and stationery expenses but not for, for example, purchase of tax publications. However, the case study in Chapter 9 suggests that cost of the corporation tax can be separated from TDS costs or compliance costs of other, indirect, taxes due to separation of organizational responsibilities.

Questions on fiscal attitudes, included evasion behaviour, perceptions about the effectiveness of income tax enforcement, respondents' opinions about the Income Tax Department and the adequacy of government services, as these were hypothesised to be important determinants of actual or perceived compliance costs.

One feature of the questionnaire is the possibility of cross-checks, especially useful in the case of incomplete responses. For example, advisor costs are categorised by the type of advisory services (legal, accounting) and, separately, by the activity for which services are used.

2.1.2 Other information sources

Focus group meetings with industry associations and chambers of commerce during the questionnaire design phase of the study threw up valuable qualitative information on sources of compliance costs as also several suggestions to improve the questionnaire.

Valuable additional data on illegal payments and bribes by companies and their impact for the year 1999-2000 are in a World Bank-Confederation of Indian Industry (CII) data set.[24] This was used for additional analysis of illegal compliance costs.

Among secondary sources, information from various reports of the Comptroller and Auditor General (CAG),[25] were used to (a) estimate the cost of delayed refunds, (b) examine the extent and nature of assessment errors by the Income Tax Department, and (c) arrive at an estimate of the size of the universe for this study (consisting of companies in the year 2000-01).

The commercially available PROWESS data base on Indian companies compiled by Centre for Monitoring the Indian Economy (CMIE)[26] was used in arriving at estimates of aggregate compliance costs of companies in India.

2.2 Compliance cost estimation

2.2.1 Basic compliance cost estimates

Equations defining basic compliance cost estimates reported in the next chapter are now presented.

Gross compliance costs = Internal (personnel + other) costs + payments to advisors + bribe costs
= Legal compliance costs + bribe costs.

The major compliance cost components are taken directly from answers to questionnaires. This pertains to internal personnel and non-personnel costs as well as to external costs. Regarding internal costs, compliance expenditure classified by objects is also directly available. Estimates for attribution of costs to different tax provisions and administrative procedures are also directly available from questionnaire responses.

2.2.2 The cost of delayed refunds

A deficiency in the questionnaire employed that only came to light after the fact is the neglect of the cost of delayed tax refunds. Due to possible risk avoidance behaviour of companies, many over pay taxes and claim refunds.[27] The opportunity cost of delayed refunds should be added to gross compliance costs as defined above to arrive at the true gross compliance costs of companies. Only

[24] The data was compiled by the CII for the World Bank for a chapter entitled "Governance: The Business of Government" in World Bank (2000) for which one of the authors of the current study, Das-Gupta, had the major responsibility. He thanks Dr Stephen Howes of the World Bank for permission to use the data set.

[25] See Comptroller and Auditor General (2002) and Comptroller and Auditor General (2002a).

[26] See Centre for Monitoring the Indian Economy (2002).

[27] Further information on this as well as estimates are available in the private sector case study in Chapter 8. In the survey, 27% of companies reported overpayment of taxes, though cash figures are possibly unreliable, since reported figures often coincide with refunds due.

aggregate information on these costs are available from CAG (2002) and not for individual respondents. Consequently, compliance costs at the individual company level are underestimated. As part of aggregate estimates, an additional magnitudes reported is:

Adjusted legal compliance costs = Legal compliance costs + the opportunity cost of delayed refunds.

Due to lack of information the preferred compliance cost concept which could not be estimated is:

"True" gross compliance costs = Adjusted legal compliance costs + bribe costs.

The opportunity cost of delayed refunds is the difference between the opportunity cost of funds of companies, at the appropriate interest rate (discussed below) and the interest on delayed refunds (8 percent simple interest in 2000-01) paid by the Income Tax Department per rupee of delayed refunds.

2.2.3 Mandatory and voluntary costs

Voluntary costs are taken to be costs associated with tax planning and research, appeals filed by the company (though not appeals filed against the company) and assistance with tax matters to employees. In an alternative estimate, unallocated or "other" costs are added to this. Since costs of tax planning are included, quasi-mandatory costs associated with actually being able to claim tax concessions are omitted. Apportionment of other cost items was not attempted as being too uncertain. For external costs, the classification into voluntary costs and mandatory costs is directly available from questionnaires for the items given above. However, only qualitative information is available for internal costs according to these categories, as discussed earlier. Consequently, a rough estimate which apportions internal costs in line with their importance and that of external costs is attempted. This is discussed further in the relevant section below.

2.2.4 Cash flow benefits

Companies derive monetary benefits from interest savings or earnings due to, first, the timing of advance tax instalments and, second, the time interval between withholding of taxes for employees or non-employees and deposit of withheld taxes in the government treasury. For tax instalments, it is assumed that instalments correspond to the legally laid down percentages and that they are remitted on the due dates. This is discussed further below. For the opportunity cost interest rate, it should be noted that most Indian companies are highly leveraged. For example, the average debt equity ratio in 2000-01 of the 5599 companies for whom this information is available in the CMIE's PROWESS data base was 3.23. For a leveraged company, an augmented cash flow will result in a reduced need to borrow resulting in interest cost saving at the marginal borrowing rate of the company. So cash flow benefits are valued at an assumed annual, short term, marginal borrowing interest rate of 15 percent per year, compounded weekly, based on discussion with bank officials and the private sector case study company in Chapter 8.

For TDS, there is a gap of 6 days for most companies between monthly payment of salary and wages to employees and depositing withheld taxes with the government. For non-employees, an average gap of 15 days has been suggested by the case study company in Chapter 8. So companies are assumed to derive cash-flow benefits equal to 6 or 15 days of interest saving per month on the monthly amount of tax deducted at source. More precisely, the following formula is used to estimate cash flow benefits from TDS by companies:

$$\text{Cash flow benefit from TDS} = [\text{TDS for employees}][\tfrac{6}{365}]0.15 + [\text{TDS for non-employees}][\tfrac{15}{365}]0.15.$$

For advance corporation tax, it is assumed that the benefit accruing to companies is the interest saving it achieves compared to if it were required to pay corporation tax on a weekly basis. 4 quarterly advance tax instalments are payable on the 15th in the months June, September, December and March of the financial year. The financial year is from April 1 to March 31. The respective instalments are 15, 30, 30 and 25 percent of the estimated taxes due for the year, excluding any taxes withheld by others on behalf of the company. The timing of these payments makes it clear that taxes due are less than would be the case if taxes were payable weekly, except during the last two weeks of December and March. The formula used to estimate cash flow benefits from the timing of corporation tax payments (Y) is:

$$Y = X\left[\frac{(1+(\frac{0.15}{52}))^{52}-1}{(\frac{0.15}{52})52}\right] - X[0.15(1+(\frac{0.15}{52})^{41}) + 0.3(1+(\frac{0.15}{52})^{28}) + 0.3(1+(\frac{0.15}{52})^{15}) + 0.25(1+(\frac{0.15}{52})^{2})]$$

or $Y = 0.01853X$

In the equation above, X is the total corporation income tax due from the company for the year *net* of tax deducted at source by other entities. Due to the assumed rather than actual opportunity cost of funds and the assumed rather than actual advance tax payments, this formula only provides an approximation to cash flow benefits.

2.2.5 Net compliance costs and social compliance costs[28]

From legal compliance costs estimated directly from information provided by companies, actual or net compliance costs borne by companies can be worked out by taking into account the tax deductibility of legal compliance cost expenditures and cash flow benefits. Tax deductibility is assumed to reduce costs at the surcharge inclusive corporation tax rate of 38.5 percent in 2000-01.[29] Therefore:

Net compliance costs = Legal compliance costs [1-corporation tax rate] + Bribe costs + Opportunity cost of delayed refunds – Cash flow benefits

As with legal compliance costs, net compliance costs and "adjusted" net compliance cost estimates are presented below. On the other hand, for social compliance costs, the correct measure should value the real resources expended on tax compliance regardless of who bears the costs at their social opportunity cost. Bribes, being merely a transfer between different entities should therefore be netted out. Second, however, delayed refunds are available to the government during the period of delay. The appropriate resource cost valuation is, therefore, the difference between the government's short term rate of return on borrowed funds, since the fiscal and revenue deficits of the government in 2000-01 were positive, and the private rate of return. The government's marginal cost of borrowing averaged 9.76 percent per annum in 26 auctions of 364 day treasury bills (Reserve Band of India, 2001). Consequently, the resource value of delayed refunds is assumed to be the difference between the assumed 15 percent rate of interest for the private sector and 9.76 percent on an annualized, compound, basis. Third, resources should be valued at their shadow values.

Shadow values will differ from market prices in labour surplus economies like India's, with additional differences arising from administered prices, protective tariffs, cascading central excise and state sales taxes and various other policy induced distortions. To do the shadow valuation exercise, it is necessary to separate out wage and salary costs for both internal costs and the labour component of external costs. Furthermore, non-labour costs, internal and external, should be divided into the cost of traded goods, and non-traded goods and services. Since labour needed for tax compliance work is largely scarce skilled labour, the shadow wage rate is likely to exceed the market wage. However, non-labour costs are likely to be overestimated relative to resource costs for both traded goods (at border prices) and non-traded goods and services. Since the necessary disaggregation into traded and non-traded

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28 Some of the concepts in this section are discussed in Binh et. al. (2000), which has influenced the definitions adopted here though the two sets of definitions are not identical.

29 For companies whose marginal tax rate is determined by the Minimum Alternate Tax (MAT), the surcharge inclusive marginal tax rate is 33%. This is taken into account. Foreign companies are taxed at a higher rate, though there were no foreign companies in the sample.

goods and the break-up of external costs is not available, and nor are recent estimates of shadow prices except for traded goods, shadow valuation is perforce ignored.

Given this limitation, the figure reported is:

"Social" compliance costs = Legal compliance costs + Resource cost of delayed refunds

2.3 Problems with fixed cost apportionment and other taxes

Since the study aims to estimate the compliance costs of companies only for the income tax (corporation tax and TDS), bias will result if information furnished by companies is not attributable only to the income tax. As discussed in the previous chapter, important sources of possible bias are apportionment of fixed costs and the value of time of company management. However, the private sector company case study in Chapter 8 and further anecdotal evidence suggests that bias due to inclusion of taxes other than the corporation tax may be limited due to organisational separation of responsibilities for the corporation tax and other taxes in major companies.[30]

[30] For a related finding see Blumenthal and Slemrod (1995).

3. Tax Compliance Cost of Companies in India: Sample and Aggregate Estimates

3.1 Response rate

For the mailed survey, a list of 3500 company addresses from all over the country was obtained from a large government data base of corporation tax assessees, though 5000 were requested. These addresses were generated according to a locationally stratified random design specified by the study team. No other stratification criteria could be employed to further refine the questionnaire, given the structure of the data base. Of this sample, 1000 addresses were fatally incomplete while in another 206 cases, questionnaires were returned by the post office because the address or addressee was unknown. Apart from mailed questionnaires, 11 trade associations and chambers of commerce were contacted and 1200 questionnaires handed over to their office bearers to distribute to members with covering letters from the associations themselves. Despite two rounds of reminder letters and e-mails (from mailing lists supplied by associations) and, on request, resending questionnaires electronically, the response rate remained low. Consequently, a further 200 questionnaires were distributed after personal contact with companies in Mumbai. This generated the bulk of responses (28 out of 45 usable responses). As a result, the sample design, though conceived as a stratified random sample, degenerated into a "convenience" sample, though convenience, in this case is clearly a misnomer.

The eventual net response rate, excluding unusable responses, was an unsatisfactory 1.15 percent. Further information is in Annex 3.1. The questionnaire and the covering letter sent with it are in Annex 3.2.

3.2 Sample characteristics

Distribution by gross income: sample versus population

The available sample consists of 44 private sector companies and one public sector company. Given the single public sector company, it is not included in the statistical sample. Instead, it is presented as a case study in Chapter 8. Information on the distribution of 3,34,261 (public and private sector) company assessees in terms of *returned income or loss* is available in CAG (2002) for the year 2000-01, the year to which sample data pertain, for four income groups, which combine both profitable and loss making companies. While noting the absence of public sector firms in the sample, the comparison between CAG and sample income figures in Table 3.1 provides the some indication of the representativeness of the sample.

Table 3.1: Distribution of Companies: Population versus Study Sample

Income/loss range in 2000-01 (Rs ' 000)	CAG distribution of companies in 2000-01 (%)	Sample distribution of Companies (%)	Sample minus population (%)	Cumulative CAG distribution of companies in 2000-01 (%)	Cumulative Sample distribution of companies (%)	Sample minus population (%)
0-50	59	20	-39	59	20	-39
50-500	17	5	-12	76	25	-51
500-1000	12	5	-7	88	30	-58
>1000	12	70	58	100	100	0
Total	100	100	0	100	100	0

Compared to the CAG distribution, the sample distribution has an over-representation of large firms. This suggests that inferences from the sample for smaller firms will be less reliable than for large firms. Further information on the distribution of firms by other indicators, including turnover, book value of assets and profit or loss is given below.

Measures of sample size relative to population

CAG (2002) reports Department of Company Affairs information on the population of Indian companies, according to which there were 5,69,100 companies in 2000-01. This reduces to 5,66,182 after subtracting 2918 non-profit associations registered under the Companies Act. Since no public sector firm is in this study sample, deducting the 1266 public sector companies from this further reduces the applicable population to 5,64,916. However, not all of these companies have productive, taxable, activity. Of the 5,64,916 companies, CAG (2002), as indicated earlier, reports 3,34,261 company assessees on the tax rolls. If it assumed that all public sector firms are assessees, then the relevant population further reduces to 3,32,995. This implies a study sample of 13 to 14 companies per lakh of population.

However, by other indicators, the size of the sample is somewhat less unsatisfactory. One problem is that even several assessee companies are "paper" companies set up as investment or R&D subsidiaries to provide tax shelters or to circumvent regulatory obstacles. For example, the 6635 companies in the CMIE's PROWESS data base with non-zero, sales, gross fixed assets or wage bills accounted for approximately 84 percent of corporation taxes in 2000-01 (Table 3.2).[31] Compared to the CMIE sample, Table 3.2 shows that a larger proportion of relevant financial aggregates is covered by the sample in contrast to the small number of companies. *Overall, therefore, while the sample size is clearly inadequate for reliable statistical inference, especially for smaller firms according to the reported income criterion, sample statistics appear to be worth reporting if results are treated as preliminary and viewed with caution.*

Table 3.2: Indicators of Sample Size

Indicator	Sample Total (Rs Crore)	Sample as a % of Aggregate	
Book Value of Assets[@]	31,378	5.02*	
Sales/Turnover	26,234	3.37*	
Profit Before Tax	3,774	14.99*	
Corporation Tax Paid		2.64**	7.15*,[#]

***Memo:* Tax Provision of CMIE sample firms**

Public Sector Firms (% of total)	Private Sector Firms (% of total)	CMIE as a % of total corporation tax in 2000-01**
56.1	43.9	84.21

Notes: @: Instead of Book Value of Assets, the closest CMIE variable available is Gross Fixed Assets (GFA). This introduces an element of error in the aggregate comparison, particularly in case of asset revaluation. The definition of GFA suggests this error will not be large.

#: Aggregate CMIE data are on provision for tax rather than tax paid. However, data are not adjusted for tax provision for prior years or adjustments for excess tax provision. This aids sample comparison as the questionnaire sought information on tax paid *during* rather than *for* the year 2000-01 (April 1 to March 31).

* CMIE Sample of 6634 private sector companies. This is arrived at by excluding (a) Public sector firms and (b) All private sector companies with zero Sales, zero Wages and Salaries or zero Gross Fixed Assets from the total CMIE sample of 7026 companies.

**: Accounts figures for (gross) Corporation Income Tax are from the Union Budget (2002).

[31] The published summary of PROWESS, CMIE (2002), reports data on 6333 companies for 2000-01. These companies contributed (a) 74% of gross value added in mining and manufacturing compared to Central Statistical Organization's National Accounts Statistics, 77.8% of the value of output reported in the Annual Survey of Industries, 58.1% of corporate tax collections of Rs 35,696 crore given in the Central Government Budget, and 83.3% of excise duty collections compared to the budget figure of Rs 89,638 crore for the year.

Basic characteristics of sample companies

The table below provides basic information about sample companies in terms of location, size and age (including for the public sector company, to ensure confidentiality). The table also summarises information on key size indicators.

Table 3.3: Basic Company Information

Location

Location	Delhi	Mumbai	Other Metro	Others	Total
Companies	2	32	5	4	43

Year of Establishment

Year	Till 1947	1948 to 1960	1961 to 1970	1971 to 1980	After 1980#
Companies	7	4	3	5	22
Note: # There are 15 companies which were established in 1991 or thereafter.					

Age of Companies (Years)

Average	Minimum	Maximum	Stand Dev	No. of Observations
27.0	1	88	24.5	41

Employee Strength (Numbers)

Full Time Employees	Below 20	21 to 100	101 to 500	501 to 1000	Above 1001
Companies	8	7	7	5	13
Average	Minimum	Maximum	Stand Dev	No. of Observations	
2240.48	2	23539	4504.9	40	
Part time Employees (in equivalent full time employees)	0	1 to 25	26 to 50	51 to 200	201 and above
Companies	21	5	4	3	4
Average	Minimum	Maximum	Stand Dev	No. of Observations	
2004	1	30000	7468.1	37	

Book Value of Assets (Rs lakh)

Book Value	Below 1 Crore	Rs 1 to 20 Crore	Rs 20 to 50 Crore	Rs 50 to 100 Crore	Over Rs 100 Crore
Companies	10	8	7	7	9
Average	Minimum	Maximum	Stand Dev	No. of Observations	
100923	15	1559436	310089		

Turnover (Rs lakh)

Turnover	Below 2 Crore	Rs 2 to 50 Crore	Rs 50 to 100 Crore	Rs 100 to 500 Crore	Over Rs 500 Crore
Companies	6	12	7	8	8
Average	Minimum	Maximum	Stand Dev	No. of Observations	
83416	0.7	1062000	213503	41	

Profit Before Tax or PBT (Rs lakh)

	Average	Minimum	Maximum	Stand Dev	No. of Observations
Profit	19649	0.04	256700	55251	34
Loss	-2387	-7600	-40.7	3460	6

Notable features of companies in Table 3.3 are:

(a) The large number of companies from Mumbai due to the circulation of 200 questionnaires by individual contact to companies in Mumbai.

(b) The dominance, as mentioned, of large companies with 13 having more than 1000 full time employees.

(c) On the other hand, though Rs 1 crore is a small asset base and even Rs 100 crore is not very large, 10 companies had gross fixed assets below a crore of rupees and only 9 had assets over Rs 100 crore.

(d) The distribution by turnover indicates somewhat larger companies by sales than gross fixed assets, suggesting, overall, that sample companies had higher labour intensities than the Indian corporate sector as a whole, though this could not be verified.

(e) Almost half the companies in the sample had manufacturing as their primary business activity (Annex 3.5, Table A3.5.1) followed by banking, insurance and financial services. No hotels and restaurants nor any real estate service companies responded to the survey.

(f) In terms of profitability, loss making and zero profit companies are underrepresented. For example, 41.4 percent of companies in the (adjusted) PROWESS data base are loss making, while a further 1.6 percent are zero profit firms. In terms of provision for tax of zero profit or profitable firms, 13.1 percent of the sample made no tax provision This implies that only 45.5 percent of firms made positive tax provision.[32,33]

Table 3.4: Tax Payments by Sample Companies

	Average	Minimum	Maximum	Stand Dev	No. of Observations
All Taxes Paid (Rs Lakh)					
Tax Paid	15078.6	0.02	250000.0	49423.3	27
As a % of Profit Before Tax (Profitable firms only)*	137.3	2.9	671.9	158.7	23
Corporation Income Tax Paid (Rs lakh)					
Tax Paid	5094.6	0.07	82272.5	15587.9	35
Effective Tax Rate (%) (Profitable firms only)	45.7	1.1	190.0	51.3	30

Notes: Effective tax rate: Taxes as a percent of profit before tax.
*Excludes two outliers: 118182.8 and 3165.17.

Data on tax payments and effective tax rates are in Table 3.4. Given that tax paid during the year is partly for previous years, some tax rates in the table are above the surcharge inclusive corporation tax

32 An income tax data base of companies from Mumbai shows that percentages of companies reporting losses *for tax purposes* for the financial years 1998-99, 1999-2000, and 2000-01, were 64 percent, 60 percent and 65 percent respectively. Losses for tax are different from losses in financial reports due to tax deductions and different rules for tax depreciation, as well as due to the inclusion of other sources of income such as house rent and capital gains. For profitable companies taxable profits are also affected by carried forward losses. Sample sizes for the three years were 9387, 35,475 and 42,793 respectively. Thanks are due to Arbind Modi of the Income Tax Department, for sharing this information.

33 A retired member of the Central Board of Direct Taxes, now a private consultant to several leading corporations, said in private conversation with one author that companies tend to overstate their profits and suppress liabilities and losses to "paint a rosy picture" for shareholders and lenders despite the resulting tax liability. About 50% of public limited companies and not a few private limited companies whose details he has had occasion to examine did this. This is apparently done with the knowledge of their financial auditors, including several well known auditing firms. To the extent that this is correct, compliance costs as a percentage of profits or taxes will be understated in this study due to the resulting reporting bias.

rate for Indian companies of 38.5 percent in 2000-01.[34] The other notable feature in the table is the high variability of tax as a percentage of profit before tax as shown by the standard deviation.[35]

3.3 Compliance cost estimates for surveyed firms

3.3.1 The choice of scale variables

Compliance costs in current rupees convey little information as to their burden. To judge the burden these costs entail it is, therefore, useful to express them in terms of quantities that facilitate inter-company and inter-country comparison. The most common variables used in earlier studies are gross fixed assets, sales/turnover or employment. All three are employed below to facilitate comparison with different studies. In addition, if compliance costs are interpreted as a "hidden tax" as some have called it, the ratio of compliance costs to PBT provides the implicit "effective hidden tax rate" and allows the incidence of compliance cost inclusive corporation taxes to be examined. Consequently, this ratio is also presented. A difficulty with the use of PBT arises in case of loss making companies. Below, loss making company ratios are reported separately. The fifth, vital, standard of comparison is corporation tax paid. This is because compliance costs are a component of the cost of collecting taxes. However, here too a problem arises with negative taxes, tackled in the same way below as for loss making firms. Furthermore, tax payments may have only a poor association with other measures of company size if tax shelters and concessions are exploited to different degrees by companies.

In figures 3.1 to 3.5 variations in (log) compliance costs with (the log of) these five scale variables are graphed. The compliance cost variable is legal or total compliance costs, without bribes.[36] As can be seen, PBT and employment are poor predictors of compliance costs, while the association between these costs and other size variables is better. The association between different scale variables in the sample is presented in graphs and in a correlation matrix in Annex 3.4.

3.3.2 Legal compliance costs

Gross compliance costs excluding bribe costs, or legal compliance costs, are examined in Tables 3.5 and 3.6 for profitable and loss making firms separately. The large coefficients of variation, even after excluding large valued outliers, show that no scale variable is a reliable predictor of these costs. While for some firms, costs are high, even extremely high, by international standards, on average they are reasonable except as a percentage of tax paid and per employee. The former is more an indication of the comparatively porous Indian corporation tax than the burden of compliance costs. Nevertheless, the internationally high ratio to tax does indicate that the corporation tax is an expensive source of government finance. The cost per employee, at around 40 percent of India's per capita GDP in 2000-01, is clearly unacceptable. The small sample size and high coefficients of variation suggests that these conclusions should be taken as tentative and subject to confirmation with a larger sample of companies.[37]

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34 Effective tax rates greater than 100% can arise, since companies were asked to report taxes paid *during* not *for* the year. For companies subject to Minimum Alternate Tax on the book value of assets, the effective surcharge inclusive marginal tax rate, for MAT in excess of corporation tax paid, was 33 percent in 2000-01.

35 In a linear regression of taxes paid on profit before tax or loss, the "marginal corporation income tax rate" turns out to be 27.4 percent for sample companies (t-value = 16.6, R square =0.893). This is below both the statutory corporation tax rate for Indian companies and the surcharge inclusive MAT rate. It may be noted that the questionnaire sought information on tax paid during rather than for 2000-01.

36 Only two companies provided quantitative information on bribes. Consequently, the study is unable to shed much light on gross compliance costs, though fairly rich information on bribe costs is presented in Chapter 6. In addition, examination of the impact of bribes and their determinants is facilitated due to the availability of a second data set, which, however, does not provide information on compliance costs.

37 In additional tables in Annex A3.5, the ratio of compliance costs to scale variables with companies classified by employee strength or turnover are given. Costs are broadly, but never strictly, regressive in these tables.

Figure 3.1 Total Compliance Costs versus Turnover

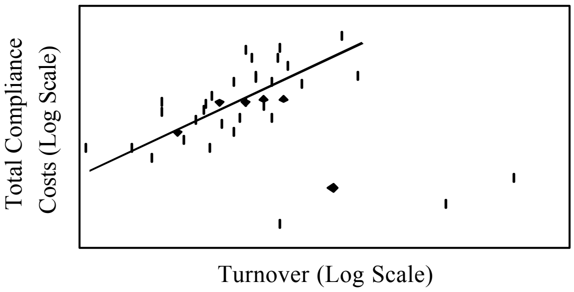

Figure 3.2 Total Compliance Costs versus Book Value of Assets

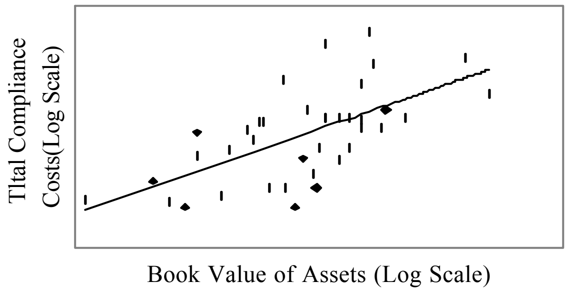

Figure 3.3 Total Compliance Costs versus Profit Before Tax/Loss

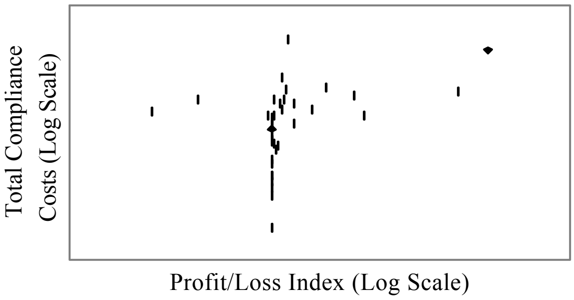

Figure 3.4 Total Compliance Costs versus Tax Paid

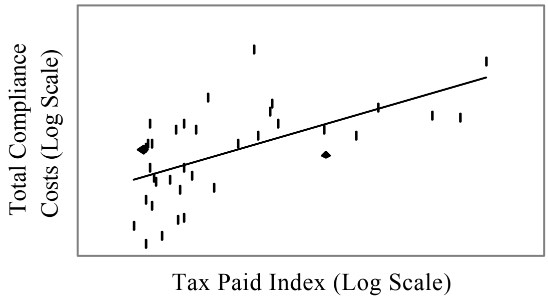

Figure 3.5 Total Compliance Costs versus Employment

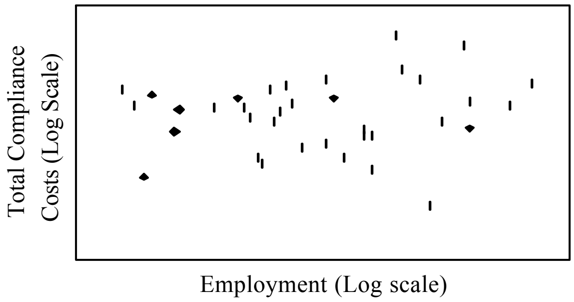

Table 3.5: Estimates of Legal Compliance Costs of Profit Making Units

	% of turnover	Per full time & part time employee (Rupees)	% of profit before tax	% of tax	% of book value of assets
Average	0.35	6475	4.12	30.41	1.30
Minimum	0.003	47	0.025	0.11	0.00
Maximum	2.07	39616	30.00	392.47	7.76
Standard Deviation	0.53	10278	6.33	71.58	2.07
Coefficient of Variation	1.53	2.00	1.54	2.35	1.59
No of observations	32	30	29	32	31

Note: The table excludes the following outliers (i.e. lying outside average± 3 standard deviations).
(a) % of turnover: 7.72.
(b) Per full time & part time employee: 95,345.
(c) % of profit before tax: 1363.64. A zero profit company is also excluded.
(d) % of tax: 1136.39.
(e) % of book value of assets: 17.99 and 10.66.

Table 3.6: Estimates of Legal Compliance Costs of Loss Making Units

	% of turnover	Per full time & part time employee (Rupees)	% of loss	% of tax	% of book value of assets
Average	0.21	6501	1.71	NA	1.43
Minimum	0.01	130	0.17	NA	0.04
Maximum	0.55	26500	4.53	NA	5.19
Standard Deviation	0.21	11256	1.77	NA	2.51
Coefficient of Variation	1.00	1.73	1.03	NA	1.76
No of observations	5	5	5	4	5

Notes: (1) The table excludes the following outliers (i.e. lying outside average± 3 standard deviations).
(a) Per full time & part time employee: 216,667.
(b) % of profit before tax: 11.60.
(c) % of book value of assets: 43.33.
(2) Total compliance costs as a % of tax are not reported because of both positive and negative taxes and high variability.

3.3.3 Distribution of compliance costs by company size

Tables 3.7 to 3.11 provides information on compliance costs by company size as measured by each of the 5 scale variables. Additional information on each scale variable, for companies classified by employee strength or book value of assets, is in Annex 3.5. Though coefficients of variation are still large, and though trends are not monotonic, even after grouping observations, *compliance costs are broadly regressive by all indicators of firm size*. In particular, costs per employee and as a percentage of tax are unacceptably high for smaller companies, suggesting that reforms to lower compliance costs will help restore the competitiveness of smaller companies whose competitiveness is clearly distorted by compliance requirements.

Table 3.7: Legal Compliance Costs Per Employee (in Rupees)

No. of Employees	Below 20@	21 to100	101 to 500	501 to 1000	Above 1001
Average	20138	11818	2335	3729	1616
Minimum	2981	629	504	290	47
Maximum	35273	39616	4543	9923	12225
Standard Deviation	13937	14077	1609	3708	3739
Coeff. of Variation	0.69	1.19	0.69	0.99	2
No. of observations	4	8	7	5	10

Note: @: Excludes two outliers. See the notes to Tables 3.5 and 3.6.

Table 3.8: Legal Compliance Costs as a Percentage of Turnover

Turnover	Below Rs. 2 crore@	Rs 2 to 50 crore	Rs 50 to100 crore	Rs 100 to 500 crore	Over Rs 500 crore
Average	1.28	0.40	0.16	0.13	0.01
Minimum	0.22	0.03	0.02	0.03	0.003
Maximum	2.07	1.13	0.39	0.50	0.04

Standard Deviation	0.88	0.38	0.12	0.16	0.01
Coefficient of Variation	0.69	0.95	0.77	1.26	0.87
No of observations	4	12	7	8	6
Note: @: Excludes one outlier. See the notes to Table 3.5.					

Table 3.9: Legal Compliance Costs as a Percentage of Book Value of Assets

Book value of assets	Below Rs. 2 crore@	Rs 2 to 50 crore	Rs 50 to100 crore	Rs 100 to 500 crore	Over Rs 500 crore
Average	4.17	0.97	0.33	0.46	0.02
Minimum	0.517	0.049	0.080	0.044	0.001
Maximum	7.76	4.48	0.90	0.87	0.05
Standard Deviation	2.90	1.26	0.27	0.59	0.02
Coefficient of Variation	0.70	1.30	0.82	1.28	1.38
No of observations	7	14	7	2	5
Note: @: Excludes three outliers. See the notes to Tables 3.5 and 3.6.					

Table 3.10: Legal Compliance Costs as a Percentage of Profit Before Tax

Profit before tax	Loss making companies*	Below Rs. 2 crore*	Rs 2 to 50 crore	Rs 50 to 100 crore	Rs 100 to 500 crore	Above Rs 500 crore
Average	1.71	8.38	2.20	0.22	0.17	0.06
Minimum	0.170	0.850	0.242	0.217	0.047	0.025
Maximum	4.53	30.00	9.78	0.22	0.34	0.09
Standard Deviation	1.77	8.39	2.67	N.A.	0.15	0.05
Coefficient of Variation	1.03	1.00	1.21	N.A.	0.88	0.80
Number of observations	5	11	12	1	3	2
Note: *Excludes one outlier and one zero-profit company. See the notes to Table 3.5.						

Table 3.11: Legal Compliance Costs as a Percentage of Income Tax Paid

Income tax paid	Negative net tax@	Below Rs. 10 lakh#	Rs 10 lakh to 1 crore	Rs 1 to 25 crore	Rs 25 to 100 crore	Over Rs 100 crore
Average	-22.87	164.18	17.55	12.40	0.59	0.24
Minimum	-14.66	28.37	1.83	0.48	0.44	0.11
Maximum	-31.08	438.00	43.88	58.77	0.75	0.39
Standard Deviation	11.61	165.39	16.27	20.43	0.22	0.14
Coefficient of Variation	0.51	1.01	0.93	1.65	0.37	0.61
Number of observations	2	6	12	10	2	3
Note: @: Excludes one firm with the value -392.47. #: Excludes one outlier. See the notes to Table 3.5.						

3.3.4 The cost of delayed refunds

A total of 12 companies in the sample reported payment of excess taxes.[38] The reason given for this by the case study company in Chapter 8, is due to tax evasion penalty not being leviable under Indian

[38] This information is from responses to Q6 of the questionnaire which asks "Some companies overpay income taxes in order to avoid charges of concealment of income, preferring to claim refunds in case claims are not disallowed. In case you company received a refund due to overpayment of taxes during 1-4-2000 to 31-3-2001 please indicate the amount

law if taxes assessed have already been paid. [39] Refunds are, however, given after long delays by the Income Tax department. Given the low rate of interest paid by the government on delayed refunds, (8 percent simple interest per annum in 2000-01) the opportunity cost of these blocked funds is the difference between the relevant opportunity cost interest rate of the company and 8 percent simple interest. As explained in Chapter 2, this rate is assumed to be 15 percent (compound) per year. If interest is taken to be compounded weekly by the market, the cost, works out to be Rs 81.58 per year per Rs 1,000 of refund due. No data are available from the survey for the average duration of delay, though aggregate estimates which use secondary data are presented later in the chapter. Information on overpayment of taxes as measured by the refund received due to this, is in Table 3.12. The median value, at 46 percent of gross taxes, suggests that costs of delayed refunds are substantial, especially for companies near the average or above it.

Table 3.12 Refund Received Due to Over-payment of Taxes (Rs lakh)

	Average	Minimum	Maximum	Standard dev	Coeff of Var	Median	No. of obs
In Rupees	947.2	4.3	10000.0	2854.4	3.0	84.0	12
As a % of gross tax	436.9	1.5	3921.6	1159.6	2.7	46.2	11

3.3.5 Benefits from income tax compliance requirements

Besides cash flow benefits from compliance requirements, there are also qualitative benefits found in earlier studies. Though these are hard to value, respondents opinions about these benefits are reported in Table 3.13. As can be seen from the table, 62 percent of companies agreed that their income statement and balance sheets are better prepared due to compliance requirements. Also worth noting is that over 50 percent of companies found auditing requirements useful in detecting dishonest employees. Surprisingly, only 23 percent of companies felt that there were cash flow benefits.

Table 3.13: Benefits From Income Tax Compliance Requirements

	Number of positive responses (A)	Total responses (B)	(A) as a % of (B)
Company's income statement and balance sheets are better prepared	28	45	62
Better detection of employee malfeasance (due to auditing requirements under section 44AB)	23	45	51
Asset management is improved	17	44	39
Stock and inventory control is improved	18	40	45
Asset and stock valuation are improved	19	41	46
Better control on borrowing and repayment of loans	14	43	33
Cash flow benefits	10	43	23
Other advantages	4	7	57

3.3.6 Net compliance costs

Estimates of net compliance costs in Table 3.14 only net out cash flow benefits from the timing of advance tax payments and the tax deductibility of compliance expenditure. Estimates of cash flow benefits from TDS are only available for 5 firms, and these estimates are presented in Table 3.15. As in the case of legal compliance costs, the cost of delayed refunds cannot be taken into account either.

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of such refund."

[39] In the Allingham-Sandmo (1972) model, overpayment of taxes to avoid penalty can be an expected income maximising strategy, in the absence of refunds, if and only if tax evasion is not expected income maximising. However, with uncertainty about the extent of overpayment required to avoid penalty, quasi mandatory compliance costs in terms of the net interest (or opportunity) cost of delayed refunds implies that both tax evasion and overpayment of taxes can simultaneously be income maximising.

Nevertheless, the estimates presented here are unexpected. Tax deductibility and cash flow benefits reduce legal compliance costs by 86 percent. Since tax deductibility reduces legal compliance costs by either 38.5 percent if MAT is not applicable or 33 percent if it is, cash flow benefits are the major source of cost reduction. As discussed in Chapter 2, these are estimated at 1.853 percent of taxes paid directly by the company (that is, excluding taxes withheld by others). Once again, the averages are to be viewed cautiously given the large coefficients of variation, especially for net compliance costs as a percentage of legal compliance costs. In terms of their distribution, net compliance costs turn negative for large firms measured by book value of assets or turnover (see Annex 3.6). This is similar to the pattern of net compliance costs found in Australia, reported in Chapter 1.

No estimate of social compliance cost is made for the sample, as necessary information on delayed refunds is not available.

Table 3.14: Net Compliance Costs (NCC) after Tax Deduction of Compliance Expenditure and Cash Flow Benefits from Timing of Advance Tax Payments but Excluding Bribe Costs

	Cash Flow Benefits as a % of Legal Compliance Costs@	NCC: % of Legal Compliance Costs@	NCC: % of Profit Before Tax$	NCC: % of Tax Paid*
Average	85.55	14.45	2.09	23.76
Minimum	33.00	-329.03	-1.53	-1.72
Maximum	429.03	67.00	18.45	269.37
Standard deviation	95.48	95.48	4.06	54.11
Coefficient of variation	1.12	6.61	1.95	2.28
Number of positive observations	39	30	18	24
Total Number of observations	39	39	29	35

Notes: @: Excludes two outliers with % of legal compliance costs of -1178.61 and -836.60.
$: Excludes one outlier: -838.64.
*: Excludes one outlier: 697.28.

If cash flow benefits from TDS are also taken into account net compliance costs reduce further (Table 3.15), though the additional benefits are relatively small.[40]

Table 3.15: Legal and Net Compliance Costs of Five Companies

	Company A	Company B	Company C	Company D	Company E	Average	Standard Deviation	Coefficient of Variation
Legal Compliance Costs								
% of Profit Before Tax	0.66	1.14	0.34	1.62	0.24	0.80	0.57	0.72
% of Tax Paid	2.03	3.58	0.77	6.14	0.48	2.60	2.33	0.89
Net Compliance Costs after Cash Flow Benefits of Advance Tax and Tax Deductibility								
% of Legal Compliance Costs	-17.08	-41.93	-144.35	9.29	-193.61	-77.54	87.18	-1.12
% of Profit Before Tax	-0.11	-0.48	-0.49	0.15	-0.47	-0.28	0.29	-1.03
% of Tax Paid	-0.35	-0.45	-1.08	0.33	-0.94	-0.50	0.56	-1.12
Net Compliance Costs after Cash Flow Benefits of Advance Tax, Tax Deductibility and TDS								
% of Legal Compliance Costs	-18.48	-75.48	-162.55	5.62	-209.14	-92.01	92.07	-1.00
% of Profit Before Tax	-0.12	-0.86	-0.56	0.09	-0.51	-0.39	0.38	-0.96
% of Tax Paid	-0.37	-1.65	-1.22	0.10	-1.01	-0.83	0.70	-0.84

40 The private sector company case study in Chapter 8 reports similar findings.

3.4 Aggregation methodology

Aggregate estimates for all Indian companies for 2000-01 are now attempted, despite the small sample size and variability relative to size indicators in the sample. Clearly, these estimates should be viewed as preliminary and subject to a substantial margin of error. The data source used in the aggregation exercise is PROWESS. Estimates are only provided for legal compliance costs, adjusted legal compliance costs, net compliance costs, adjusted net compliance costs and "social" compliance costs. Illegal compliance costs are not projected given the very limited information available. The estimate of the cost to companies of delayed refunds is based on information in CAG (2002a).

In brief, aggregate estimation is done by using the sample legal compliance cost to turnover ratio and, alternatively the legal compliance cost to book value of assets ratio. Group means for different size groups are multiplied by PROWESS group means for turnover or book value of assets. A weighted average is then formed using PROWESS sample proportions.[41] Rupee figures are obtained by using tax data from PROWESS and the ratio of tax paid by PROWESS companies to the government budget figure for corporation tax collection in 2000-01 (Rs 35,696 crore). Besides estimates based on group means, "high" and "low" estimates based on a truncated 5 percent confidence intervals are also reported. A similar exercise was carried out for net compliance costs. Social compliance costs are estimated only at the aggregate level by adding the estimated social cost of delayed refunds to legal compliance costs. Further discussion of the aggregation methodology and detailed tables are in Annex 3.6.

3.5 An estimate of the cost of delayed refunds based on a CAG report

CAG (2002a) provides information on delays, in months, by the Income Tax Department in granting refunds after the end of the relevant assessment year according to different categories and also by state. However, no information is available on the time elapsing between tax payment by the company and the end of the assessment year. Consequently, if it is assumed that refunds arise largely due to tax over-payment, the mandatory compliance cost element in delayed refunds will be reflected in CAG data. To the extent that this assumption is incorrect, for example if a refund arises due to excess taxes withheld by others, mandatory costs are underestimated. Consequently, the estimated cost of refunds by the method we now describes is conservative, and excludes quasi-mandatory costs of risk insurance against penalties and possibly also a part of mandatory costs.

The formula used to value the compliance cost of delayed refunds is $X[1+ nr - (1+r_m)^n]$, where r is the rate of simple interest paid by the Income Tax Department (8 percent per annum), r_m is the opportunity cost interest rate of the company, n is the period of delay, and X is the amount of refund in rupees. As discussed in Chapter 2, r_m is taken to be 15 percent per annum. The number (or fraction) of years, n, is calculated for each category in CAG data as a simple average of upper and lower limits of the delay, measured in months, for different Indian states. Results of this exercise are given in Table 3.16. To compute the social cost of delayed refunds, the same exercise was carried out, except that a compound interest rate of 9.76 percent for the government is assumed as discussed in previous chapter.

[41] An alternate estimate, which corrected the PROWESS distribution of firms to ensure conformity with population proportions of corporate assessees in CAG (2002), according to four taxable income or loss ranges, is not reported as this led legal compliance costs to fall below the CMIE subset of companies – a clearly impossible result. No satisfactory way of overcoming this problem could be devised with available information. The tax share of the 98% of tax assessee companies not in the PROWESS data base is around 15 percent, suggesting that they are relatively small or loss making companies.

Table 3.16 Estimated Costs of Companies Due to Delayed Refunds in 2000-01	
Category	Cost
Delay in issue of refund vouchers (Rs Crore)	613.99
Due to delayed completion in assessment (Rs Crore)	114.50
Delay in allowing refund in appeal cases (Rs Crore)	24.43
Delay in obtaining administrative approval (Rs Crore)	0.26
Estimated total delay costs (Rs Crore)	**753.18**
Delayed refund cost as a % of corporation tax revenue in 2000-01	**2.11**
Cases of delayed refund where costs could not be estimated	Amount refunded
Refunds granted after completion of scrutiny assessment (Rs Crore)	37.74
Avoidable payment of interest on refund due to mistakes in computation (includes over payment, short payment and non-payment of interest) (Rs Crore)	15.36
Delay due to irregular withholding of refunds (Rs Crore)	13.98
Total delayed refunds where costs could not be estimated (Rs Crore)	**67.08**
Corporation tax revenue in 2000-01 (Rs Crore)	*35696*
Source: CAG (2002a).	

3.6 Aggregate estimates

Aggregate estimates are reported in Table 3.17. The aggregate estimates perforce assume that costs of companies not in the PROWESS private sector data set, including all public sector companies, are similar in terms of the scale variables (turnover and gross fixed assets) as included companies. This needs to be rectified in subsequent research.

The lowest estimates for different compliance cost measures and the highest show wide variation. Furthermore, confirming their preliminary nature, estimates using gross fixed assets and turnover have only a small overlap.

In the table, legal compliance costs are estimated to be between 4.33 and 13.18 percent of taxes paid. When the cost of delayed refunds is added, the range of estimates rises to between 6.44 and 15.29 percent of taxes. The upper estimate is high by international standards, but, surprisingly, lower than recent estimates for Australia and the United States reported in Chapter 1. However, the omission of bribe costs must be borne in mind.

On the other hand, while not all companies have negative net compliance costs (Annex 3.6), *estimates of net compliance costs in Table 3.15 suggest that, in aggregate, companies are able to recover legal compliance costs.* This happens despite the under-estimation of cash flow benefits, since TDS benefits could not be estimated. Note, however, that bribe costs are also omitted due to insufficient information. The addition of delayed refund costs returns all estimates to positive territory. Inclusion of missing items, including cash flow benefits and bribe costs, would be likely to leave compliance costs low by international standards.

The private sector company case study in Chapter 8, as well as qualitative information in Chapter 5, suggest that delayed refunds are only partly due to procedural hurdles and the need to window dress collections to meet revenue targets. Reduction in delay can be achieved by companies on payment of bribes in, it has been learnt, most cases. Anecdotal evidence suggests that the going bribe rate is 10 percent of refunds due. That bribes demanded are more costly than the expected cost of waiting for refunds explains why many companies do not pay bribes to expedite refunds. This means that the cost of delayed refunds is itself largely an indirect outcome of corruption.

Both social compliance costs and, after adding administrative costs, gross operating costs, leave compliance costs around a half percent below adjusted legal costs. That no adjustment has been made for price distortions using shadow prices and the small sample base for estimates should be kept in mind when assessing these estimates.[42]

Table 3.17: Aggregate Estimates of the Compliance Costs of Companies

	Estimate for PROWESS companies			Projection for all Indian companies		
	Low	**Middle**	**High**	**Low**	**Middle**	**High**
Legal Compliance Costs						
Estimates Based on the Proportion of Gross Fixed Assets (GFA)						
Rs Crore	1061	1387	1738	2872	3755	4704
% of GFA	0.17	0.22	0.28			
% of Turnover	0.14	0.18	0.22			
% of Profit Before Tax	4.21	5.51	6.90			
% of Corporation Tax	8.05	10.52	13.18	8.05	10.52	13.18
Estimates Based on the Proportion of Total Sales/Turnover						
Rs Crore	571	737	908	1546	1994	2458
% of GFA	0.09	0.12	0.15			
% of Turnover	0.07	0.09	0.12			
% of Profit Before Tax	2.27	2.93	3.61			
% of Corporation Tax	4.33	5.59	6.89	4.33	5.59	6.89
Private Cost of delayed refunds (% of tax)				2.11	2.11	2.11
Adjusted Legal Compliance Costs Projected by GFA				**10.16**	**12.63**	**15.29**
Adjusted Legal Compliance Costs Projected by Turnover				**6.44**	**7.70**	**9.00**
Net Compliance Costs (Excluding Bribes and TDS Cash Flow Benefits)						
Estimates Based on the Proportion of Gross Fixed Assets (GFA)						
Rs Crore	-35.7	14.2	82.4	-97	38	223
% of GFA	-0.006	0.002	0.013			
% of Turnover	-0.005	0.002	0.011			
% of Profit Before Tax	-0.142	0.056	0.327			
% of Corporation Tax	-0.27	0.11	0.62	-0.27	0.11	0.62
Estimates Based on the Proportion of Total Sales/Turnover						
Rs Crore	-94.6	-20.5	63.0	-256	-55	170
% of GFA	-0.015	-0.003	0.010			
% of Turnover	-0.012	-0.003	0.008			
% of Profit Before Tax	-0.376	-0.081	0.250			
% of Corporation Tax	-0.718	-0.155	0.478	-0.72	-0.16	0.48
Private Cost of delayed refunds (% of tax)				2.11	2.11	2.11
Adjusted Net Compliance Costs Projected by GFA				**1.84**	**2.22**	**2.73**
Adjusted Net Compliance Costs Projected by Turnover				**1.39**	**1.95**	**2.59**
"Social" Compliance Costs						
Social cost of delayed refunds (% of tax)				1.28	1.28	1.28
"Social" Compliance Costs Projected by GFA				**9.32**	**11.80**	**14.46**
"Social" Compliance Costs Projected by Turnover				**5.61**	**6.87**	**8.16**

42 An assessment of the appropriate measure of the cost to society per rupee of corporation tax collected, its marginal efficiency cost of funds,, or "the aggregate income loss to individuals per rupee of tax revenue from a marginal increase in the level of the corporation tax by the least cost means of doing so, administrative or structural", is not attempted here given poor data and further ad hoc assumptions needed. any given revenue instrument.

"Social" Operating Costs			
Administrative Costs of the Income Tax Department*	0.31	0.31	0.31
Social Operating Costs Projected by GFA	**9.63**	**12.11**	**14.77**
Social Operating Costs Projected by Turnover	**5.92**	**7.18**	**8.48**

Notes: (1) Definitions of compliance cost measures are in Chapter 2.
(2) Estimated TDS Costs are 5.68% of the Non-Corporate Income Tax or Rs 1799 crore in Chattopadhyay and Das-Gupta (2002). These are partly borne by corporations but are not included here because of lack of necessary information to apportion costs.
(3) The estimated cost of other government departments at Rs 27.28 crore and bank collection costs at Rs 334 crore, have been included in the estimated compliance cost of the non-corporate income tax in Chattopadhyay and Das-Gupta (2002) without any apportionment of between corporate and non-corporate income tax.
*: The Ministry of Finance figure for revenue expenditure of the income tax department is Rs 870 crore for 2000-01. Following apportionment of costs between taxes by the CAG for 1999-2000 (including "Direction and Administration"), 12.7% percent or Rs 111 crore is taken as the share of costs attributable to the corporate income tax. The CAG (2000) figure, which omits Direction and Administration, is Rs 107 crore.

3.7 Summary of findings

The major findings of the analysis of compliance costs in this chapter are summarised in Table 3.18. The fragile nature of these estimates, given the small sample size and high variation within the sample are worth pointing out again.

Table 3.18 Summary of Findings on the Income Tax Compliance Cost of Indian Companies in 2000-01

Sl.	Compliance Cost Measure	Sample Findings	Projection for All Indian Companies
1	Legal compliance costs = Internal (personnel + other) costs + payments to advisors	Highly variable but unacceptably high for some firms. Average is affected by high cost cases despite exclusion of outliers. Averages: Rupees 6475 per employee, 4.12% of profit before tax, 30.41% of tax paid	Between 4.33% and 13.18% of tax paid
2	Distribution of legal compliance costs by company size	By and large, regressive for all measures of company size	No information
3	Gross compliance costs = Legal compliance costs + bribe costs.	Not estimated. Analysis of bribe costs is in Chapter 6	No information
4	Adjusted legal compliance costs = Legal compliance costs + opportunity cost of delayed refunds.	Median refunds due to deliberate overpayment of taxes to avoid penalty average of 46% of taxes, with the average being 10 times as high. Delayed refunds largely arise due to non-payment of bribes or to window dress revenue collections	Between 6.44% and 15.29% of tax paid. Delayed refund costs 2.11% of tax paid
5	"True" gross compliance costs = Adjusted legal compliance costs + bribe costs	Not estimated.	No information

6	Cash flow benefits from timing of advance tax payments and TDS	Over 50% of legal compliance costs	Not directly estimated
7	Net compliance costs = Legal compliance costs + opportunity cost of delayed refunds – cash flow benefits from timing of tax payments – tax deduction of compliance expenditure (excluding bribe costs and cash flow benefits from TDS)	Average 15% of legal compliance costs. While still high for some, they are negative for most large firms.	Between *minus* 0.72% and *plus* 0.62% of tax paid before delayed refund costs
8	Social compliance costs = legal compliance costs + *social* opportunity cost of delayed refunds	Not estimated	Between 5.61% and 14.46% of tax paid. Delayed refund social cost: 1.28% of tax paid
9	Social operating costs = Social compliance costs + administrative expenditure	Not applicable	Between 5.92% and 14.77% of tax paid

The major conclusions are that social costs are moderate by international standards at the lowest estimates but high if the higher estimates are correct. However, private costs, on a net basis can be reduced (on average) to zero, if the problem of delayed refunds is tackled. To reduce compliance costs, particularly the large costs of delayed refunds, administrative corruption will need to be curbed and administration of refunds streamlined.

4. Compliance Cost Characteristics of Surveyed Firms

Additional information on variation in legal compliance costs, its components and correlates is now examined. After presenting statistical results that confirm regressivity, internal compliance costs disaggregated by source and object are examined. This is followed by an examination of external costs and reasons for engaging tax advisors. Particular attention is paid to the cost of scrutinies and appeals. Next, a disaggregation of legal compliance costs into voluntary and mandatory costs is attempted, given the important difference in their implications for policy, though estimates of internal costs and the basis of the mandatory versus voluntary division are crude. Two other pieces of information are then presented. The first is on TDS cash flow benefits for firms providing this information and the second is on the large tax concessions of sample firms. The latter contribute to compliance costs, while reducing taxes, so raising the social costs of collecting the corporation tax.

4.1 Compliance costs and company size: Statistical analysis

A full scale statistical analysis of determinants of legal compliance costs was attempted for this study. The limited sample size, often further curtailed by missing observations, resulted in high standard errors or omission of many variables of interest. So these results are not presented. Perhaps the only result worth reporting is that companies which claimed harassment by the Income Tax Department had significantly higher compliance costs than others, after controlling for other legal compliance cost determinants. A summary of these regression exercises is in Annex 4.1 for the information of the reader.

Table 4.1 Legal Compliance Costs and Company Size

Size Variable	Constant ('000)	Size Coefficient@	Elasticity	R Squared	Observations
Linear regressions on Legal Compliance Costs in Rupees					
Turnover (in Rs)	1596.4**	0.052*	0.097	0.013	37
Book Value of Assets (in Rs)	1430.2**	0.371***	0.341	0.232	36
Employment (in numbers)	1525.9**	230.8*	0.158	0.024	34
Profit Before Tax/Loss (in Rs)	1781.5**	0.141***	0.035	0.005	36
Net Tax Paid (in Rs)	1880.2**	0.57	0.038	0.004	36
Double-Log regressions on Legal Compliance Costs in Rupees					
Turnover (in Rs)	1.98***	0.441***	0.441	0.480	37
Book Value of Assets (in Rs)	2.64***	0.394***	0.394	0.441	36
Employment (in numbers)	0.497***	0.258**	0.258	0.404	34
Profit Before Tax/Loss Index #	-0.980***	0.303*	0.139	0.446	21
Net Tax Paid Index#	-0.688***	0.355***	0.285	0.147	37

Notes: (1) *: Significant at 10%; **: Significant at 5%, ***: Significant at 1%.
(2) @: Coefficients are multiplied by 1000 excepting for employment.
(3) Regressions also included the number of assessment years still open, if the variable proved significant at least at 10%.
(4) Results for the number of assessment years still open are reported in Table 4.6 below.
(5) #: Given negative values of these variables, a linear transformation given by

$$x_{index} = 0.1 + \frac{x - x_{min}}{x_{max} - x_{min}}$$

was used. Elasticities are for the basic – not transformed – variable.

Here we restrict attention to statistical results for the impact of company size on compliance costs from two or 3 variable regressions. These are reported in Table 4.1. In regressions, the goodness of fit turns out to be better for double-log regressions than for linear regressions.[43] *Regression results*

[43] However, R Squared statistics have not been made comparable to R Squares from linear regressions. Given the substantial differences, this was not felt to be necessary.

confirm results presented in Chapter 3, that legal compliance costs are regressive with respect to all size variables, with regressivity being particularly pronounced for the income variable, profit before tax.

4.2 The size of tax returns

Though regression results in Annex 4.1 do not statistically support this, the number of pages of documents submitted with tax returns has been identified in the literature as a useful summary indicator of compliance costs (see Pope and Fayle, 1991). Sample information is summarised in Table 4.2. There is a wide variation in the average number of pages of documents submitted by companies, with the number ranging between 9 and 3100. This is only partly linked to company size. Scanty information available suggests that the average is comparable to that in some countries with complex corporation tax codes.

Table 4.2: Pages of Documents Submitted by the Company with its Income Tax Return

	Number of Pages
Average	326
Minimum	9
Maximum	3100
Standard Deviation	541
Number of observations	41

4.3 Contribution to internal costs of various compliance activities

Company opinions on the importance of different compliance activities on a 5 point scale are in Table 4.3. As expected, additional information asked during scrutiny assessment followed by maintaining accounts are the major contributory factors. For the latter, differences in accounting requirements for tax purposes and to satisfy disclosure requirements under the Companies Act are of importance. The low importance of tax planning and research and tax training are in accordance with expectations, but should be treated with skepticism, given probable respondent bias.

Table 4.3: Importance of Activities Contributing to Internal Costs
(in descending order by average score)

	Very Important (4)	Quite Important (3)	Average (2)	Quite Unimportant (1)	Unimportant (0)	Can't say	Average Score	No of Observations
Information asked for during scrutiny assessment	22	14	2	0	1	0	3.44	39
Maintaining account books (MAB)	15	3	3	0	1	0	3.41	22
Completing and Submitting tax returns	21	11	6	0	0	0	3.39	38
MAB: for compulsory financial audit under section 44AB	21	11	5	0	1	0	3.34	38
Completing and Submitting TDS returns	21	10	5	1	1	0	3.29	38
To obtain a tax refund	15	17	6	0	0	1	3.24	38
MAB: for employee TDS	17	12	8	2	0	0	3.13	39
MAB: for TDS other than for employees	17	12	8	0	2	0	3.08	39
Litigation initiated by the company	16	13	3	0	6	2	2.87	38
Litigation initiated by the IT Department	16	9	6	1	5	2	2.81	37

Research and tax planning (RP)	4	6	13	1	4	1	2.18	28
Others requirements	3	1	0	0	3	0	2.14	7
RP: for other tax concessions	3	7	16	3	6	1	1.94	35
Tax related training for employees	0	9	15	5	9	0	1.63	38
Providing assistance to employees	5	5	8	9	10	0	1.62	37
To obtain a PAN number	5	4	10	7	11	0	1.59	37
RP: for exemption under sections 10A and 10B	1	0	8	3	10	2	1.05	22

Turning to objects of expenditure (Table 4.4), the small share of expenses on employees does not accord with international experience, but is plausible in a low wage economy like India's. The cost of office space also accords with expectations given the high market rentals in localities where most companies have their head offices. The relatively high expenditure on data processing is also, in rupee terms, plausible. In all cases, however, the high coefficients of variation and minimum-maximum ranges should be noted.

Table 4.4: Internal Compliance Costs by Object of Expenditure (Rs '000)

	Average %	Average	Minimum	Maximum	Coefficient of Variation	No of observations
On employee salaries, etc.	24.7	656	10	5,000	1.65	36
Office space/services at market rental value	11.8	313	1	2,400	1.93	34
Computers and data processing	9.9	262	1	5,000	3.33	37
Accounts/record preparation, storage, etc.	8.0	214	1	4,000	3.24	37
Travel and conveyance	5.3	140	<1	3,600	4.27	37
General supplies and stationery	3.2	84	<1	2,000	4.07	35
Photocopying, fax and postal expenses.	2.5	66	<1	1,500	3.80	37
Purchase of tax publications	0.8	22	1	150	1.53	36
Additional costs to enable availing of tax incentives	1.5	41	2	150	1.80	34
Others	32.3	857	694	1,021	0.27	30
All Internal Costs	100.0	1314	7	22,200	2.41	38

Note: Row averages do not add up to the "all internal costs" figure due to missing observations. Figures in the "average %" column add up to 100% and are based on figures in the average column, except for "all internal costs".

4.5 Use of external advisors

External costs are now examined. Tables 4.5 and 4.6 show that 70 percent of companies use outside tax advisors to prepare returns, with small companies being somewhat more dependent on external assistance.

Table 4.5: Who Prepares Tax Returns		
	No of responses	Percentage
In house	13	30
Paid advisor	31	70
Number of responses	44	
Total questionnaires	45	

Table 4.6: Tax Return Prepared In-house or By Company: Cumulative Distribution By Size of Company					
Companies classified by number of employees					
Number of employees	Below 20	21 to100	101 to 500	501 to 1000	Above 1001
In house	0	0	1	2	10
Paid Advisor	7	15	21	25	28
Companies classified by turnover					
Turnover	Below Rs. 2 crore	Rs 2 to 50 crore	Rs 50 to100 crore	Rs 100 to 500 crore	Over Rs 500 crore
In house	0	1	1	5	11
Paid Advisor	6	17	24	28	29

Table 4.7: Fees Paid to Tax Advisors*				
	For completing tax return		**For all income tax related work#**	
Range of Fees Paid (Rupees '000)	Number of Responses	Cumulative % of Responses	Number of Responses	Cumulative % of Responses
5 or less	2	7	1	2
5 to 25	6	28	4	12
25 to 50	4	42	4	22
50 to 75	3	52	1	24
75 to 100	3	62	5	36
100 to 150	1	65	2	41
150 to 200	5	82	3	48
200 and above	5	100	21	100
No. of observations	29		42	
Average Fee Paid (Rs.)	157,322		830,720	
Maximum (Rs.)	1,000,000		13,705,000	
Minimum (Rs.)	500		4,000	
Standard Deviation	225,174		2,145,081	
Coefficient of Variation	1.43		2.58	
% of companies using advisors	69		100	

Note: *Advisor: Chartered accountants, lawyers and other tax professionals engaged and paid by the company.
#: On a regular basis or occasionally for tax or legal advice.

Other tasks entrusted to tax advisors besides return preparation, however, form the bulk of work of tax advisors with fees paid to them for return preparation accounting for a fifth of their total fees (Table 4.7). Comparing Table 4.7 with Table 4.4, external costs are seen to account for around 39 percent of the total legal costs of sample companies. This is similar to the general pattern in most developed countries. The average *share* of advisor fees amounts to 42 percent of legal compliance costs (Table 4.8), implying a skewed distribution with smaller firms making greater relative use of external professional services.[44] As expected, compulsory external financial audit is the main source of fees of external professionals.[45] Other important sources of income for advisors are litigation, particularly for cases by the company and, unexpectedly, providing assistance to employees. The importance of litigation costs is an issue that is returned to in the next section. Research and tax planning, in contrast, is unimportant though, as with internal costs, respondent bias cannot be ruled.

Table 4.8: Major Activities for which Tax Advisors Are Used
(in Descending Order of Importance)

	% of advisor fees	External cost % for companies using advisors for the activity					
		Average	Minimum	Maximum	Standard Deviation	Coeff. of Variation	% of companies
For compulsory financial audit under section 44AB	21.80	33.08	4.32	100.00	32.45	0.98	30.95
Maintaining account books	19.59	32.66	12.50	50.00	19.21	0.59	9.52
Litigation initiated by the company	8.59	19.90	0.73	45.65	12.21	0.61	42.86
Litigation initiated by the IT Department	6.27	14.10	1.00	28.30	8.87	0.63	35.71
For scrutiny assessment	4.82	22.75	5.49	56.78	16.59	0.73	38.10
Providing assistance to employees	4.02	12.79	2.00	44.44	14.27	1.12	16.67
To obtain a tax refund	1.49	13.63	1.43	39.02	11.14	0.82	28.57
Research and tax planning (RP)	0.52	6.35	0.36	22.73	7.52	1.19	26.19
% of legal compliance costs	38.74	42.47	0.40	95.69	27.47	0.65	100.00

Regarding the distribution of fees, Table 4.9 shows that fees paid to advisors are only poorly predicted by company size, especially when size is measured by number of employees rather than turnover. However, in relation to turnover, the rate of increase in advisor's fees is less than proportionate.

Table 4.9: Distribution of Fees Paid to Tax Advisors for Income Tax Related Work By Company Size (in Rupees)

Companies classified by number of employees					
No. of Employees	Below 20	21 to100	101 to 500	501 to 1000	Above 1001
Average	230,715	160,938	196,071	767,725	1,197,555
Minimum	5,125	2,000	15,000	45,000	55,000
Maximum	578,450	700,000	500,000	2,120,000	7,100,000
Standard Deviation	235,257	224,861	219,145	942,405	2,116,510
No. of Observations	5	8	7	5	10

44 The average across companies is equivalent to a weighted average, with weights being the shares of companies in total fees paid by all companies to advisors.

45 That only 31% of companies reported using external professionals for compulsory audits results because of companies not giving the break up of external costs with an average of 40% of costs being unallocated or for "other purposes". In fact, this should be 100%.

Companies classified by turnover					
Turnover	Below Rs. 2 crore	Rs 2-50 crore	Rs 50-100 crore	Rs 100 to 500 crore	Over Rs 500 crore
Average	184,940	200,955	510,714	611,944	1,516,667
Minimum	20,000	5,125	15,000	150,000	55,000
Maximum	578,450	700,000	2,120,000	1,400,000	7,100,000
Standard Deviation	239,624	254,109	736,594	517,490	2,759,815
No. of Observations	5	11	7	8	6

A final observation on use of tax advisors can be made give the information in Table 4.10. The issue addressed by the information in the table is: "Why should external expertise be relied on rather than developing in-house expertise?" While the obvious and correct answer is the cost advantage of doing so, the table seeks to ascertain what the sources of this cost advantage could be. *The most important reason turns out to be tax instability followed by tax ambiguity or complexity.* Even administrative obstacles are less important reasons for engaging tax advisors than these reasons. Tax planning, as before, is the least important reason for seeking professional assistance.

Table 4.10: Reasons for Engaging a Tax Advisor

	Very Important (4)	Quite Important (3)	Average (2)	Quite Unimportant (1)	Unimportant (0)	No Opinion	Average score	Total responses
Frequent changes of laws	22	14	4	0	1	1	3.37	42
For perfection of tax calculation	26	9	3	0	3	0	3.34	41
Complex tax affairs to deal with	6	15	11	2	6	1	2.33	41
Limited in-house expertise	8	10	11	3	6	3	2.29	41
Lack of assurance about tax officials help	10	7	14	3	5	2	2.36	41
To reduce tax burden	5	12	13	2	8	1	2.10	41
Others	2	0	0	0	0	7	4.00	9

4.4 Cost of scrutiny and appeals

In the section on internal costs it was seen that respondents felt these costs to be the most burdensome. Scrutiny assessment proceedings and appeals are also important sources of external costs. One reason for this is the long delay in completing scrutinies and the large number of appeals filed. Anecdotal evidence suggests that appeals are mainly filed by the Income Tax Department, though statistics on this are not available. These appeals are filed despite reportedly low success rates of the Department, so as not to be taken to task for lack of due diligence during external audit by the CAG, and consequent "passing the buck". For example, during 2000-01, there were 183,340 pending company assessments out of a total workload of 481,702 assessments, which is itself about 50 percent more than the number of company assessees. Of these, 30,301 were scrutiny assessments. While no break up is available by company and non-company cases, 292,266 income tax appeals and court cases were pending at various levels, or one for every hundred income taxpayers. Regarding fraud and tax evasion cases, there were 210,665 penalty cases pending disposal and 12,793 pending prosecution cases. While no data are available on appeals success rates of the Department, nor on whether appeals were filed by assessees or the Department, the success rate in prosecution cases, counting both convictions and compounded cases as successes, has averaged 31.2 percent during the past 5 financial years. If departmental success rates in appeals are similar, then policy guidelines need rethinking – or the department's legal capacity needs strengthening, since currently, the major outcome of disputes is unnecessary compliance costs imposed on taxpayers and even greater costs to society without much of a return in terms of additional revenue.

Table 4.11: Number of Companies Scrutinised

	No of responses	% of responses
Yes	23	62.16
No	14	37.84
No Comment	NA	NA
Total responses	37	100.00

Table 4.11 documents the high rate of scrutiny of company assessees (62 percent of the sample) in comparison with individuals. Table 4.12 presents information on the number of assessment years in dispute of sample companies. The table is startling in that the average company has 10 to 11 assessment years in dispute for tax or penalty with a maximum of 20 years.[46] If the two to three years it takes for completion of scrutiny assessments are added to this, the number of open assessment years of a typical company turns out to be 12 to 14. This is unacceptable by any reasonable standards.[47]

Table 4.11: Number of Assessment Years in Dispute

Authority	Tax or penalty	Average	Minimum	Maximum	Standard Deviation	Coefficient of variation	Number of responses
Commissioner (Appeals)	For tax	2.35	1	8	1.70	0.72	23
	For penalty or interest	2.40	2	3	0.55	0.23	5
Income Tax Appellate Tribunal	For tax	5.33	1	14	4.13	0.77	21
	For penalty or interest	2.25	1	4	1.26	0.56	4
High court/ Supreme Court	For tax	2.95	1	10	2.69	0.91	10
	For penalty or interest	--	--	--	--	--	0
Total Assessment years	For tax	7.85	1	20	6.16	0.79	26
	For penalty or interest	2.63	1	4	1.06	0.40	8

However, the link between pending assessment years and compliance costs is not statistically robust in statistical exercises reported in Table 4.13.[48] Going by the most significant result in the table, the double log regression where the size variable is the profit before tax index, a one year increase in the number of disputed assessment years, results in legal compliance costs increasing by 5.68 percent.[49]

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[46] While CAG (2002) does not provide separate details for the corporation and personal income tax, it does provide overall details of case pendency at the level of the ITAT, high courts and the Supreme Court. If information for 2000-01 is taken to be representative, the expected duration of cases is 37 months in the ITAT, 42 months in high courts and 36 months in the Supreme Court. Weighting expected durations by the proportion of cases at different levels (pending Supreme Court cases for the current year, high court cases of 4 years ago and ITAT cases of 7 year ago), the expected duration of a tax dispute can roughly be estimated at 58 months. This is considerably less than the estimates reported in the private sector case study in Chapter 8, suggesting either overestimation by the case study company, shorter expected durations for non-corporate cases, or both.

[47] See also the case studies of companies in Chapter 8.

[48] In fact, in regressions summarised in Annex 4.1, the impact on compliance costs of pending disputed years was very often significant, but of the wrong sign.

[49] This estimate uses the average disputed years figure of 7.85+2.63 = 10.48 in Table 4.5: That is 5.68 = 0.595/0.1048.

This suggests that substantial reduction in both legal compliance costs and social operating costs are possible if appeal and case filing policies of the Income Tax Department are made cost effective.

Table 4.13 Legal Compliance Costs and Assessment Proceedings

Size Variable	Size Coefficient for Number of Assessment Years	Elasticity with respect to Number of Assessment Years
Linear Regressions of Legal Compliance Costs in Rupees		
Turnover (in Rs)	216.7	0.874
Book Value of Assets (in Rs)	172.9	0.698
Employment (in numbers)	332.8	1.343
Profit Before Tax/Loss (in Rs)	219.6	0.886
Net Tax Paid (in Rs)	206.6	0.834
Double-Log Regressions of Legal Compliance Costs in Rupees		
Turnover (in Rs)	0.288	0.288
Book Value of Assets (in Rs)	0.341	0.341
Employment (in numbers)	0.487*	0.487
Profit Before Tax/Loss Index	0.595***	1.150
Net Tax Paid Index	0.579**	1.119

Note: (a) See the notes below Table 4.1.
(b) Regressions are the same as in Table 4.1: R-square, observations and other coefficients are reported there.

4.6 Mandatory and voluntary compliance costs

Voluntary costs are taken to include costs of research and tax planning, of appeals filed by the company and of providing assistance to employees. Quasi-voluntary costs associated with procedures to obtain concessions are excluded, since tax planning has already been accounted for. For external costs, information on these expenditures is available in rupees directly from the questionnaire. For internal costs, only the importance of different costs on a five point scale is available, as presented in Table 4.3. Consequently, a rough estimate is made of these costs.

Table 4.14: Voluntary Costs as a Percentage of Legal Compliance Costs

	Average	Minimum	Maximum	Standard Deviation	Coefficient of Variation	No. of Observations
Internal Voluntary Costs	17.78	0.00	44.45	13.52	0.76	32
External Voluntary Costs	22.16	0.73	88.89	19.53	0.88	22
Total Legal Voluntary Costs*	19.11	0.00	88.89	17.43	0.91	38
Total Voluntary Costs including "Others/Unallocated"						
Internal Voluntary Costs	19.99	0.00	62.79	16.31	0.82	32
External Voluntary Costs	43.08	0.73	88.89	30.52	0.71	22
Total Legal Voluntary Costs	24.73	0.00	88.89	21.90	0.89	38

Note: * Average total costs are below both internal and external costs because of differing numbers of observations: If either component is missing, total voluntary costs are taken as equal to the other component.

To do this the scores of items in Table 4.3 are assumed to be the weight in total costs of each item. Weights are then proportionally adjusted to add up to 100 percent. If the external cost proportion for an item exceeds the estimated internal cost proportion, the internal proportion is adjusted up to the average of the external and internal proportions (and then weights are proportionally readjusted to again add up to 100 percent). This is done so as to reduce downward bias, if any, in internal cost estimates assuming that where external costs are important, so too are internal costs. Costs of each item are taken to be proportional to these adjusted weights. In computing average total voluntary costs, one more upward adjustment is made: If either external cost or internal cost details are missing, the total voluntary cost percentage is assumed to be equal to the percentage for which the information is available.

Results are presented in Table 4.14. The table suggests that the bulk of costs are associated with mandatory costs, despite possible upward bias in voluntary cost estimates, with limited variation across firms. Even if all unallocated expenditures are included, the voluntary cost percentage remains below that of mandatory costs. The tentative conclusion, given the rough estimates of internal costs, is that voluntary costs lie between 19.1 and 43.1 percent of total compliance costs. Voluntary costs below 50 percent accord with information in studies in other countries.[50] The other point of interest is that the percentage of voluntary costs has a weak positive relationship with legal compliance costs with an elasticity of 0.36, with the goodness of fit of a double-log regression being low, with an R Square of only 0.203.

4.7 Cash flow benefits of TDS obligations

Except in the case study in Chapter 8, no quantitative information is available on the cost of TDS obligations, though, as reported in the next Chapter, these are reported to be high. This is on a gross basis. On a net basis, taking into account cash flow benefits, computed as discussed in Chapter 2, some companies are able to recover much of their outlay. Details for 5 companies, in Table 4.15 (and in Chapter 8), show, however, that there is wide variation in the extent of cash flow benefits. This variation, furthermore, shows no clear relation to the number of employees in the company.

On average, these benefits amount to 14.5 percent of total legal compliance costs or one third of a percent of tax paid. In terms of the source, TDS benefits from non-employees are about a third of TDS benefits from employees.

Table 4.15: TDS Cash Flow Benefits of 5 Companies

	Company A	Company B	Company C	Company D	Company E	**Average**	**Standard Deviation**	**Coeff of Var.**
% of Tax Paid								
TDS Benefit: Employees	0.02	0.77	0.10	0.08	0.06	0.20	0.32	1.55
TDS Benefit: Non-Employees	0.01	0.43	0.04	0.14	0.02	0.13	0.18	1.37
Total TDS Cash Flow Benefits	0.03	1.20	0.14	0.23	0.08	0.33	0.49	1.47
In Rupees per Employee per Annum								
TDS Benefit Employees	2.19	85.10	89.64	55.19	60.16	58.46	34.86	0.60
TDS Benefit Non-Employees	1.88	47.92	36.66	93.17	20.98	40.12	34.34	0.86
Total TDS Cash Flow Benefits	4.06	133.03	126.30	148.37	81.14	98.58	58.46	0.59
% of Profit Before Tax								
TDS Benefit: Employees	0.005	0.24	0.04	0.02	0.03	0.07	0.10	1.45
TDS Benefit: Non-Employees	0.004	0.14	0.02	0.04	0.01	0.04	0.06	1.34
Total TDS Cash Flow Benefits	0.009	0.38	0.06	0.06	0.04	0.11	0.15	1.40
% of Legal Compliance Cost								
TDS Benefit: Employees	0.75	21.46	12.91	1.37	11.52	9.60	8.68	0.90
TDS Benefit: Non-Employees	0.65	12.09	5.28	2.31	4.02	4.87	4.40	0.90
Total TDS Cash Flow Benefits	1.40	33.55	18.19	3.67	15.54	14.47	12.91	0.89

50 In the mid-1990s, as a proportion of compliance cost, large firms in Hong Kong, Malaysia and Singapore spent more than other firms on tax planning. This information is in Ariff (1995), Loh et. al. (1997 and 1997a) and Chan et. al. (1999) as reported in Slemrod and Venkatesh (2002).

4.8 Tax saving through concessions

The importance of tax planning can be discerned from an examination of the extent of concessions made use of by companies. These are tabulated in Table 4.16. Although there is wide variation in the extent to which tax concessions are used to reduce tax liability, the tax savings achieved by the average firm are substantial, amounting, on average to over 200 percent of taxes paid. That this is achieved with a low outlay on tax planning suggests that Indian corporations have little need to resort to complicated tax sheltering arrangements to save taxes.[51] Comparing tax savings in rupee figures and as a percentage of taxes, the most important concessions for smaller companies turn out to be export related while backward area and infrastructure development concessions are of greater importance to large firms.

Table 4.16: Taxes Saved Through Income Tax Concessions by Sample Companies

	Tax saving (in Rs lakh)				Tax saving as a % of tax paid			
	Average	Minimum	Maximum	Standard Deviation	Average	Minimum	Maximum	Standard Deviation
Export related@	1422.7	3.2	8769.0	2791.9	193.12	1.38	926.27	317.77
Accelerated Depreciation#	28.3	0.003	73.3	31.9	65.14	0.002	258.13	128.66
Backward Area/ new industry/ infrastructure related*	4819.7	2.0	27900.0	11309.3	83.28	2.50	177.60	80.96
Others$	16373.3	146.7	32600.0	22948.0	42.21	3.12	81.30	55.28
All concessions	3201.9	2.0	32600.0	8763.6	207.12	1.90	1082.46	311.25

Notes: @: Under Sections 80HHB, 80HHC, 80HHD, 80HHE, 10A,10B. Number of responses : 11
#: Or, 100% depreciation on certain assets. Number of responses : 4
*: Under Sections 10C, 80HH, 80HHA, 80-IA, 80-IB. Number of responses : 6
$: One company specified "Capital expenditure on Research and Development u/s 35(2)". Number of responses: 2.

4.9 Conclusions

The major points emerging in this chapter relate to the importance of administrative delays, scrutiny procedures and litigation as sources of compliance costs. These are all well known as problem areas for tax administration. So the oft made point that streamlining of administrative procedures need improving finds additional support from this examination.

The other major findings are the importance of tax instability and complexity for seeking external assistance and the reported lack of importance of tax planning to compliance costs, despite companies achieving substantial tax saving via concessions.

[51] But see point (f) in section 5.2 below.

5. High Compliance Cost Requirements: "Hot Spots"

5.1 Information from the survey and focus group meetings

Tables 5.1 and 5.2 provide information on tax provisions identified as "hot spots" or high compliance cost areas by companies. Opinions are in Table 5.1 while compliance cost estimates are in Table 5.2. Tables 5.3 and 5.4 present similar information for administrative procedures. The relatively low variability of responses, as measured by the coefficient of variation (except for refunds in Table 5.4), is striking and in sharp contrast to most other findings in this report.

As would be expected, compulsory requirements yielding companies no benefit, including TDS and compulsory audits, figure at the top. Areas, which would possibly benefit from re-examination and tax simplification, however, are also identified in the tables. The most troubling item is that compliance costs for claiming export benefits are rated near the top of Table 5.2 and also receive a relatively high score in Table 5.1. This suggests that a portion of the value of these concessions is eroded by compliance cost, reducing their effectiveness per rupee of concession granted in boosting exports. Other than this, the tables throw up only one other surprise with other areas in the table being known for their complexity.[52] The high compliance cost of the MAT confirms results in another study.[53]

The other surprise is costs in connection with free trade zones which focus group participants verify to be of importance. These costs, associated with the need to get repeated clearances, again hampers export growth to an extent. Related "hot spots" are compliance with non-resident withholding and newly amended international tax provisions both of which have an international dimension. While it is not clear how far streamlining of the law in these areas can go, alternatives that can be explored to lower compliance costs are better taxpayer education and assistance, for example through improved advance ruling procedures and a broadening of their scope. In any case, compliance requirements with these hot spots are worth detailed examination.

Table 5.1: High Compliance Cost Income Tax Provisions

	Applicable	Time taken: High	Time taken: Average	Time taken: Low	Average Score*
TDS for non-employees	42	18	18	4	2.4
TDS for employees	41	16	15	8	2.2
Audit requirements u/s 44AB	39	26	11	0	2.7
Valuation of perquisites to employees	39	17	10	8	2.3
Minimum Alternate Tax (u/s 115JA/115JB)	26	11	7	7	2.2
Non-resident withholding (u/s 195 etc.)	26	5	14	5	2.0
Loss carry forward and set off	22	6	11	3	2.2
Income accruals	21	1	12	5	1.8
Claiming export benefits (u/s 80HHC, 80HHE, 10A/ 10B etc.)	19	8	6	4	2.2
International tax provisions	19	8	6	5	2.2
Others (Inconsistencies with Companies Act, depreciation provisions, establishment	18	9	4	4	2.3

52 Problems of obtaining certificates from those collecting taxes at source from companies are no longer a problem as appropriate streamlining has been introduced.

53 As discussed in Chapter 1, in the USA, the Alternate Minimum Tax (AMT) caused compliance costs to rise by 11.5% for those subject to AMT but increased compliance costs by as much as 136% for companies *not* subject to AMT (Slemrod and Venkatesh, 2002).

costs in connection with free trade zones)					
Tax collected at source	17	7	4	6	2.1
Taxes and deemed dividends	5	1	2	2	1.8
*Note: Time taken High = 3, Time taken Average = 2, Time taken Low = 1.					

Table 5.2: Compliance Costs of High Compliance Cost Income Tax Provisions
(% of legal compliance cost)

	Average	Minimum	Maximum	Std Dev	Coeff. of Var.	Obser-vations
Audit Requirements u/s 44AB	13.26	0.005	30.00	8.48	0.64	21
Claiming export benefits (u/s 80HHC, 80HHE, 10A/ 10B etc.)	10.04	0.005	30.00	9.82	0.98	11
TDS for employees	9.01	0.015	24.70	6.71	0.74	18
TDS for non employees	8.44	0.015	40.20	9.13	1.08	18
International tax provisions	6.75	2.000	15.00	5.68	0.84	4
Loss carry forward and set off	6.50	0.005	15.00	5.14	0.79	12
Valuation of perquisites to employees	6.25	0.040	20.00	5.15	0.82	17
Income accruals	5.50	1.000	10.00	3.72	0.68	10
Non-resident withholding (u/s 195 etc.)	5.37	0.040	10.00	3.93	0.73	11
Minimum Alternate Tax (u/s 115JA/115JB)	5.29	0.010	10.00	3.73	0.70	7
Tax collected at source	4.18	0.005	10.00	4.20	1.01	6
Inconsistencies with Companies Act, depreciation provisions, establishment costs in connection with free trade zones, etc.	4.08	0.010	10.00	3.22	0.79	9
All categories above*	46.96	0.070	100.00	26.86	0.57	24

Notes: (1) u/s: Under section.
(2) *: The average figure in the total row is not the column sum. It has been computed from company by company totals.

Among administrative problems, refunds, scrutiny assessment, TDS and litigation are, by now, recurrent themes. The need for administrative streamlining in these areas, finds further support from the information presented here. In Table 5.5, which summarises responses to open ended questions by respondents, the same issues recur. However, two important areas not found in close ended questions are highlighted here: Lack of accountability and transparency in tax administration matters and non-transparent and ambiguous terminology of tax laws. Lack of accountability and the ill effects of administrative discretion have been pointed out by others over the years, without any effect on administrative functioning. So too has the need for clear legal drafting.

Table 5.3: Compliance Requirements With Income Tax Administrative Procedures

	Applicable	Time taken-High	Time taken-Average	Time taken-Low	Average Score*
Refunds	33	24	5	1	2.8
Scrutiny assessment procedures	37	22	6	4	2.6
Accounting for TDS	36	19	10	4	2.5
Appeals and litigation	33	17	7	4	2.5

Completion and filing corporation tax return	37	16	14	3	2.4
Obtaining clearances, approvals, etc. from IT authorities	29	11	9	6	2.2
Accounting for IT purposes (u/s 132, 145A)	25	8	9	5	2.1

Note: * Time taken – High = 3, Average = 2, Low = 1.

Table 5.4: Cost of Compliance With Income Tax Administrative Procedures
(% of legal compliance cost)

	Average	Minimum	Maximum	Std Dev	Coeff of Variation	Obser-vations
Appeals and litigation	14.67	0.040	65.00	15.31	1.04	15
Scrutiny assessment procedures	14.50	0.005	50.00	11.78	0.81	14
Refunds	11.74	0.040	70.00	17.11	1.46	15
Completing and filing corporation tax return	10.32	0.005	25.00	7.23	0.70	15
Accounting for TDS	9.47	0.005	25.00	6.75	0.71	15
For clearances, approvals, etc. from IT authorities	6.51	1.000	15.60	4.57	0.70	9
Accounting for IT purposes (u/s 132, 145A)	5.14	0.005	12.00	3.80	0.74	7
All categories above*	43.07	0.020	100.00	25.85	0.60	23

Note: *: The average figure in the total row is not the column sum. It has been computed from company by company totals.

Table 5.5: Problems Identified By Respondents in Open Ended Questions

Problem area	Number of Respondents mentioning problem
Slow Assessments/Appeals procedure at various level	9
Complicated returns and complicated rules/lack of accountability in case of refunds/approvals etc., delays in refunds/ follow up for refunds	9
Collection of TDS certificates from various customers and getting credit for the same (*Note: procedure now streamlined*)	9
The complex scheme of the Act for granting allowances and disallowances, Complex maze of provisions, concessions and rules	8
Delays in delivering orders/ tax orders	5
Lack of accountability and transparency in tax administration matters	5
Nontransparent and ambiguous terminology/tax laws.	4
Complexity in compliance with various procedures	4
Complex tax audit report	3
Need for elimination of tax categories both at Central and State level	1
Difficulty in compliance with transfer pricing regulations	1
Changes to extend the purview of prerequisites	1

5.2 Comments on factors contributing to compliance costs in focus group meetings

These comments, which serve to flesh out the bare bones provided by numbers, made by individuals with long experience "in the trenches", are of great interest. Specific suggestions made by participants are underlined.

General comments

(a) A basic malady today of the tax system was the unhelpful attitude of officials and their lack of accountability.

(b) Technical lapses arose due to new procedures not being pre-tested. A key illustration is the additional tax fiasco under the now repealed section (u/s) 143(1A) which introduced automatic additional tax at 20 percent for technical defaults applicable under the summary assessment scheme u/s 143(1)(a).

(c) *On CBDT[54] Notifications*: An important source of compliance costs is new or unforeseen notifications. In addition, Revenue Department interpretations of new notifications very often differ from taxpayers' interpretations leading to judicial references. For example, ambiguities have arisen from the CBDT notification[55] whereby Voluntary Retirement Scheme (VRS) payments are treated as capital expenditure.

(d) <u>There is a need for continued training of departmental officers in income tax law and procedures.</u>

(e) <u>Tax simplification by doing away with exemptions and deductions was a good way to lower compliance costs</u>.

(f) There are built-in incentives in the income tax law for individuals to form companies to claim cost deductions. An estimated 60 percent of the companies are purely tax shelters.

On problems with assessment procedures and assessing officers

(g) In many areas there are cases where the Income Tax Department itself breaks the law.

(h) Assessing officers' fear of targets lead to significant compliance costs to taxpayers via "high pitched assessments".

(i) AO's are not penalised or accountable for improper or incorrect assessments. The claim that AO's are held accountable for incorrect assessments is baseless.

(j) Multinational companies have to bring vouchers from their head offices [abroad] on a day-to-day basis for income tax assessment, greatly adding to their compliance costs.

(k) Recent transfer pricing provisions are likely to give more discretionary power to AOs.

On advisors and external costs

(l) A large proportion of advisors fees were to cover the cost of "idle time" waiting for appointments, meetings and hearings, often on benches outside the rooms of concerned income tax officials.

(m) Among major reasons that taxpayers used professional advisors was because outsourcing was generally cheaper, and, second, to secure representation before tax authorities.

(n) Tax consultants continue to be used despite "simplification" because nothing had really changed in the field despite high level reforms.

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54 Central Board of Direct Taxes.

55 *Economic Times*, Feb 23, 2001.

On Tax Deduction at Source

(o) The TDS compliance burden on companies was high. Among reasons are:

(1) Companies had to go through two assessments, one for income tax and one for TDS.

(2) Great uncertainty prevailed due to the fact that *no time limit on TDS assessments exists* unlike income tax audits where there is a 5 year limit on reopening of assessments. So, TDS assessment records have to be maintained for at least 10 years.

(3) There was lack of coordination between TDS withholders, withholdees and IT officials leading to avoidable costs to companies which could be sorted out by streamlining of procedures.[56]

(4) TDS penalties were often levied on withholders though the fault lay with withholdees.

(5) Administrative problems arose due to "non-application of mind" by tax officials leading post-filing costs of TDS being very large.

(p) There were 10,000 to 15,000 cases in 1998-99 of penalties u/s 201 [making the principal officer of a company liable for TDS defaults] read with section 221 [on TDS penalties], most of these being unsustainable.

(q) Prosecutions were often launched following misinterpretation of the law by assessing officers. Subsequent approval of the decision to launch prosecution by senior officers was often given following the transfer of the senior officer who were aware of facts of the case.

(r) For prosecutions, all directors of companies were defendants (and usually granted bail) who were required to be present at all sessions court hearings. Failure to appear could result in non-bailable warrants of arrest being issued.

(s) Sessions judges were usually untrained in tax matters and often referred prosecution cases back to tax authorities for explanation leading to further delay. Many TDS prosecution cases were pending for up to 20 years.

(t) Companies were not in general averse to helping revenue collection of the government by deducting taxes from those who otherwise might not have paid – but they were upset by this resulting in criminal liability in case of technical lapses, especially when these lapses were only in the tax department's mind.

(u) For TDS on payments to non-residents u/s 195, the rate of deduction has to be determined on a case-by-case basis by assessing officers in a prescribed form. <u>To reduce compliance costs a prescribed uniform rate was needed.</u>

(v) <u>The scheme for rationalisation of TDS proposed in an article in the *Economic Times*, 18 February, 2001, was good in principle and should be seriously considered</u>.

(w) <u>Firms should be compensated for the tax collection service they provided to the government</u>.

On costs due to clearances and permissions

(x) An important contributory factor to compliance costs was the need to obtain various clearances and prior approvals from IT authorities and also the need to follow up on letters and petitions on various matters.

(y) Clearances for immoveable property sales u/s 230A were a major problem.

(z) <u>Penal provisions for IT Department staff in case of delays in clearances were needed.</u>

[56] The recent increase in the time limit for submission of TDS certificates is reported to have resolved this issue. See Chapter 8.

On high compliance cost income tax provisions and notifications

(aa) Conflicts with the Companies Act (and other legislation) that imposed costs include, importantly, differences in accounting requirements and depreciation provisions.

(ab) Procedures connected with amalgamation, merger or de-merger of companies (or restructuring) led to considerable compliance costs.

(ac) For companies setting up units in free trade zones, the compliance requirements of section 10A and 10B [for newly established undertaking in free trade zones or for exports] imposed an additional burden in terms of research and tax planning costs. There are cases where these costs have deterred companies from setting up units in these zones due to the compliance burden. This hurts exports.

(ad) Grievances about sections 44AB (compulsory financial audit) have received little attention from the authorities.

(ae) It is often very difficult for an employer to open a provident fund for his employees because income tax rules regarding provident funds are quite different from the Provident Fund rules. The need for different rules by two arms of the government for the same purpose was not clear.

On appeals and litigation

(af) Up to 90 percent of cases in which assessing officers make additions end up in appeal.

(ag) Cases took between 2 and 7 years at the Income Tax Appellate Tribunal (ITAT), 7 and 8 years for judicial references and between 3 to 4 years in case of tax prosecutions.

(ah) Time delays in appeals were exacerbated by an inadequate number of benches though additional benches had recently been sanctioned.

(ai) The success rates of the Department in appeals and prosecutions was very low. The major outcome of appeals was higher compliance costs.

(aj) A possible reason for filing of appeals by the IT Department, even when they did not have a proper case, was because appeal filing decisions were made by ITAT counsels themselves – who stood to gain from them.

(ak) One reason for the growth in appeals cases was cases between the tax authorities and government companies[57], which should ideally be settled outside the court system instead of wasting taxpayers' money.

(al) <u>Refund of appeal fees in case of dismissed appeals should be made mandatory</u>.

On delayed refunds

(am) Non-refund of excess tax paid but adjustment of refunds due against future taxes was the norm.

(an) Many man-hours were wasted in collecting refunds.

(ao) Lower level officers were over-enthusiastic about meeting revenue targets and did not pay sufficient attention to refunds.

(ap) <u>Penal provisions for IT Department staff in case of delays in refunds should be instituted</u>.

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[57] See, for example, the public sector undertaking case study in Chapter 8.

On the requirement to file returns under the "1 in 6 scheme"[58]

(aq) A reduced filing frequency should be prescribed if no taxes are found due in any assessment year.

5.3 The tax cost to companies of CAG audit objections

The incorrect application of various tax provisions by the tax officials burdens taxpayers who have their tax assessments revisited. Costs associated with reopened assessments should have been factored into reported costs in Chapters 3 and 4. No separate estimates of the contribution of reopened assessments is possible from data available.

Table 5.6: Audit Objections By the CAG and Their Tax Effect: 2000-01 (in Rs Lakh)

Nature of Objection	Under estimation of income	Over estimation of expenditure	Tax effect	Number of cases
Incorrect valuation of closing stock		56332	56332	20
Underassessment of income and tax	4506	6609	11114	92
Incorrect computation of income of financial corporations or business income	7888		7888	67
Incorrect carry forward/set off of losses		7533	7533	65
Over-assessment of income and tax	7375		7375	23
Irregular allowance of depreciation/ incorrect rates of depreciation applied		5910	5910	67
Other types of incorrect assessment of taxes*			9840	55
Total			**105992**	**389**
Memo:				
Total tax effect of all audit objections			*128838*	*618*
Total tax effect as a percentage of corporate income tax collections			*3.6*	

Notes: * Irregular exemption; Excess deduction under Chapter VIA; Incorrect allowance of deduction; Incorrect allowance of relief in respect of profits from export business; Mistake in allowance of deduction of profits derived from services provided to foreign tourists.
For detailed explanation of items in the table see Annex 3.5.
Source:CAG (2002)

Instead, by examining the most expensive and most frequent mistakes made by tax officials, additional information can be gained about problem areas. While only internal evaluation of the reasons for these lapses can bring the full reasons to light, areas where additional training is needed for income tax officials – or areas which they deliberately ignore – are presumably reflected in their mistakes. In Table 5.6 the number and value of major audit objections by the CAG in 2000-01 are summarised.[59] The most serious problem is with valuation of closing stocks of companies followed by the portmanteau category "underassessment". Both of these are areas where a good deal of discretion is available to assessing officers. Given that only a small proportion of cases are externally audited, in many cases mistakes probably do not come to light. Of the next 4 categories in the Table, items 3 to 6, three deal with areas where the tax law is known to be complex and so could largely reflect genuine mistakes by assessing officers which can be remedied by training.

58 Under the “1 in 6 scheme”, filing is mandatory for individuals who have club memberships, credit cards, cellular phones, travelled abroad during the year, or own a house or a car.

59 Audit objections are made when mistakes come to light during annual test checks by auditors. However no information is available in CAG (2002) on the total number of test checks carried out, though this was reported in previous years.

5.4 Conclusions on specific high compliance costs areas

To close this analysis of hot spots, the major areas that have come to light are listed. Regarding legal and tax provisions, an important general finding is that there are five areas related to international transactions that have been found or are expected to be troublesome. These areas will become increasingly important as global links of Indian companies grow.[60] Instead of listing specific areas here, they are listed in Chapter 9 along with suggestions for reform.

Besides detailed examination by the Income Tax Department and simplification where possible of these provisions and procedures, improving taxpayer services for business appears to offer the best scope for reducing compliance costs of these provisions. However, with regard to concessions, the large tax benefits companies derive from them suggest that tax simplification by scrapping concessions, especially where the extent of the concession is not justified by commensurate achievement of social objectives, is an additional option for lowering compliance costs.[61]

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[60] As reported in Chapter 1, Slemrod and Venkatesh (2002) infer that US companies with international operations had compliance costs 143% higher than other US companies.

[61] Reform of procedures as well as tax simplification have both been suggested by the Kelkar Committee. See Government of India, Ministry of Finance and Company Affairs (2002).

6. Compliance Costs Associated with Inefficiency and Corruption

6.1 Survey based information on compliance behaviour and illegal compliance costs

Table 6.1 reports respondents' opinions of the percentage of companies in similar businesses who do not file returns or do not pay any corporation tax. As can be seen, 8 percent of companies belong to this group. If greater weight had been assigned to smaller companies, this percentage could have been higher, as no opinion was expressed mainly by smaller companies in the sample.

Table 6.2 provides information about respondent's opinions on the extent of income underreported to tax authorities. As can be seen, the 12 responding companies feel that there is no underreporting or that underreporting is low, with a weighted average underreporting percentage of less than 10 percent. This is despite companies feeling that the probability of detection and punishment of tax evasion is low: The weighted average subjective probability of detection and punishment is 6.1 percent, with only 3 companies feeling that the probability is above 5 percent, and no company feeling that it is above 40 percent (Table 6.3).

Table 6.1: Percentage of Companies in Similar Businesses Who Do Not File Corporation Tax Returns or Fail to Pay Any Corporation Tax: Opinion of Respondents

	No of responses	% of responses
0 percent	9	20.5
1 to 25 percent	9	20.5
26 to 50 percent	1	2.3
51 to 75 percent	0	0.0
76 to 100 percent	0	0.0
No Opinion	25	56.8
Total responses	44	
Average % of companies not filing return or paying taxes	7.9	

Table 6.2: Percentage of Deliberately Underreported Income of Companies in Similar Businesses: Opinion of Respondents

	No of responses	% of responses
0 percent	5	11.1
1 to 25 percent	6	13.3
26 to 50 percent	1	2.2
51 to 75 percent	0	0.0
76 to 100 percent	0	0.0
No Opinion	33	73.3
Total responses	45	100.00
Average % of companies evading tax	9.4	

Table 6.3: Tax Evading Companies Against Whom Penalty Proceedings are Initiated: Opinion of Respondents

	No of Responses	% of responses
0 to 5 percent	11	25.00
6 to 10 percent	1	2.27
11 to 20 percent	1	2.27
21 to 30 percent	0	0.00
31 to 40 percent	1	2.27

41 to 50 percent	0	0.00
51 to 75 percent	0	0.00
Over 75 percent	0	0.00
No Opinion	30	68.18
Total responses	44	100.00
Average "subjective detection and punishment probability"	6.1	

On the other hand, nearly a third of companies expressing an opinion felt that they had been subjected to harassment by income tax officials (Table 6.4). As mentioned earlier, statistical analysis of *legal* compliance costs, summarised in Annex 4.1, suggests that harassment makes a statistically robust contribution to higher compliance costs.

Eight of the 14 companies, or over 50 percent of companies expressing an opinion on the issue, felt that companies in similar businesses paid bribes to Income Tax officials (Table 6.5). The 70 percent "no comment" rate may suggest that the actual percentage of bribe paying companies is higher. However the two companies providing quantitative information on cash bribes reported bribe amounts that are small relative to their sales or profits but large relative to the legal income of tax officials, at around 4 to 5 times the monthly salary of an Income Tax Assessing Officer (Table 6.5)[62]. Bribes reported as a percentage of tax saving (by 3 companies), on the other hand, suggest substantial bribes and possibly substantial benefits from bribes.

The survey did not ask about "on-the-books" festival gifts, an issue that did not come to light during pre-surveys. This was reported in an open ended response by one company, as well as by the private sector company in the case study in Chapter 8, at around Rs 80,000 per year. The case study company also reported that the expected nature and value of such gifts was known and depended on the rank of the tax official.

All of this suggests that illegal compliance costs, while widespread and not by any means small, are not directly the major source of compliance costs, though indirectly, they may be large if delayed refunds are largely attributable to harassment on non-payment of bribes. Nevertheless, bribe incomes of corrupt tax officials are probably several times higher than their legal salaries. The information in this survey finds support from earlier evidence, reported on in the next section.

Table 6.4: Number of Companies Harassed

	No of responses	% of responses
Yes	10	22.22
No	21	46.67
No Comment	14	31.11
Total responses	45	100.00

Table 6.5: Bribes Paid by Companies Engaged in Similar Business

	No of responses	Percentage to total
Yes	8	18
No	6	13
No Comment	31	69
Total responses	45	100

62 See also the case study in Chapter 8, where the reported bribe is Rs 5 lakh.

Table 6.6: Estimates of Bribes Paid by Companies in Similar Businesses			
	In Rupees		As a percentage of tax saved
Company A	85,000	Company C	10
Company B	100,000	Company D	10
Case study private sector company	500,000	Company E	30

6.2 Bribe costs – some earlier survey-based evidence

A survey of 210 companies on "Conditions for Business Operation and Growth" was commissioned by the World Bank and conducted in 1999 by the Confederation of Indian Industry (CII). The survey found a fair degree of uniformity in corruption among different government departments. Nevertheless the differences that do exist suggest that IT officials are not as corrupt as, for example, customs or public utility officials. Even so, 43 percent of companies reported paying bribes frequently and only 13 percent claimed never to have paid bribes. The survey did not provide any information of the quantum of bribes to income tax officials. However the median quantum of bribes reported by companies bidding for government contracts (2 to 9 percent of government contracts averaging 5 percent: Table 6.8) is somewhat higher than data from the current survey suggests is the case for income tax officials, if a return of 15 percent on investments is assumed.

An additional, disturbing, feature of illegal compliance costs is that the quantum of bribes is variable, possibly subject to negotiation and not always (though usually) a guarantee that "benefits" paid for will be forthcoming (Table 6.9). This contributes to uncertainty about tax related costs of business, increasing the "effective" compliance costs due to their psychic element.[63]

Table 6.7: Frequency of Bribes, 1999 (% of responses)								
	Never (a)	Seldom (b)	Sometimes (c)	Frequently (d)	Usually (e)	Always (f)	**d+e+f**	**Average Score**
Score	1	2	3	4	5	6		
Government Contracts	24	10	21	12	17	16	45	3.36
Income Tax Officials	**13**	**16**	**28**	**14**	**15**	**14**	**43**	**3.44**
Customs Officials	14	10	31	14	13	18	45	3.56
Electricity/Telephone connections	14	15	22	10	23	16	49	3.61
Licenses/Permits	9	17	24	15	24	11	50	3.61
Note: 210 Confederation of Indian Industry member companies surveyed. Source: World Bank (2000)								

Table 6.8: Bribes Paid by Bidders for Government Contracts, 1999							
% of contract value in additional or unofficial payment to secure contracts	0	0-1	2-9	10-17	18-25	25+	Average
% of responses	22	15	54	4	3	2	4.80
Note: 210 Confederation of Indian Industry member companies surveyed. Source: World Bank (2000)							

63 Related information on bribe benefits is presented in Section 6.4 below.

Table 6.9: Frequency and Nature of Bribes to Government Officials, 1999 (% of responses)								
Bribe payments	Always (a)	Mostly (b)	Frequently (c)	Sometimes (d)	Seldom (e)	Never (f)	**a+b+c**	**Average Score**
Score	6	5	4	3	2	1		
It is common to pay irregular additional payments to get things done	15	19	21	28	6	11	55	3.76
It is usually known in advance how much the additional payment is	2	17	16	43	16	8	35	3.24
If a firm pays the required "additional payment" the service is usually delivered	12	36	28	18	5	1	76	4.29
Note: 210 Confederation of Indian Industry member companies surveyed. Source: World Bank (2000)								

6.3 Qualitative information from the survey and focus group meetings

Some qualitative information was provided by participants in focus group meetings and by survey respondents via responses to open ended questions. Information from these sources is now summarised.

On tax evasion

(a) There was a direct link between the compliance costs and tax evasion.

(b) The effect of illegal and harassment compliance costs on small taxpayers was to cause them to undergo attitudinal changes, which adversely affected their willingness to comply.

(c) Taxpayers no longer had any social consciousness.

(d) There are huge amount of tax evasion in India.

(e) Psychic costs are a very important part of compliance costs. Many individuals do not want to be in the tax net only because of the mental tension they suffer from being a part of it.

On bribes

(f) Lack of integrity of income tax officials and the Assessing Officers' fear of targets lead to significant compliance costs to taxpayers.[64]

(g) In tax collecting agencies some people take bribes in the name of their *'Sahibs'* or superiors.

(h) Bribes in kind are of importance.

(i) Bribing of appellate authorities to get favourable judgments was of importance.

(j) Bribes were invariably demanded for tax clearance certificates (Form 34A) under section 230A in Delhi. To get clearances for immovable property sales under section 230A, bribes also had invariably to be paid in Mumbai to income tax officials. To avoid harassment, the opportunity cost of which was (e.g.) Rs 20,000, a bribe of Rs. 5,000 was typically paid.

64 This point is repeated from section 5.2 as it is applicable in both sections.

(k) Despite the "*inspector raj*" being abolished (partly replaced by "*ordinance raj*") there was still a fixed rate chart of bribes (especially in the state of Haryana) that all companies were forced to pay. This led to companies having a very negative attitude towards government.[65]

(l) The need to pay bribes led to companies concealing their income since bribe costs could not be shown on the books.

On harassment

(m) An example of a section where compliance requirements were always associated with harassment was section 194J of the Income Tax Act. Under sub-section 2, tax deduction at source from fees for professional and technical services can be done at a rate lower than prescribed, with the approval of the Income Tax Assessing Officer (AO). The harassment arises in obtaining this clearance.

(n) In TDS matters, the corporate sector provides a service to the government but, in return, they are harassed, including via penalty proceedings which are initiated for the late issue of TDS certificates. There is a total absence of any proactive mechanism. For example, the scope of Advance Rulings could be extended to cover certain administrative issues.

6.4 Private benefits from bribes

Table 6.10: Perceived Benefit from Unofficial Payments: Responses of Surveyed Firms

	Very Important (4)	Quite Important (3)	Average (2)	Quite Unimportant (1)	Unimportant (0)	No Opinion	Total responses	Average score
Saving of tax liability	4	2	1	2	3	4	16	2.2
To obtain a tax refund	5	3	0	2	2	4	16	2.6
Prevention of harassment from officials	8	4	1	0	0	4	17	3.5
For long-term relations with tax officials	0	6	1	3	3	4	17	1.8

In Table 6.10, prevention of harassment by income tax officials is most cited as the reason for payment of bribes with 12 out of 17 respondents claiming this to be important. Obtaining tax refunds is also a source of harassment and, as discussed in Chapters 4 and 5, a source of added compliance costs. Both of these add to (quasi-) mandatory costs, because of the absence of direct benefits. The other two reasons, which are more in the nature of voluntary costs, especially bribes to save taxes, have benefits that probably outweigh costs. While these responses will almost certainly suffer from participatory bias and overstate the costs of harassment, they still suggest that reducing the extent of discretion of income tax assessing officers can lower compliance costs.

6.5 Statistical analysis of the determinants of and impact of corruption

The determinants of bribes are studied here, by taking advantage of the World Bank – CII data set described above. The best variable available in the data set for our purpose is the frequency of bribe payments to income tax officials.[66] This is regressed, using multinomial probit, on a set of control factors and hypothesised bribe determinants available in the data set.

Control variables include an indicator of company size (employees), three indicators of the ownership pattern (whether listed on a stock exchange, government equity share and foreign equity share) and one for the main sector to which the company belongs (manufacturing/non-manufacturing).

65 This tends to contradict World Bank-CII survey data that the quantum of bribes is uncertain.

66 Detailed variable definitions are in Annex 6.5.

An additional control variable, to test for respondent bias caused by high taxes rather than corruption, is the extent to which respondents' perceive high taxes as an obstacle to business (no problem = 0, major problem = 3). Unfortunately, the question in the survey was not specific to the corporation tax.

Hypothesised determinants of bribes available in the data set include:

(a) The extent of a problem IT regulations/ administration is in the perception of respondents (no problem = 0, major problem = 3).

(b) Respondents' opinions of the affordability of courts (which is largely collinear with opinions about the honesty, quickness and fairness of courts). This is included as effective judicial redressal could possibly be curb harassment and, therefore, bribes.

(c) Respondents' opinions about how helpful the government and bureaucracy are to business, (very helpful = 5), which is the best variable available to capture the impact of bribes in return for services or reduced taxes. Under this interpretation, the coefficient would be positive. Alternatively, if this variable captures the extent to which the bureaucracy provides services without demanding bribes, it would have a negative coefficient. Mixed motives would, of course, lead to indeterminacy of sign and possible insignificance. Again, unfortunately, the variable is not specific to income tax officials.

Table 6.11: Determinants of Bribes Paid to Income Tax Authorities
(Dependent: Bribes to IT Officials, always = 5, never = 0)

(Multinomial Probit Regression Analysis)	Coefficient	z-value	Coefficient	z-value	Coefficient	z-value
Problem: IT regulations/ administration (no = 0, major = 3)	0.15	1.59	0.06	0.55	0.09	0.94
Obstacle: High taxes (no = 0, major = 3)	-0.11	-1.37	-0.05	-0.55	-0.07	-0.84
Affordability of Courts	0.05	0.87	0.05	0.89	0.07	1.17
Govt/ bureaucracy helpful to business (very helpful = 5)	-0.26***	-3.19	-0.37***	-4.32	-0.33***	-3.79
Listed	-0.21	-1.22	--		-0.23	-1.30
Manufacturing	0.68***	3.42	--		-0.68***	3.31
No. of Employees	--		-0.00002	-1.37	-0.00003**	-1.74
Govt equity share (%)	--		-0.01**	-1.48	-0.009	-1.31
Foreign equity (%)	--		0.007	1.49	0.006	1.19
Number of observations		163		156		156
LR Index (Pseudo R square)		0.045		0.041		0.062
Log likelihood		-272.43		-262.37		-256.74
LR statistic (d.f)		26.02 (6)		22.52 (7)		33.78 (9)
Probability of LR statistic		0.0002		0.002		0.0001
Number of ordered indicator values		6		6		6

Notes: ***: Significant at 5% or better.
**: Significant at 5 to 10%.

Results are reported in Table 6.11, where, in alternative regressions, different sets of controls are included to gauge the sensitivity of results. The results indicate, first, that possibly important determinants of bribes are omitted from the regression, resulting in a poor goodness of fit. Second, however, the negative and significant coefficient of the "Govt/ bureaucracy helpful to business" variable suggests that payment for service is not the major reason for bribe payment. This leaves harassment. However, obstacles from income tax regulations and administration per se are not, according to the results, a reason for bribes.

Determinants of tax evasion behaviour

To cross check results for bribe determinants, the link between corruption and tax evasion is also examined. Results from the bribe regression on the lack of importance of bribes as payment for service would be supported if corruption was not significantly associated with evasion. On the other hand, a positive association is inconclusive, since this could be interpreted as supporting the suggestion of a focus group participant, that the need to pay bribes led companies to conceal income since bribe costs could not be shown on their books. Unfortunately, the tax evasion variable is for sales off-the-books, more relevant for sales tax evasion and only indirectly for corporate tax evasion.

Other controls in the regression include the five basic controls in the previous regression and three variables to capture the impact of legal and illegal market competition.[67]

Table 6.12: Determinants of Percent of Sales Off the Books
(Dependent: % of Sales off the books by companies in similar business)

(OLS Regression Analysis)	Coefficient	t-value
Intercept	-16.17**	-1.80
Corruption	3.28***	2.17
Bribes to IT Officials (always = 5)	1.07	1.02
Market competition (0 = none)	1.17	1.55
Problem: Domestic producers sell below your prices (major = 3)	0.64	0.60
Obstacle: Competitors' tax avoidance	3.77***	2.16
Listed	-0.45	-0.13
Manufacturing	-3.67	-0.76
No. of Employees	0.0001	0.86
Govt equity share (%)	-0.07	1.00
Foreign equity (%)	-0.01	-0.27
Number of observations	105	
R square	0.18	
Adjusted R square	0.10	
F- Statistic	2.13	
Probability of F	0.03	
Mean of dependent variable	4.76	

Notes: ***: Significant at 5% or better.
**: Significant at 5 to 10%.

Results of this analysis are in Table 6.12. While the overall goodness of fit is poor, the strong association between corruption and evasion, since it could reflect the importance of bribes for service, renders the results of the two regressions taken together, on the nature of bribes, indeterminate. One important finding, however, is that porous tax laws or lax enforcement, permitting illegal competition

[67] For a theoretical analysis of the importance and impact of illegal competition see Palda (2001). Other important papers in the limited work on company tax evasion are Wallschutzky (1988) and Rice (1998). The paper by Yaniv (1999) suggests that advance tax payments are an important determinant of the extent of tax evasion. However, his hypothesis cannot, unfortunately be taken into account in our analysis.

via tax evasion (as captured by competitors' tax avoidance), has a strong association with underreporting. Consequently tax simplification and better enforcement are likely to improve compliance, though this may or may not impact compliance costs.

6.6 Conclusions

Overall, the evidence and information in this chapter throws up some interesting if preliminary information on the impact of inefficiency and corruption. To summarise:

- Bribes by companies are possibly not uncommon, though they probably do not contribute substantially to compliance costs.
- Besides bribes *per se*, the established tradition of festival gifts to government officials, including tax officials, contributes marginally to compliance costs.
- Bribes are however, likely to be a major income source of corrupt officials.
- There are additional psychic costs associated with bribes due to their uncertain quantum and, in case of services expected in return, the 25 percent chance that "contracted" services will not be delivered.
- The study suggests that bribes in return for services are possibly less important than bribes to escape harassment. This result should be taken as tentative as some of the evidence presented may point in the opposite direction.
- Official inefficiency is manifested in a low perceived effectiveness of tax enforcement which leads to direct and indirect costs via tax evasion. Even so, the perceived extent of tax evasion by companies is not high.
- The need to pay bribes may itself be a cause of tax evasion, since companies cannot report bribe payments in their accounts.

The major policy implications are merely a reiteration of what is already widely accepted: lowering the discretionary powers of income tax officials, increasing their individual accountability and reducing occasions for direct contact with taxpayers where possible. Despite possibly low tax evasion by companies, room for better enforcement also appears to exist along with tax simplification.

Among specific areas, alleged bribe taking by appellate authorities to give favourable judgments is a disturbing finding,. Opportunities for this should, perhaps, be curbed, by establishing after the fact reviews of a sample of appeal cases. Second, alleged widespread bribes and harassment through delays if bribes are not paid for quick refunds suggest the need to streamline refund procedures, as has already been mentioned. Streamlining of procedures for grant of tax clearance certificates (Form 34A) under section 230A and removal of discretion in setting rates for tax deduction at source from fees for professional and technical services under section 194J of the Income Tax Act are other areas meriting attention.

7. The Policy Environment and Compliance Costs

7.1. How psychic costs of policy are estimated

In line with the attempt to measure psychic costs of individuals of complying with income tax obligations in Chattopadhyay and Das-Gupta (2002), an attempt is also made here to measure psychic costs of companies even though appropriate interpretation of opinions expressed, being those of responding company officials rather than company owners, is less clear. To do this, similar questions to those in individual questionnaires were included in the company questionnaire. Psychic costs associated with lack of simplicity of the tax structure, uncertainty due to ambiguity of tax provisions, and uncertainty due to frequent changes in tax laws are the three important contributors to psychic costs studied. Indirect evidence of their importance has already been presented in Chapter 4.

Psychic costs questions were designed to elicit the willingness to pay of respondents (or the compensating variation of consumer choice theory in economics). Companies were accordingly asked how much extra tax would they be willing to pay if, say, the tax system is made simpler. The specific questions are reproduced in Box 7.1. A fourth question, on the value of publicly provided goods and services, was also included as this has been found to be an important determinant of negative fiscal attitudes by some researchers.[68] Percentages of tax were converted to rupees in analysis by using information on taxes paid from questionnaire responses.

Box 7.1: How Psychic Costs of Policy and Government Expenditure Benefits are Estimated

Q1 Imagine a private firm, on payment, is able to offer your company a guarantee of immunity in the event that it is found in violation of the law, due to existing AMBIGUITIES in Income Tax provisions. If you accept this offer, what service charges (as a % of tax paid by your company) would the company be willing to pay?

The company would be willing to pay_______ % over and above corporation tax paid to the government as service charges.	Offer not accepted *(Mark Ö)*

Q 2 Imagine that income tax laws are made EASY FOR COMPANY OFFICERS TO UNDERSTAND and SIMPLE TO COMPLY WITH but at the same time taxes are increased. How much extra tax would the company be willing to pay?

The company would be willing to pay_______ percent extra tax.	Cannot say *(Mark Ö)*

Q 3 Imagine the Government legally guarantees that there will be ABSOLUTELY NO CHANGE in Income tax laws and no new notifications for the next 5 years, but, in return, your company has to agree to a small increase in its taxes. If you agree to this proposal, how much extra tax would the company be willing to pay?

The company would be willing to pay_______ percent extra tax.	Cannot say *(Mark Ö)*

Q 4 The government collects taxes from you and provides various public services in areas such as health, education, law and order, infrastructure, etc. In your estimate, how much benefit is your company able to derive from the government **as a % of tax paid by it?** (Mark X on the scale below)

No opinion *(Mark Ö)*

0% 20% 40% 60% 80% 100% 120% 140% 160% 180% 200%

____

[68] See Cowell and Gordon (1988), Wallschutzky (1988), Bordignon (1994), and Pommerehne, Hart and Frey (1994).

7.2. Costs of the policy environment

7.2.1 Psychic costs

To avoid partial double-counting, estimates of psychic costs are not added to estimates of objective compliance costs presented earlier. This is because taxpayers are likely to spend less time and money complying with taxes if the tax system were simpler, less ambiguous and more stable so adding psychic costs to objective costs will result in double counting. Tables 7.1 reports psychic costs of respondents as a percentage of taxes paid. The table shows that *psychic costs are not small* and while variable, *have coefficients of variation that are well below that of legal compliance costs*. Average psychic costs are about 50 percent of objective legal compliance costs of the sample, reported in Chapter 3. Among component costs, tax uncertainty created by ambiguity of tax laws has the highest psychic cost as also the lowest coefficient of variation, though the small number of responses should be kept in view. Costs of tax complexity and instability have similar magnitudes at around 4 to 5 percent of taxes paid, and are viewed seriously by a larger number of respondents than tax ambiguity but also have higher variability than the cost of tax ambiguity.

Table 7.1: Psychic Costs of Tax Ambiguity, Simplicity and Stability

	Willingness to pay extra tax (%)						
	Average	Minimum	Maximum	Standard Deviation	Coefficient of variation	No. of responses	Offer not accepted/ cannot say
A. For a guarantee of immunity against violation of law due to ambiguities	10.1	1.0	25.0	8.7	0.86	8	35
B. For tax laws that are easy to understand and comply with	4.9	0.0	15.0	5.1	1.04	16	27
C. For a legal guarantee of absolutely no change in tax laws for the next 5 years	4.4	0.0	20.0	6.6	1.50	17	26
All psychic costs	**15.0**	**0.01**	**55.0**	**18.1**	**1.21**	**20**	**23**

Tables 7.2 to 7.4 provides information on the distribution of psychic costs by company size as a percentage of taxes and as a percentage of turnover. Small companies are defined for these tables as those with less than 500 employees or Rs 100 crore turnover. Table 7.2 reveals, interestingly, that only small companies in the sample are concerned about tax ambiguity which possibly partly explains their greater use of tax advisors. The same pattern is visible for psychic costs connected with lack of simplicity or stability of the income tax.

Table 7.2: Willingness to Pay for a Guarantee of Immunity Against Errors Due to Ambiguity of Income Tax Provisions

	As a percentage of turnover			As a percentage of tax		
	Small	Large	All	Small	Large	All
Average	6.6	NA	6.6	11.3	1.6	10.1
Minimum	---	NA	---	1.0	1.6	1.0
Maximum	---	NA	---	25.0	1.6	25.0
St Dev	NA	NA	NA	8.6	N.A.	8.7
No of observations	1	0	1	7	1	8

Note: Small companies: With less than 500 employees or Rs 100 crore turnover.

Table 7.3: Willingness to Pay Extra Taxes for Easy to Comply with Income Tax Provisions

	As a percentage of turnover			As a percentage of tax		
	Small	Large	All	Small	Large	All
Average	0.9	0.1	0.6	6.6	0.9	4.9
Minimum	0.0	0.0	0.0	0.0	0.0	0.0
Maximum	6.6	0.2	6.6	15.0	1.6	15.0
St Dev	2.1	0.1	1.8	5.2	0.6	5.1
No of observations	9	4	13	11	5	16
Note: Small companies: With less than 500 employees or Rs 100 crore turnover.						

Table 7.4: Willingness to Pay Extra Taxes for Stability of Income Tax Provisions						
	As a percentage of turnover			As a percentage of tax		
	Small	Large	All	Small	Large	All
Average	0.3	0.1	0.3	5.5	0.9	4.4
Minimum	0.0	0.0	0.0	0.0	0.0	0.0
Maximum	1.3	0.2	1.3	20.0	1.6	20.0
St Dev	0.5	0.1	0.4	7.3	0.7	6.6
No of observations	10	3	13	13	4	17
Note: Small companies: With less than 500 employees or Rs 100 crore turnover.						

Turning to perceptions about benefits derived from their tax payments and a related matter, whether respondents felt the corporation tax to be high or low, opinions of company officials responding to the questionnaire are in Tables 7.5 and 7.6. Table 7.5 shows that respondents are fairly uniform in their belief that government expenditure benefits to them are around 20 percent of taxes paid. Nevertheless, respondents feel, on average, that the corporation tax should only be somewhat reduced rather than greatly reduced (Table 7.6). This suggests that most respondents recognise the redistributive role played by government expenditure. Consequently, a negative attitude to paying taxes, which could result in increased non-compliance, is hard to infer.

Table 7.5: Perceived Benefit from the Government Expenditure as Percentage of Tax Paid		
Percent of Tax Paid	No of responses	Percentage to total
0 to 5 percent	4	10
6 to 10 percent	7	17
11 to 20 percent	11	26
21 to 40 percent	2	5
41 to 60 percent	3	7
61 to 80 percent	1	2
81 to 200 percent	0	0
No Opinion	14	33
Average benefit as a % of tax paid	22	
Minimum	0	
Maximum	80	
Standard Deviation	18	
Total responses	42	

Table 7.6: Burden of Income Tax: ("Income Tax ought to be… ") Opinion of respondents		
Opinion (Score)	No of responses	Cumulative responses (%)
Greatly Reduced (5)	6	13.33
Somewhat Reduced (4)	29	77.78
About the Same (3)	5	88.89
Somewhat Increased (2)	1	90.11
Greatly Increased (1)	1	92.33
No Opinion	3	100.00
No. of Responses	45	
Average Opinion Score	3.9	

7.2.2 Overall satisfaction with income tax department

The other aspect of fiscal attitudes that is of possible importance is the satisfaction of respondents with tax administration. This aspect is reported on in Table 7.7 for respondents to the survey carried out for this study and in Tables 7.8 to 7.10 for companies responding to the World Bank-CII survey discussed in Chapter 6.

Interestingly, fully 78 percent of respondents are satisfied with or neutral towards the Income Tax Department. While satisfaction levels can clearly be improved if some of the administrative obstacles identified earlier are removed, opinions are possibly about as good as can be expected for a tax collecting department. Reasons for this can be further analysed from opinion data in the World Bank-CII survey. Table 7.8 shows that only 10 percent of respondents felt income tax administration to be a major obstacle to doing business, though high taxes as a whole are perceived by 35 percent of respondents as a major obstacle (Table 7.9). Similarly, under 5 percent of firms reported facing major difficulties with income tax authorities during the period 1994 to 1998 (Table 7.10).

Table 7.7: Respondents' Satisfaction With the Income Tax Department			
Opinion (Score)	Number of Responses	Percentage of Total Responses	Cumulative Percentage of Responses
Very Satisfied (5)	2	7	7
Quite Satisfied (4)	12	44	52
Neutral (3)	7	26	78
Quite dissatisfied (2)	5	19	96
Very Dissatisfied (1)	0	0	96
No Opinion	1	4	100
Total Responses	27	100	100
Total number of questionnaires	45		
Average Opinion Score	3.3		

Table 7.8: How Problematic are Income Tax Regulations and Administration (% distribution of responses)				
No Obstacle	Minor Obstacle	Moderate Obstacle	Major Obstacle	No Opinion
18.10	35.71	28.10	10.00	8.10
Data Source: World Bank-CII survey				

Table 7.9: How Problematic Are High Taxes
(% distribution of responses)

No Obstacle	Minor Obstacle	Moderate Obstacle	Major Obstacle	No Opinion
13.81	16.19	28.10	35.24	6.67

Data Source: World Bank-CII survey

Table 7.10: Difficulties with Income Tax Officials During the Last Five Years
(% distribution of responses)

No Obstacle	Minor Obstacle	Moderate Obstacle	Major Obstacle	No Opinion
18.57	47.14	25.24	4.29	4.76

Data Source: World Bank-CII survey

7.3 Statistical analysis of Business Environment Survey data

The World Bank – CII data set also allows an attempt to be made at a preliminary statistical assessment of, first, the impact of government policy on company performance and, second, the link between government service quality and respondents' assessment of government efficiency. This analysis is now reported.

Government policies and company performance

Company performance is measured in terms of percentage change in sales.

As in earlier statistical exercises with this data set, basic control variables include an indicator of company size (employees), three indicators of the ownership pattern (whether listed on a stock exchange, government equity share and foreign equity share) and one for the main sector to which the company belongs (manufacturing/non-manufacturing). The other major control variable here is the extent of market competition, captured by the number of rival sellers in the main business area of the company.[69]

The six possible government obstacles include the income tax, integrity and efficiency of the income tax department, policy uncertainty or instability, general government regulations, infrastructure quality and corruption.

OLS regression results are reported in Table 7.11. The overall regression fit turns out to be poor. Only monopoly power (the market competition variable) appears to have an impact on sales growth, besides the generally slow growth of manufacturing firms. In other words, no policy obstacle appears to significantly affect sales growth, a heartening result.

Table 7.11: Determinants of Sales Growth of Companies
(Dependent: % growth in sales last year – 1998-99)

(Ordinary Least Squares Regression Analysis)	Coefficient	t-value
Intercept	0.80	0.06
Market competition (0 = no competitor, 5 = more than 3).	3.84***	2.55
Problem: General government regulations (no = 0, major = 3)	1.47	0.48
Policy instability / uncertainty (no = 0, major = 3)	-1.67	-0.58
Problem: Income Tax (no = 0, major = 3)	3.24	0.92
Infrastructure quality index	-1.04	-0.52
Corruption	2.77	0.93

69 Detailed variable definitions are in Annex 6.5.

Integrity & efficiency of IT Dept (very good = 6, very bad = 1)	-2.11	-1.25
Listed	-0.34	-0.07
Manufacturing	-11.68***	-2.06
No. of Employees	0.0002	1.11
Government equity share (%)	0.139	1.37
Foreign equity (%)	0.24**	1.68
Number of observations	137	
R square	0.15	
Adjusted R square	0.07	
F- Statistic	1.87	
Probability of F	0.044	
Mean of dependent variable	10.59	

Notes: ***: Significant at 5% or better.
**: Significant at 5 to 10%.

Determinants of perceptions of government efficiency

The scale variable capturing respondents' opinions about the efficiency of the government is next regressed on hypothesised determinants, controlling for the same set of variables as in the previous regression, except for market competition. Four possible determinants of government efficiency are included: corruption, the integrity and efficiency of the IT Dept, an infrastructure quality index based on respondents' perceptions, and respondents' opinion of the quality, integrity, and efficiency of public servants are included. Multinomial probit regression results are reported in Table 7.12.

Table 7.12: Determinants of Respondents' Opinion of the Efficiency of Government
(Dependent: Efficiency of government, Very Efficient = 6, very inefficient = 1)

(Multinomial Probit Regression Analysis)	Coefficient	t-value	Coefficient	t-value
Corruption	-0.18**	-1.90	-0.18**	-1.85
Integrity & efficiency of IT Dept	-0.09	-1.13	-0.09	-1.10
Infrastructure quality index	0.053	0.54	0.13	1.31
Quality, integrity, efficiency of government leadership and parliament	0.47***	6.42	0.48***	6.31
Listed	---		0.23	1.07
Manufacturing	---		-0.17	-0.94
No. of Employees	---		0.00001	-0.87
Government equity share (%)	---		-0.001	-0.23
Foreign equity (%)	---		0.002	0.36
Number of observations	159		151	
LR Index (Pseudo R square)	0.140		0.157	
Log likelihood	-205.52		-191.73	
LR statistic (d.f)	66.03 (4)		71.51 (9)	
Probability of LR statistic	0.0000		0.0000	
Number of ordered indicator values	6		6	

Notes: ***: Significant at 5% or better.
**: Significant at 5 to 10%.

The overall goodness of fit is poor and integrity and efficiency of the IT Department has the wrong sign but is insignificant. Corruption is significant and negative but has a coefficient suggesting that bribe frequency has a small impact on respondents' opinion of government. Much more important is the quality of top government leadership and parliament. This result, while it tends to confirms the importance of honest and competent leadership, suggests that compliance costs through corruption and dishonest or inefficient income tax staff are not of major importance in shaping opinions of companies.

7.4 Conclusions

Overall, therefore, an interesting picture of the policy environment emerges from this chapter. Respondents' estimates of psychic costs of policy instability and the complexity and ambiguity of tax laws are high, at about 50 percent of objective legal compliance costs. Of this, costs of tax law ambiguity are perceived to be twice as high as costs of either tax complexity or instability. Nevertheless, the income tax and its administration are not perceived as obstacles to doing business with 78 percent of respondents being satisfied with or neutral to the tax administration. This inference from tabulated data is also supported by regressions results for the impact of government policy on sales growth.

Overall, respondents perceive limited benefits from government services though they also believe that tax rates are only somewhat higher than they should be. Consequently, compliance behaviour is unlikely to be affected by negative perceptions of the government. In fact, among possible determinants of government efficiency, only corruption has a significant (but small) negative effect on perceptions and only the perceived quality of top leadership has a significant (and large) positive influence. Income tax administration integrity and efficiency is not statistically significant.

The results in this chapter reinforce earlier conclusions, that costs of the policy environment and tax laws are high and require reduction, even though their impact on economic performance appears limited. The importance of budget day announcements of tax changes by the Finance Minister are a major manifestation of policy instability. Only when the budget speech of the Finance Minister, at least for tax policy changes, becomes routine and boring can it be said that costs of policy instability have been reduced. A similar comment also applies to unforeseen administrative notifications which affect the tax structure or related procedures. To reduce costs of complexity and ambiguity, tax law simplification, including improved legal drafting, is possibly the policy step indicated.[70] Strengthening advance rulings and extending their scope can also reduce costs of tax ambiguity and complexity.

One source of change in tax laws that is possibly necessary, despite its contributing to tax instability, is judicial rulings. However, even here the lack of familiarity of some courts with tax matters has often been pointed out, particularly in criminal tax cases, so that, to the extent that this is correct, strengthening judicial capacity could help in lowering compliance costs stemming from court judgments.

[70] As discussed in Chattopadhyay and Das-Gupta (2002), simplification is not the same as a shorter tax law as this could result in increased ambiguity. A fuller discussion of simplification is to be found there.

8. Case Studies

8.1 A case study of a large and established, Indian owned, manufacturing company

8.1.1 Overview and key findings

Through this case study, certain important features of income tax compliance activities of companies, which cannot be inferred from answers to questionnaires and which did not come to light in focus group meetings, are highlighted.

Information for the case study was obtained through 6 meetings and follow up phone calls during September-October, 2002, with tax and accounting staff of a large, Indian owned, manufacturing company. The company is one of several belonging to one of India's leading industrial houses. During the meetings, discussion centred on the company's assessment experience with the Income Tax Department (ITD) and the strategies it utilises to keep compliance costs in check. Besides qualitative information, detailed quantitative information on compliance costs was obtained, going well beyond what was available from the mailed questionnaire.

After reviewing the major findings of the case study, basic features of the company are described followed by a review of compliance requirements and tax procedures which, according to the company, contribute to corporation tax compliance costs. This is followed by a detailed examination of the process and content of scrutiny assessments of the company and also of post-assessment proceedings. The use of tax advisors and outsourcing, and the role of corruption in adding to compliance costs are next briefly discussed. Detailed compliance cost and benefit estimates are then presented. The case study closes with a list of qualitative comments made by company officials and major conclusions.

The major findings from the case study are that:

1. The company follows a two plank risk avoidance strategy for corporate taxes, giving rise to quasi-voluntary compliance costs. Firstly, it continues to have its tax assessment done in one of the smaller metropolitan cities where it has its registered office, despite its head office being in a major metro 900 kilometres away. This is because of the favourable reputation it has acquired in the IT Office there over the past half century and, therefore, the reduced chances of being harassed.

2. Secondly, it overpays taxes in order to avoid penalty, preferring to lose interest on the overpaid taxes instead.[71] Due to tardy refunds, this means that the company typically has money due from the ITD throughout the year, this "float" amounting to between 40 percent to 100 percent of its assessed tax liability in any year. This adds very substantially to compliance costs. As discussed in Chapter 3, such a strategy appears to be followed by a large section of Indian corporations with 27 percent of survey respondents claiming refunds due because of overpaid taxes.

3. The company takes a long term view of tax disputes and devotes considerable effort to tax planning. It does this via "below the line" notes in its tax return in which concessions which it has not claimed but feels may become allowable pending future litigation outcomes, are noted. These are then routinely disallowed by the ITD and appealed by the company. In consequence, the previous 13 years of tax assessments (including that for the year 2001-02), are yet to be finalised and all assessments up to 1999-2000 are under litigation at various stages up to the Supreme court. Nevertheless, most currently pending court cases have been filed by the ITD, with the company having succeeded in its tribunal appeals. The company has never been raided, nor, due to its penalty avoidance strategy, had to pay penalty for tax evasion.

[71] According to company sources, even if extra tax is officially assessed over an above self-assessed tax, per the Supreme Court judgment in the Prithipal case (cite: Income Tax Reports, Volume 249, 2001. Page 670) no penalty can be assessed if the extra tax has already been paid.

4. In consequence, a substantial part of the company's compliance costs are voluntary costs associated with appeals and litigation, reflecting costs of tax ambiguity.
5. Despite its clean reputation, the company legally gives festival gifts to IT officials and also pays illegal bribes, though the total amount of both payments is less than 1 percent of taxes paid. Of this, around 20 percent is channelled through professional tax advisors. However, it routinely refuses to pay the going 10 percent bribe typically demanded by IT Department officials for prompt refunds, since its interest loss on delayed refunds is below this.
6. The tax department of the company deals exclusively with corporation tax matters, with TDS, excise duty and sales tax matters being handled by departments which are directly concerned. Consequently, total corporation tax compliance cost estimates are not likely to be biased upward due to inclusion of compliance costs of other levies. This division of responsibilities is thought to be fairly widespread among larger manufacturing companies in India. However, the questionnaire used for this study did not enquire about such organisational responsibilities.
7. Since "float" costs, which are found to be substantial, are not included in compliance costs estimated from information obtained through the questionnaire, survey based legal compliance costs reported in this study are likely to be underestimates.

8.1.2 Basic company information

The company in this case study is the market leader in its areas of manufacturing, consisting largely of business inputs, with market shares of between 20 percent and 100 percent in different products. The company has 4 subsidiaries whose accounts are included in their annual report. These include investment companies, a joint venture in a foreign manufacturing unit, and an R&D and consultancy firm. Incorporated in the mid 1940s, the company has five manufacturing units located in different parts of India. The company had between 10,000 to 20,000 full time equivalent employees in the period focused on in this case study, 2000-2001. In this year both the book value of the company’s assets and its turnover were in the range of Rs 1000 to Rs 2000 crore, placing it among the top 200 Indian companies by either indicator. Its profit before tax was around 5 percent of sales. Due to accelerated depreciation and certain other incentives, it estimated its corporation income tax at around 13.5 percent of profits for the year, though the surcharge inclusive rate of corporation tax was 38.5 percent in 2001-02. In the previous year (1999-2000), the company had returned a zero corporation tax liability. Nevertheless, due to taxes deducted at source by others on its investment income, it paid taxes and claimed a refund. For the most recent year for which its income assessment has been completed, 1998-99, though it had returned and was assessed zero corporation tax, it was assessed Minimum Alternate Tax (MAT) amounting to around 16 percent of profit before tax.

Tax compliance and planning activities of the company are mainly carried out in-house. While tax accounting and tax deduction at source are the responsibility of the accounts department of the company, there is a separate tax department which oversees preparation of the company's tax return and liaison with the ITD. This department is headed by a General Manager supported by three other officers. In addition to tax matters of the case study company, which take up about 60 percent of the tax department's resources, the department handles tax matters for all other group companies. The department reports to the group Vice President (Finance), though this is merely a reporting relationship without major operational significance.

8.1.3 High compliance cost areas identified by the company

Besides costs directly associated with long term tax disputes, company representatives, in completing the survey questionnaire, also identified several other routine and non-routine areas as contributing to high compliance costs. These are given in Table 8.1. While, as expected, scrutiny assessment and to some extent tax withholding, are seen to be burdensome, surprisingly, the company also finds compliance with MAT provisions highly burdensome. Enquiries as to why this is the case elicited the response there are two parallel calculations one by the Tax department and the other by the Accounts department. Since MAT results in a higher effective tax rate for the company, it is possible that the company response reflects higher taxes rather than substantially higher compliance costs.

These responses are similar to responses of companies surveyed except for (a) the compliance burden of international tax provisions and taxes on deemed dividends which were reported by respondents to have an average compliance burden compared to a low burden by the case study company; and (b) income accruals, MAT and loss carry forward and set off which were reported by respondents to have an average compliance burden compared to a high burden by the case study company.

Table 8.1: Burden of compliance requirements of different income tax provisions and administrative procedures (opinion of the company)

Tax Provisions and compliance requirements	Time taken to comply with income tax requirements	Approximate percentage of total compliance cost
Tax deduction at source for non-employees	Average	5 percent
Tax deduction at source for employees	High	5 percent
Non-resident withholding (u/s 195, etc)	Average	
International tax provisions	Low	
Taxes on deemed dividends	Low	
Claiming export related benefits (e.g. under sections 80HHC, 80HHE,10A, or 10B, etc.)	Average	
Valuation of perquisites to employees	High	
Income accruals	High	
Minimum Alternative Tax (u/s 115JA or 115JB)	High	35 percent
Audit requirements under Section 44AB	High	
Loss carry forward and set off	High	
Inconsistencies with the Companies Act or any other applicable legislation including depreciation provisions, establishment costs in connection with free trade zones, etc.	Average	
Administrative Procedures		
Refunds	High	2.5 percent
Method of accounting for income tax purposes	Average	
Completing and filing corporation tax returns and depositing tax	High	
Accounting for TDS, completing and filing TDS returns	Average	3.5 percent
Scrutiny assessment procedure	High	37.5 percent
Obtaining clearances, approvals and permissions from Income Tax authorities	High	
Appeals and litigation	High	

Turning to the composition of costs (Table 8.2), the company identified record keeping and return preparation and filing to be most important. The company stopped providing assistance to employees in calculating and paying their own taxes three years ago, as this conflicted with confidentiality of employee salary records. So tax assistance to employees does not contribute to compliance costs.[72]

[72] The administrative procedure introduced this year, whereby employers can submit returns for employees as a group provided they do not have substantial income from elsewhere, has yet to be taken advantage of by the company, though this is to be done in future. Once this happens, this will add to the compliance costs of the company while reducing employee compliance costs.

These responses are similar to responses of companies surveyed via mailed questionnaires, except for completing and filing tax returns, depositing tax and obtaining clearances, approvals and permissions from IT authorities, which were reported by survey respondents to have an average compliance burden compared to a high burden by the case study company.

Table 8.2: Areas Contributing to Income Tax Compliance Costs
(company's opinion)

Activity	Importance
Keeping records and maintaining account books	Very Important
Of which on compulsory financial audits (under Section 44AB of the Income Tax Act)	Very Important
Of which for tax deduction at source for employees	Quite important
Of which TDS other than for employees	Quite important
Completing and submitting corporation tax return in the tax office; filling up tax c*hallans* and depositing taxes/*challans* at a bank	Very Important
Completing and submitting TDS returns and depositing TDS	Very Important
Appearance before the tax authorities to obtain a tax refund	Very Important
Appearing before the tax authorities and preparing explanations for scrutiny assessment	Very Important
Research and tax planning for the present and future, including purchase of tax guides, etc.	Quite important
Expenditure on training of employees in tax matters/ participation in external seminars	Quite important
Expenses for obtaining a Permanent Account Number (PAN)	Quite important
Costs related to appeals/revisions and other litigation initiated by you	Quite important
Costs related to appeals/revisions and other litigation initiated by the Income Tax Department	Average
Cost of providing assistance to employees for their individual tax compliance requirements	Unimportant
Note: All costs are incurred in-house except for outsourcing of TDS for senior employees.	

8.1.4 Audit objections to IT Department administrative errors of relevance to the company

As discussed in Chapter5, lapses and mistakes in scrutiny assessments leading to audit objections by the CAG may lead to subsequent re-opening of assessments as the IT Department attempts to recover taxes not assessed due to its mistakes. However, this adds to the compliance cost of companies not to mention additional tax and interest pertaining to previous years. According to the company, assessment mistakes which have led to reopening of assessment of group companies in recent years, include the following.

- Incorrect allowance of prior period expenses
- Incorrect allowances of non-business expenditure
- Incorrect allowances of deduction for payment outside India
- Incorrect allowances of expenditure on know-how
- Incorrect computation of capital gains
- Mistake in assessments while giving effect to appellate orders
- Excess or irregular refund

No separate estimates of the tax effects or additional compliance costs of reopened assessments is made.

8.1.5 Recent scrutiny history and features

Basic information

Since its inception, income tax assessment of the company has taken place in a second tier metropolitan city in which it has its registered office, though the company now has its head office in a major metropolitan city 900 kilometres away. The reason for this is because the company has developed a good reputation over the years in the IT office in which it is assessed, which may not immediately be the case if it now requests assessment in the city where its headquarters are. Tax assessments of subsidiaries and other group companies are separate from that of the case-study company.

The company was selected for scrutiny assessment by the Income Tax Department (ITD) in each of the six years 1995-96 to 2000-01. This selection is in accordance with ITD scrutiny selection strategy where all large corporate assessees above a specified size are routinely selected for scrutiny assessment.

Of assessments for years before 2000-01, 1998-99 is pending with the relevant Commissioner (Appeals), the 5 assessment years immediately preceding 1998-99 are pending with the Income Tax Appellate Tribunal (ITAT), and 6 years prior to this are pending before courts. However, according to the company, a further 12 assessment years before this can also be affected by different cases pending in high courts or the Supreme Court. This brings the total number of potentially open annual tax assessments to 26 up to 2000-01.

Representatives from the tax department of the company usually attend hearings. Scheduling of scrutiny hearings is generally flexible and on mutually agreed dates, after the hearing date given in the hearing notice. Typically, the company tries to have scrutiny hearings scheduled on a Friday so that any spillover can be completed on Saturday. A single company representative travels from the head office located to the city where it is assessed for hearings. Where possible, other, unrelated, company work is also undertaken by the representative, since the per visit travel and stay costs are around Rs 18,000. Documents required for hearings by the ITD, including documents filed with the tax return, amount to around 600 pages for the 1999-2000 assessment year (financial year 1998-99). These are usually sent in advance of hearings to the concerned assessing officer by post, courier or hand delivery, adding marginally to costs. Preparing for hearings usually takes around 10 hours per hearing for tax department staff, with additional time being spent by other departments from whom information or documents have to be collected. The hearings themselves average 3 to 4 hours unless complicated issues arise.

The 45 page assessment order received by the company for the 1999-2000 assessment year, which is the most recent assessment it has received, contained 15 disallowances. Of these, 6 had no effect on the company's taxes as these pertained to below the line notes. These were for claimed expenses not seen as part of allowable expenditure by the ITD, differences in opinion as to the timing of expenditure and as to whether certain expenses were of a capital or revenue nature. Of the disallowances, four major disallowances of below the line claims pertained to the MAT, suggesting particularly high costs of tax ambiguity of the MAT. Compared to disallowances which had a tax effect, the assessment order allowed certain doubtful claims of the company, amounting to 15 percent of disallowances.

Despite the disallowances, the company did not need to pay additional taxes. As a rule, additional taxes demanded by the ITD after scrutiny have had little direct effect on the company's cash flow. This is because of, firstly, pending refunds and accumulated losses from previous years and secondly, because extra demands which are to be appealed are usually stayed by assessing officers pending the appeal outcome. In consequence, unanticipated "tax shocks" to the company's cash flow are of limited size.

However, small extra demands are not contested by the company if the additional cost of an appeal is felt to exceed these demands. For example, for assessment year 1999-2000, the additional demand assessed by the ITD, consisting of both tax and interest, was not paid but, per the company's request, adjusted against refund due for 2000-01. For larger amounts, especially those which are likely to have an impact on several assessment years, the company appeals to the commissioner and, if required, files a second appeal to the ITAT.

Chronology and duration of a scrutiny and post-assessment proceedings

During assessment year 1999-2000, the scrutiny process required 8 hearings and took a total of 910 days to complete.[73] Details are in Table 3 below. Table 3 also provides company estimates of typical post assessment proceedings and outcomes. These have arisen in each assessment year over the past decade and a half. While there have been no penalty proceedings, due to the risk avoidance strategy followed by the company, rectification applications, appeals and references to courts have all been made by the company. ***As can be seen, the time taken for successive steps in the error correction and redressal mechanism for the corporation income tax increases sharply with each step, so that, in the worst case scenario, a tax dispute can take 23 years to resolve!*** This situation is clearly unacceptable and can act as a major deterrent to industrial growth. This is compounded by the fact that the IT Department's success rate in appeals and references is not very high, thus suggesting that decisions to pursue appeals by the IT Department are not based on cost effectiveness calculations.

Table 8.3: Assessment and post-assessment proceedings for a typical assessment		
Sl	Item	Duration/Outcomes
(A) Scrutiny Chronology for Assessment Year 1999-2000		
1	Return submitted	Day 1
2	First scrutiny notice received	Day 315
3	First scrutiny hearing	Day 348
4	Second scrutiny hearing	Day 365
5	Third scrutiny hearing	Day 500
6	Fourth scrutiny hearing	Day 591
7	Fifth scrutiny hearing	Day 654
8	Sixth scrutiny hearing	Day 689
9	Seventh scrutiny hearing	Day 745
10	Eighth scrutiny hearing	Day 836
11	Assessment order received	Day 910
12	Number of adjourned/postponed hearings	NIL*
(B) Typical durations of other proceedings relevant to the company in recent assessments		
13	Whether rectification(s) u/s 154 sought	Yes
14	Time taken for rectified order(s)	180-310 days
15	Rectification outcome(s)	Most rejected by the ITD
16	If first appeal filed, typical number of hearings	5
17	Time taken for first appeal	6 to 18 months
18	First appeal outcomes in company's favour	66 percent
19	If second appeal filed to ITAT, typical number of hearings	1 to 3

[73] In late 2000 there were 2 scrutiny hearings. The next 5 hearings were in 2001, with a lull between April and July was since transfers of IT officers across the country are usually made in these months. A second lull of two months occurred during October-December 2001, as the company asked for suspension of hearings, being busy with tax filing for the current assessment year. The 8th and final hearing was held in March 2002, just before the legal deadline for completion of the assessment.

20	Time taken for typical second appeal	48 to 66 months
21	Second appeal outcomes	Most have confirmed first appeal**
22	If High Court reference filed, typical number of hearings	1to 3
23	Time taken for court proceedings up to judgment	10 to13 years.
24	Reference outcome in most recent case	Reversal of ITAT order
25	Time taken by ITD to give effect to appeal/high court order	22 to 24 months
26	Time taken for final assessment before rectifications, appeals and references for assessment year 1999-2000	28 months
27	**Time taken for typical final assessment with rectifications**	**34 to 38 months**
28	**Time taken for typical final assessment with first appeal**	**34 to 46 months**
29	**Time taken for typical final assessment with second appeal**	**82 to 112 months**
30	**Time taken for typical final assessment with High Court reference**	**202 to 268 months**
Notes: *: The company requested that no hearings be scheduled during the period between the sixth and seventh hearings. **: ITAT tribunals, it is reported, tend to play safe in matters of law and leave complicated decisions to high courts.		

Major disallowances and disputes in recent scrutiny assessments and their aftermath

Generally the company accepts the IT Department's assessment if the case put forward by them is thought, after examination, to be doubtful. If in-house experts feel that there is merit in the case, and the amount involved is sufficiently large, the company appeals. However, second appeals and references have usually been initiated by the IT Department. Disputed taxes in references to courts amount to about 6 percent to 7 percent, in total, of taxes returned in 2000-01.

Nevertheless, the major disallowances and disputes in the company's assessments arise year after year as the company repeats the same claims (through "below the line" notes in its return) pending the outcome of litigation. This shows that the company takes a long term approach to its tax declarations. Furthermore, any ruling in the company's favour can result in tax refunds for several assessment years. Three major issues currently pending in the courts and the associated cost-benefit calculations of the company are now described.

(A) Profits from industrial undertakings engaged in infrastructure development like power generation, distribution and transmission are allowed as a deduction from gross income under section 80IA of the Income Tax Act. The company had set up a captive power plant in one of its units in the mid 1990s. Earlier, up to 1999-2000 captive generation of power was deductible under the MAT. The company estimated that almost 40 percent of its profit before taxes was attributable to the efficiency gain from own generation of power. This was supported by a financial audit certificate and a deduction under Section 80IA was claimed. This was disallowed on scrutiny. The assessment order argued that the company did not have a license to sell power, so that allowing this deduction would be tantamount to recognizing that the company was selling and buying power within the company itself. Instead, producing power for own consumption was merely a cost cutting measure for which the company is rewarded by higher profits. The ITD position was reversed on appeal. The claim is now pending for the past 3 years in the ITAT. Given that 5 assessments are affected by this dispute, the eventual per year gain to the company will be nearly thrice the tax it paid in 2000-01, excluding interest owed by the ITD. The projected additional litigation cost, including costs of legal counsel and representation, company staff time and various fees, is estimated to be under 1 percent of the potential gain to the company, even if the dispute eventually finds its way to the Supreme Court. This dispute clearly illustrates the costs of tax instability, in this case due to changes in MAT computation.

(B) Tax incentives are provided for setting up of industries in (notified) backward regions under section 10C of the Income Tax Act. Sales tax incentives are also available. The company did not include profit arising from sales tax incentives in their returned profit for the corporation tax. This was disallowed. The ITD argued that as long as profit emerges with the commencement of production, tax should be levied on it. Despite an earlier Supreme Court ruling with a bearing on the issue,[74] the company feels that this case is still worth pursuing since the extra tax per year amounts to around 20 percent of its annual tax in 2000-01, and there are four past and, potentially, current and future assessments affected by the case. The annual cost of pursuing the case amounts to around 10 percent of annual potential gains or 1.5 percent of tax paid in 2000-01.

(C) The company provides technical services to a foreign joint venture set up around 15 years ago. This consultancy income is exempt in the host country and, under the applicable double taxation treaty (DTA), profit exempt in the host country is, in the company's opinion, not taxable by the home country. However, though the assessment order allowed this exemption claim, it was reversed by the Commissioner (Assessment). The High Court has since ruled in the company's favour and the matter is now before the Supreme Court. If needed, the company plans to go to the International Court of Justice on this matter. Though the issue affects four assessments, the gain to the company from a favourable ruling will not be substantial amounting in all to around 7 percent to 8 percent of taxes in 2000-01, excluding interest from the ITD. Being a settled matter at the high court level, the case is handled in-house. In consequence, the total projected cost of this litigation, is no more than 15 percent of the potential gain.

8.1.6 Use of tax consultants and outsourcing of compliance functions

Besides getting its accounts audited as required by the Companies Act and the Income Tax Act, the company uses external assistance primarily to help with tax planning in specific cases and, more importantly, for litigation. For this, the company has identified a panel of tax experts. The company pays no retainers but pays consultants on a case to case basis. Consultant's bills are usually not questioned, with a company representative expressing the view that competition between tax experts ensures that there is no over-billing. Furthermore, once experts are retained for a case, the company is able to seek advice from them informally for future cases, so that these can be handled in-house.

In case of appeals and litigation, in-house professionals usually represent the company up to the second appeals stage. In critical cases, where help is sought from paid tax consultants, the involvement of the in-house tax department is encouraged, so that staff learn from court proceedings and ensure that critical mistakes are not made in future cases.

Tax consultants engaged for tax planning and representation in legal proceedings were paid a relatively small total fee in 2000-01 (see Table 4 below).

In addition to these consultants, payment of salaries of top company officials is outsourced to an external consultant for an annual fee. Though this consultant also takes care of TDS for these employees, apportionment of the fee paid to them is difficult. We assume, below, that the TDS burden is similar to the company's in house TDS burden and contributes 5 percent to the consultant's costs.

Besides occasional use of tax consultants and the outsourcing mentioned above, the major use of external assistance is for mandatory tax audit. The tax audit fee was nearly thrice the fee paid to tax consultants in 2000-01.

8.1.7 Bribes and other related expenses

Of the fees paid to tax consultants, 20 percent is reported to be on account of bribes paid to officials. In addition, around 4 times this amount was reported to have been paid as bribes, in specific situations,

[74] Sahney Steel and Press Works Ltd. And Others Vs. Commissioner of Income Tax, *Indian Tax Reports*, 1997, Vol. 228, page 253.

to IT officials. While bribe payments through advisors is routine, other bribe payments vary greatly in different years. The company also annually budgets a small sum (around 15 percent to 20 percent of off-the-books bribes) for festival season gifts to income tax officials.

The company has faced major problems with refunds. Even if appeal or reference orders are favourable, tax refunds are difficult to extract from the IT Department. However, no pressure is put by the company to hasten refunds. The company feels that it does not pay in the long run to put pressure on IT officials. Furthermore, the company routinely refuses to pay the going 10 percent bribe typically demanded by IT officials for prompt refunds, since its interest loss on delayed refunds is below this. Since, currently, interest paid by the IT Department on delayed refunds is only 8 percent simple interest per year, compared to a marginal borrowing cost of 15 percent for the company (on cash credit from banks), the net interest cost is around 8.1 percent per annum (assuming weekly compounding of cash credit interest).[75] A consequence of this is that the largest component of compliance costs borne by the company is in connection with refunds.[76]

8.1.8 Components of compliance costs

Tax department costs amounted to 2.5 percent of taxes returned in 2000-01. This includes both wage and non-wage costs, and cover all activities of the tax department. To this must be added the cost of advisors and tax audit (1.8 percent of taxes returned), gifts to tax officials (0.08 percent) and bribes (0.51 percent).

Other departments incurring significant tax compliance costs include the accounts department and the five manufacturing units, which incur both wage costs and non-wage costs (1.6 percent). In particular, the entire cost of TDS for employees and non-employees (1.3 percent) is incurred outside the tax department.[77] A major component of costs other than TDS costs is collection of TDS certificates from customers deducting taxes from payments made to the company. These costs contributed an estimated 1 percent of taxes paid in 2000-01. To the credit of the IT Department, collection of TDS certificates is no longer a problem (after 2000-01) since the grace period for submission to the IT Department has recently been extended by two years.

Other minor costs include unallocated overheads (0.28 percent) and fees for outsourcing of senior management TDS (0.06 percent). The greatest component of compliance costs turns out to be float costs associated with pending refunds. Float costs work out to be 6.2 percent of taxes returned.

8.1.9 Benefits from compliance activities

The company does not see any qualitative benefits from its tax compliance activities. However, it derives monetary benefits from interest savings due to first, the timing of advance tax instalments and second, the gap between withholding of taxes for employees and non-employees and deposit of these sums in the government treasury. Following the methodology described in Chapter 2, and the 15 percent marginal borrowing rate of the company, these cash benefits are estimated from the monthly amount of tax deducted at source, estimated by the company at 1.11 percent of sales for employees and 0.93 percent for non-employees. Consequently, for 12 TDS instalments in the year, the total compliance benefit is 1.36 percent of corporation income tax paid for the year. For advance tax, the benefit from the timing of tax payments amounts to 1.2 percent of income tax for the year. The difference between advance tax estimates here and in chapter 3, is that the actual amounts of advance tax payments as well as specific information on the opportunity cost of funds have been made use of.

The combined benefits are meagre compared to the situation internationally, discussed in Chapter 1.

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[75] The company is significantly leveraged so that its borrowing rate rather than its rate of return on investments reflects its opportunity cost.

[76] Consequently, 50 percent of the company's float costs are added to the estimate of mandatory costs made below.

[77] Software development costs for TDS could not be estimated, though these are not significant on an annualised basis.

8.1.10 Gross and net compliance costs in 2000-01

Table 4 brings together the various components of compliance costs discussed above. These costs are somewhat higher than those obtained from the mailed survey for companies of comparable size in terms of employees and turnover, testifying to the importance of "float costs". However, costs are somewhat lower as a percentage of assets as compared to surveyed companies. While low compared to costs of smaller companies and individuals, they are also higher than costs of large companies in other countries for which data are available, discussed in Chapter 1.[78] The finding that estimated mandatory costs[79], despite bribes and the extensive tax planning, exceed 55 percent of gross compliance costs is in line with the average reported in Chapter 4 if the estimate including unallocated costs is taken, but much lower than estimates there if "others" is excluded. Furthermore, of the remainder, a large fraction consists of quasi-voluntary costs. Clearly, the company's penalty payments to the government are likely to have exceeded quasi-voluntary costs if these costs had not been incurred. The other interesting finding is that, for this company, tax compliance is a "capital intensive" activity, with personnel costs plus cost of tax consultants being under a third of total compliance costs. The implied "capital-labour" ratio is, however, relatively less "capital intensive" than the company's other activities.[80]

Of the costs in Table 8.4, bribe and gift costs form part of private costs but not social costs being inter-agent transfers. On the other hand, compliance benefits are purely private benefits. Third, the cost estimates do not reflect indirect (distortionary and psychic) costs of tax ambiguity and complexity. Examples of direct costs of tax ambiguity have been given above.[81] The shadow value of resources has also not been taken into account. Overall, therefore, social costs are likely to be higher than reported in the table, possibly in excess of gross private compliance costs in the table.

Table 8.4: Compliance Costs in 2000-01 (Percentage of corporation taxes returned)	
Tax department costs attributable to the company	2.541
Of which employee costs	1.905
Advisor costs (including tax audit cost)	1.778
Bribe costs	0.508
Gifts to tax officials	0.081
Costs of other department attributable to the company	1.574
Outsourcing of senior management salary matters to consultant (at 5 percent of consultant's fees for TDS)	0.061
Overheads	0.279
"Float" costs	6.218
GROSS COMPLIANCE COSTS	***13.041***
Of which *Total TDS Cost percentage*	9.9
Total Personnel Cost percentage	18.9
Mandatory Cost percentage	55.4
Estimated Scrutiny Cost percentage	2.5

78 Though the average compliance costs reported in Slemrod and Venkatesh (2002) are high, for large companies these are lower, with an elasticity with respect to asset size of 0.6.

79 50 percent of tax department compliance costs excluding travel cost + other department compliance costs + senior management salary consultant's TDS cost + 50 percent of float cost + tax audit cost.

80 Estimated, roughly, as 14 percent of the book value of assets as a percentage of the wage bill. The assumed 14 percent rate of return is the "hurdle" rate of return used by the company in investment planning.

81 An additional example, in terms of the impact of uncertain tax concessions, is below.

MEMO ITEMS	
NET COMPLIANCE COSTS (after tax deductibility and cash flow benefits)	8.081
"SOCIAL" COMPLIANCE COSTS	10.19
Gross Compliance Costs as a Percentage Of Profit Before Tax	1.76
Gross Compliance Costs as a Percentage Of Turnover	0.084
Gross Compliance Costs as a Percentage Of Book Value Of Assets	0.068
Gross Compliance Costs per Full Time Employee Equivalent (In Rs)	1069
Effective corporation tax rate (percent)	13.48
Effective net compliance cost inclusive tax rate(percent)	14.57

8.1.11 Comments and suggestions by company officials about the corporation tax and the ITD

(A) The company has recently faced difficulty in compliance with new transfer pricing regulations:[82] Rules are so complicated that even IT officers were alleged to find them difficult to understand and apply. Effective and proper enforcement requires the IT Department to correctly distinguish between abuse of transfer pricing regulations and commercial interests genuinely pursued by the company.

(B) Some disputes which arise in the course of scrutiny may be due to IT officers being under pressure to meet revenue targets. Due to this, IT officials make unnecessary additions in assessments (or "high pitched" assessments) in spite of the law having been settled by courts.

(C) Though the company channels problems it faces with corporation tax provisions through various industry associations, administrative problems are never aired in public by it.

(D) Tax audit requirements: These are often time consuming as the interest of the investing community has to be protected through compliance with stock exchange regulations.

(E) ITAT appeals take excessively long because of the lack of tax experience of presiding officers and the complicated nature of tax cases. When in a dilemma over legal interpretations, presiding officers prefer to play safe by confirming first appeal decisions, and letting the case be decided by the courts.

(F) After restructuring, the IT Department can no longer plead that they are poorly equipped. Benefits from improved facilities should be extended to clients during their visits to IT offices. A key example is getting confidential documents photocopied within the office rather than outside where the possibility of leakage is high. The company would be ready to pay for services, like photocopying in the tax office, were these to be made available by the IT Department.

(G) There should be a level playing field for all the companies under the Income Tax Act. Stability and consistency of IT provisions would make assessments less discriminatory and discretionary in nature.

(H) Given that the company has faces major problems with tax uncertainty concerning dovetailing of central and state tax provisions (discussed above and, again, below), the company strongly feels that state tax and central tax provisions, such as regarding notified backward districts, should be harmonised.

[82] The Finance Act, 2001 inserted sections 92 to 92F in the Income Tax Act with effect from Assessment Year 2002-03 to provide a statutory framework for computation of multinational company profits liable to tax in India, if they are suspected to have manipulated prices in intra-group transactions.

8.1.12 Tax related distortions and tax uncertainty

The impact of tax concessions and tax uncertainty is illustrated by two examples given by the company. In one case, the company located a new plant in a notified backward district under the concerned state's laws. The plant so located was entitled to receive sales tax exemption for a specified period. The company estimated that its additional costs, in terms of creating needed infrastructure, would be recouped during this period, so that its profitability would be the same as from a factory located in a more industrialised district adequately provided with infrastructure. Two factors sent its estimates awry. The disallowance of the deduction it claimed from corporation tax for the sales tax it would have paid were the exemption not given has already been described above. On the other hand, expenses felt to be necessary by the company for staff welfare and community development, given the poor infrastructure, were also disallowed as a deduction from pre-tax profits. The company, therefore, finds that, in the absence of a favourable litigation outcome, its profitability is adversely affected. Clearly, future concessions to encourage different social goals will be looked at with greater scepticism by the company. Thus, the effectiveness of policy induced changes in resource allocation decisions by private firms is, in this case, reduced by tax uncertainty and conflicting policies.

On the other hand, in another case, the company reportedly failed to take advantage of a substantial tax saving from a joint business venture, due to adverse market reports about their prospective business partner. The situations illustrated in this and the previous example, according to the company, limit the impact of tax concessions on business decisions.

8.1.13 Conclusions

Overall, the case study suggests that, even for companies indulging in systematic tax planning, there are large costs associated with, most importantly, cumbersome assessment procedures and lengthy post-assessment delays. Surprisingly, direct scrutiny costs are not as high as expected if quasi-voluntary costs are excluded. On the other hand, costs associated with post-assessment litigation are substantial. Streamlining procedures may help to bring these down to internationally comparable levels.

Substantial costs of tax uncertainty also exist. However, these costs cannot easily be foretold and guarded against, except via greater clarity in drafting tax laws and subsidiary legislation.

The major impact of corruption in this case study is on the cost of obtaining refunds. These costs are reported to be 10 percent of refunds due for companies desiring quick refunds, but are substantial due to harassment via delays in obtaining refunds and the resulting opportunity cost, even for companies that do not pay the demanded bribe, as in this case study.

In terms of conceptual issues in measuring compliance costs, the importance of (a) risk avoidance costs of Indian companies including, importantly, "float" costs, (b) other quasi-voluntary costs associated with tax planning and resulting disputes and (c) costs associated with delayed refunds, are of importance. Future studies should ensure that proper attention is paid to these costs. Secondly, the likely separation of organisational responsibilities concerning corporation tax matters and other taxes needs to be verified in future studies.

8.2 A case study of a large public sector company

8.2.1 Overview and key findings

This case study is based largely on the questionnaire response of the only public sector company (PSU) to respond to the survey. In consequence, the information base is less rich than in the previous case study, which was based on a series of meetings.

Key findings are:

- Compliance cost estimates are comparable to study estimates for private sector companies (PSCs) of similar size except for compliance costs per employee which are higher than for PSCs of similar size.
- Net compliance costs, taking account only of advance tax benefits and tax deductibility of compliance expenses, are negative.
- One major area of compliance costs for the PSU is, surprisingly, costs of appeals and litigation judging from the number of assessments years in dispute and costs of tax advisors for litigation initiated by the company. This is surprising since two different arms of the same owner, the government, are involved in the disputes.

8.2.2 Basic Company Information

The PSU is a market leader in its areas of business. The company is relatively young having been incorporated only in the mid 1980s. It had 1000 to 5000 full time equivalent employees during the period under study, 2000-2001. The book value of its assets and its turnover were in the range of Rs 5000 to Rs 15000 crore. In terms of sales, it was among the top 20 companies in 2000-01and was rated among the top 10 most valuable public sector enterprises in India in terms of market capitalisation. Its profit before tax was around 30 percent of sales with a return on asset in the range of 15 to 20 percent.[83] The effective corporation tax rate for 2000-01 was 32 percent after the company saved 14 percent of gross tax dues through concessions.

8.2.3 Use of tax advisors

The PSU completes its tax return in-house. However, the company does engage tax advisors. The major reasons are frequent changes in the tax laws, complexity of tax affairs and to ensure that the tax documents and tax calculation are perfectly done. This is similar to responses by PSCs surveyed.

8.2.4 Compliance costs and components

The company did not provide any estimate of evasion nor did it choose to comment on illegal costs, harassment or questions on fiscal attitudes. This is understandable as the company identified itself in the questionnaire. Furthermore, there are unlikely to be many (or even any) companies engaged in similar business and with similar ownership and size. Furthermore, the incentive to underreport income or not file tax returns by PSUs will clearly be limited (though not unknown).

Turning to legal compliance costs, the major difference between the PSU and sample PSCs in terms of the composition of internal compliance costs is large contribution of employee costs, at over twice the PSC average. Also notable is the possible undervaluation of office space, typical of government accounting for publicly owned premises.

Table 8.5: Composition of Internal Compliance Costs (%)

	Average for sample PSCs*	PSU
On employee salaries, etc.	32.6	75
Accounts/record preparation, storage, etc.	8.0	10
Computers and data processing	8.6	5
Additional costs to enable availing of tax incentives	5.2	3.5
Office space/services at market rental value	9.7	2.5
Travel and conveyance	4.3	1
General supplies and stationery	2.6	1

[83] Comparative information presented here is taken from *Business Today*, "BT 500", November 10, 2002 and October 14, 2001.

Photocopying, fax and postal expenses.	2.1	1
Purchase of tax publications	0.8	1
Others	25.9	0.0
Total	100.0	100.0
Note: * From Table 4.4.		

The higher contribution of advisor costs to legal compliance costs as a percentage of tax paid, compared to PSCs can be seen from Table 8.6. Compliance costs per employee are much higher than the estimates for private companies of similar size. In terms of turnover, assets, profit before tax and tax paid, legal compliance costs estimates are in line with the estimates for private companies of similar size (compare Tables 3.7 to 3.11).

8.2.5 Float benefits and net compliance costs

Compliance requirements lead to benefits which are not necessarily quantifiable. The company reports no potential benefits to areas listed in the questionnaire, unlike PSCs.[84] Estimates of net compliance costs in terms of legal compliance costs, profit before taxes and tax paid are in Table 8.6. In the absence of data on TDS for employees and non-employees, cash flow benefits, which only take account of the timing of advance tax payments and tax deductibility of compliance expenditures, are underestimated. For PSCs in the sample, net compliance costs are, on average, positive, though they are negative for large firms of comparable size to the PSU (see Chapter 3 and Annex 3.5).

Table 8.6: Legal Compliance Costs in 2000-01	
Legal compliance costs	
In-house cost as a percentage of tax paid	0.2430
Of which employee costs	0.1823
Tax advisor costs as a percentage of tax paid	0.2795
Legal compliance costs as a percentage of tax paid	0.5227
Legal compliance costs as a percentage of gross tax before concessions	0.4581
Legal compliance costs as a percentage of profit before tax	0.1675
Legal compliance costs as a percentage of turnover	0.0540
Legal compliance costs as a percentage of book value of assets	0.0430
Legal compliance costs per full time employee equivalent (in rupees)	14333
Net Compliance Costs	
Net Compliance costs as a % of total legal compliance cost	-270.32
Net Compliance costs as a % of profit before tax	-0.45
Net Compliance costs as a % of tax paid	-1.41
Effective tax rates	
Effective corporation tax rate (percent)	32.05
Effective legal compliance cost inclusive tax rate (percent)	32.57
Effective net compliance cost inclusive tax rate (percent)	-1.412
Notes: (1) Net compliance costs do not include TDS cash flow benefits nor do they net out bribe costs.	

[84] See Table 3.13.

8.2.6 High compliance cost provisions and procedures

Table 8.7: Burden of Compliance Requirements of Different Income Tax Provisions and Administrative Procedures (opinion of the company)		
Tax provisions and compliance requirements	Time taken to comply with income tax requirements	Approximate percentage of total compliance cost
Tax deduction at source for non-employees	High	3
Tax deduction at source for employees	High	10
Non-resident withholding (u/s 195, etc)	High	1
International tax provisions	High	1
Taxes on deemed dividends	N.A.	
Claiming export related benefits (under sections 80HHC, 80HHE, 10A, or 10B, etc.)	High	3
Valuation of perquisites to employees	High	5
Income accruals	NA	
Minimum Alternative Tax (u/s 115JA or 115JB)	NA	
Audit requirements under Section 44AB	High	20
Loss carry forward and set off	NA	
Inconsistencies with the Companies Act; depreciation provisions, establishment costs in connection with free trade zones, etc.	High	5
Administrative procedures		
Refunds	Average	1
Method of accounting for income tax purposes	High	5
Completing and filing corporation tax returns and depositing tax	High	15
Accounting for TDS, completing and filing TDS returns	High	5
Scrutiny assessment procedure	High	15
Obtaining clearances, approvals and permissions from Income Tax authorities	High	1
Appeals and litigation	High	10

For different activities, audit requirements under section 44AB contributes 20 percent to legal compliance costs, followed by completing and filing income tax returns and scrutiny assessment procedures (Table 8.7). Compared to PSCs, TDS for non-employees and compliance requirements due to MAT were less burdensome to the PSU. The nature of business the PSU is engaged in contributes to low compliance costs from TDS for non-employees. Likewise, the low contribution of valuation of perquisites is understandable in a PSU compared to private companies, where discretion with regard to perquisites is greater and tax saving for executives is a factor in designing salary packages.

Besides tax accounting, return filing and scrutiny, the other high cost area for the company is costs due to appeals and litigation. The number of years in dispute before the different authorities is close to the sample average of 7 years for tax and 6 years for penalty and interest. This is also evident from the expenditure incurred on tax advisors for litigation initiated by the company (nearly 20 percent of total external costs).

In terms of the voluntary versus mandatory cost classification, computed as in Chapter 4, 27 percent of external costs are voluntary, rising to 71 percent if unallocated costs are included. Total internal and external voluntary cost contribute between 21.5 percent and 46.5 percent of costs. Except for external costs with "others" included, the PSUs voluntary costs are only slightly above the PSC average reported in Chapter 4.

With regard to its qualitative opinions about areas contributing to its compliance burden, the company, showing a lack of discrimination, lists all factors as very important excepting training of employees which is "quite important" and tax planning to which it did not respond (Table 8.8).

Table 8.8: Areas Contributing to Income Tax Compliance Costs
(company's opinion)

Activity	**Importance**
Keeping records and maintaining account books	Very Important
Of which on compulsory financial audits (under Section 44AB of the Income Tax Act)	Very Important
Of which for tax deduction at source for employees	Very important
Of which TDS other than for employees	Very important
Completing and submitting corporation tax return in the tax office; filling up tax *challans* and depositing taxes/*challans* at a bank	Very Important
Completing and submitting TDS returns and depositing TDS	Very Important
Appearance before the tax authorities to obtain a tax refund	Very Important
Appearing before the tax authorities and preparing explanations for scrutiny assessment	Very Important
Research and tax planning for the present and future, including purchase of tax guides, etc.	NA
Expenditure on training of employees in tax matters/ participation in external seminars	Quite important
Expenses for obtaining a Permanent Account Number (PAN)	Very important
Costs related to appeals/revisions and other litigation initiated by you	Very important
Costs related to appeals/revisions and other litigation initiated by the Income Tax Department	Very important
Cost of providing assistance to employees for their individual tax compliance requirements	Very important

8.2.7 Company opinions and case study conclusions

As mentioned, the PSU declined to offer almost any opinions of its own. In particular, it did not provide psychic cost estimates of tax complexity, instability and ambiguity. This is so even though the company identified frequent changes in the tax laws and complexity of tax affairs as major reasons for engaging tax advisors. The only opinion the company apparently felt safe in expressing was that the rate of corporation tax should be greatly reduced.

Overall, therefore, the case study merely serves to confirm the similarity of PSU to PSC costs except for one difference: the importance of employee costs. The other interesting finding is the high cost of litigation, even for a PSU.

The implications for aggregate estimates in Chapter 3, to the extent that a single case study can be relied on, is that the absence of public sector firms in the sample would not affect legal, net and social compliance cost estimates appreciably. However, there is no information on the position with regard to illegal compliance costs, which in any case could not be estimated for PSCs.

8.3 Cash flow benefits from TDS of a non-profit organisation

Though non-profit organizations are not part of our study sample, this case study, of a non-profit organization provides a second illustration that, for some organizations, cash flow benefits are indeed small relative to TDS costs as in the private sector company case study.

This organization takes an overdraft from its bank by prior arrangement if funds are not available for salary payment. Therefore, the cash flow benefit arises from the reduced extent of overdraft because withheld taxes need not be financed till due. The bank charges a low 5 per cent per annum interest for the overdraft, due to its long and close links with the organisation. In a second estimate, it is assumed, after discussion with the organisation, that it can invest TDS funds for 6 days per month in a short-term fixed deposit at 6.5 percent per annum. It may be noticed that this is above its short term borrowing rate. On this basis, float benefits are estimated at a negligible 0.15 to 0.2 percent of TDS (Table 8.9). Even at a 15 percent borrowing rate, this would only rise to 0.6 percent of TDS. In contrast, Chattopadhyay and Das-Gupta (2002) present information of the TDS costs of the same organisation. These were found to be 11.8 percent of taxes withheld.

Table 8.9: Estimates of Benefit Calculation for the TDS case study

	Item	Amount
1	Taxes deducted at source from employees (Rupees)	9,50,000
2	Days of float allowed	6
3	Taxes deducted at source from non-employees (Rupees)	13,00,000
4	Days of float allowed	15
5	Total Taxes Deducted at Source (Rupees) (=1+3)	22,50,000
6	Total TDS per month (=5/12 months)	1,87,500
8	**Total Benefit (Rupees)**	
	A. Opportunity cost at 6.5% per year (short term fixed deposit rate)	4,488
	B. Opportunity cost 5% per annum (informal overdraft rate)	3,452
9	**Benefit as a percentage of tax deducted at source**	
	A. Opportunity Cost 6.5% per annum (short term fixed deposit rate)	0.20
	B. Opportunity cost 5% per annum (informal bank overdraft rate)	0.15

9. Conclusions and Suggestions

9.1 Conclusions

The major conclusions with regard to company compliance costs and the operating cost of the corporation tax are summarised in Table 9.1, which is based on Table 3.18. In examining the table, it should be kept in mind that results are based on a small sample of 44 private sector companies.

Table 9.1: Summary of Findings on the Income Tax Compliance Cost of Indian Companies (2000-01)

Compliance Cost Measure	Sample Findings	Projection for All Indian Companies
Legal compliance costs (LCC) = Internal (personnel + other) costs + payments to advisors	Highly variable but unacceptably high for some firms. Averages: Rs 6475 per employee, 4.12% of profit before tax, 30.41% of tax paid	Between 4.33% and 13.18% of tax paid
Distribution of LCC by company size	By and large, regressive for all measures of company size	No information
Gross compliance costs: LCC + bribe costs.	Not estimated	No information
Adjusted LCC = LCC + opportunity cost of delayed refunds.	Median refunds due to overpayment of taxes to avoid penalty average 46% of taxes.	Between 6.44% and 15.29% of tax paid. Delayed refund costs 2.11% of tax paid
Cash flow benefits from advance tax and TDS	Over 50% of legal compliance costs	Not directly estimated
Net compliance costs = Adjusted LCC – cash flow benefits from advance tax and TDS – tax deduction of compliance expenditure	Average: 15% of legal compliance costs. Negative for most large firms.	Between *minus* 0.72% and *plus* 0.62% of tax paid before delayed refund costs
"Social" compliance costs = LCC + *social* opportunity cost of delayed refunds	Not estimated	Between 5.61% and 14.46% of tax paid. Delayed refund social cost: 1.28% of tax paid
"Social" operating costs = "Social" compliance costs + administrative expenditure	Not applicable	Between 5.92% and 14.77% of tax paid

Other interesting features of compliance costs are:

- While, for some firms, costs are extremely high, on average by international standards they are reasonable.
- Relatively high legal compliance costs as a percentage taxes are more an indication of the porous Indian corporation tax than the burden of compliance costs. Nevertheless, the corporation tax is an expensive source of government finance.
- Estimates of net compliance costs in Table 9.1 suggest that, in aggregate, companies are able to recover legal compliance costs, though this is not toe case for small companies.
- Social costs are moderate by international standards at the lowest estimate but high if the higher estimate is closer to the real situation.
- For 62 percent of companies, income statements and balance sheets are better prepared due to compliance requirements and over 50 percent of companies found auditing requirements useful in detecting dishonest employees.

- Regression results confirm results in Table 9.1 that legal compliance costs are regressive with respect to all size indicators used.
- Twelve sample companies reported payment of excess taxes. The reason for this is due to tax evasion penalty not being leviable under Indian law if taxes assessed have already been paid. At the median, overpayment amounted to 46 percent of taxes paid.
- In a case study, the company was found to follow a risk avoidance strategy by overpaying taxes in order to avoid penalty, preferring to lose interest on the overpaid taxes instead.

Other findings about compliance requirements of companies and compliance cost components are:

- There is a wide variation in the number of pages of documents submitted by companies with their tax returns with the number ranging between 9 and 3100.
- Additional information asked during scrutiny assessment followed by maintaining accounts are the major activities contributing to compliance costs. For the latter, differences in accounting requirements for tax purposes and under the Companies Act are of importance.
- The small share of expenses on employees (24.7 percent) does not accord with international experience, but is plausible in a low wage economy like India's.
- Seventy percent of companies use outside tax advisors to prepare returns, with small companies being somewhat more dependent on external assistance.
- External costs account for around 39 percent of the total legal costs of sample companies.
- Compulsory external financial audit is the main source of fees of external professionals. Other important sources are litigation and, unexpectedly, providing assistance to employees.
- The most important reason for use of professional advisors is the cost advantage arising from tax structure instability due to frequent changes in tax laws followed by ambiguity and complexity of tax laws.
- In a case study, the company was found to takes a long term view of tax disputes and devote considerable effort to tax planning.
- Of legal compliance costs, the bulk consists of mandatory costs, with voluntary costs being estimated to be between 19 and 43 percent of legal costs. The latter figure is if "other/unspecified" compliance costs are assumed to be voluntary.
- The average sample company had 10 to 11 assessment years locked in disputes for tax or penalty with a maximum of 20 years. Given two to three years for completion of scrutiny assessments, the number of open assessment years of a typical company is 12 to 14.
- Statistical analysis suggests that a one year increase in the number of disputed assessment years, raises legal compliance costs by 5.68 percent.
- The average times taken to close an assessment reported in a case study were as follows:

Scrutiny assessment	30 months
Typical final assessment with rectifications	34 to 38 months
Typical final assessment with first appeal	34 to 46 months
Typical final assessment with second appeal	82 to 112 months
Typical final assessment with High Court reference	202 to 268 months

- Although there is wide variation in the extent to which tax concessions are used to reduce tax liability, the tax savings achieved by the average firm amount to over 200 percent of taxes paid.
- The incorrect application of various tax provisions by the tax officials burdens taxpayers who have their tax assessments revisited. From CAG audit data, the most serious problem is with valuation of closing stocks of companies followed by underassessment of tax. Both of these are areas where a good deal of discretion is available to assessing officers.

Major findings relating to tax evasion, tax department efficiency, and harassment by or corruption of income tax officials are:

- There is no or low underreporting of taxable income in the opinion of companies, with a weighted average underreporting percentage of less than 10 percent. This is despite companies feeling that the probability of detection and punishment of tax evasion is no more than 6.1 percent. The latter suggests lax enforcement in the opinion of companies.
- Nearly a third of companies expressing an opinion felt that they had been subjected to harassment by income tax officials.
- Porous tax laws or lax enforcement, permitting illegal competition via tax evasion, with the latter having a strong statistical association with underreporting. So, tax simplification and better enforcement are likely to improve compliance, though the impact on compliance costs is uncertain.
- Sample information suggests that over 50 percent of Indian companies pay bribes to income tax officials. Information from a World Bank-CII survey suggests that income tax officials are not as corrupt as customs or public utility staff. Even so, 43 percent of companies reported paying bribes frequently and only 13 percent claimed never to have paid bribes to income tax officials.
- Though bribes do not appear to add significantly to compliance costs, bribes are likely to be a major income source of corrupt officials.
- The going rate of bribes for speedy refunds is reported to be around 10 percent of the refund due.
- There are additional psychic cost associated with bribes due to their uncertain quantum and, in case of services expected in return, the 25 percent chance that the services will not be delivered.
- Besides bribes *per se*, the established tradition of festival gifts to government officials, including tax officials, contributes marginally to compliance costs.
- Obstacles from income tax regulations and administration *per se* are not a reason for bribes.
- Statistical analysis and qualitative responses tentatively suggest that bribes in return for services are possibly less important than bribes to escape harassment.
- The need to pay bribes may itself be a cause of tax evasion, since companies cannot report bribe payments in their accounts.
- There is a strong statistical association between corruption and tax evasion.

An attempt to measure psychic costs of costs of tax uncertainty, complexity and ambiguity was made, while recognizing that responses reflect the opinions of responding company officials and not necessarily company owners. For these costs, and also fiscal attitudes of respondents, the main conclusions are:

- Average psychic costs are about 50 percent of objective legal compliance costs of sample companies, and, while variable, are have coefficients of variation well below that of legal compliance costs.
- Among component costs, ambiguity of tax laws has the highest psychic cost as also the lowest coefficient of variation. Costs of tax complexity and instability have similar magnitudes at around 4 to 5 percent of taxes paid.
- Psychic costs are regressive.
- There is a fairly uniform belief that government expenditure benefits to companies are around 20 percent of taxes paid. Nevertheless, respondents feel, on average, that the corporation tax should only be somewhat reduced rather than greatly reduced
- 78 percent of respondents are satisfied with or neutral towards the Income Tax Department.
- Only 10 percent of respondents felt income tax administration to be a major obstacle to doing business, though high taxes are perceived by 35 percent of respondents as a major obstacle. Similarly, under 5 percent of firms reported facing major difficulties with income tax authorities.
- Statistical analysis confirms this, suggesting that policy obstacles do not significantly affects sales growth.

9.2 Limitations

There are three methodological problems with estimates of compliance cost in this study, of which the first item below is important.

- For in-house costs, only an opinion scale, ranging from "very important" to "unimportant" is used, so, the study sacrifices a clear identification of the relative contribution of mandatory and voluntary in-house costs.
- As in earlier studies, sources of possible bias are apportionment of fixed costs and the value of time of company management.
- Since the necessary disaggregation into traded and non-traded goods and the break-up of external costs is not available, and nor are recent estimates of shadow prices except for traded goods, shadow valuation is perforce ignored in estimating social compliance costs.

The questionnaire could not address four issues of which two are possibly important.

- The duration of delay in receiving refunds and the opportunity cost interest rate of companies.
- Actual advance tax instalments paid. Due to an assumed rather than actual opportunity cost of funds, and assumed rather than actual advance tax payments, cash flow benefits are only approximately estimated, except in two case studies.
- The division of organizational responsibilities for tax related work. However, a company case study and anecdotal evidence suggests that bias due to inclusion of taxes other than the corporation tax may be limited due to organisational separation of responsibilities for the corporation tax.
- The value of festival gifts given to income tax officials.

Additional problems exist with the representativeness of the sample

- The sample design, initially conceived as a stratified random sample, eventually degenerated into a "convenience" sample.
- The eventual net response rate was an unsatisfactory 1.15 percent or 45 companies. However, by some indicators like proportion of sales or taxes paid, the size of the sample is somewhat less unsatisfactory for drawing inferences.
- Only one public sector company responded to the survey. Its responses are summarised in a case study and it is not included in results presented elsewhere.
- Compared to the distribution of companies in the report of the CAG, the sample has an over-representation of large firms. So inferences from the sample for smaller firms will be less reliable than for large firms.
- In terms of profitability, loss making and zero profit companies are underrepresented.

Overall, while the sample size is clearly inadequate for reliable statistical inference, especially for smaller firms, sample statistics appear to be worth reporting if results are treated as preliminary and viewed with caution.

9.3 Reform suggestions

Suggestions are listed point-wise, summarising conclusions in earlier chapters. First, general suggestions are listed. This is followed by an identification of high compliance cost legal provisions and administrative procedures for which review by the Income Tax Department and, if possible, streamlining, are suggested.

9.3.1 General suggestions

- Private compliance costs, on a net basis can be reduced, on average, to zero, if the problem of delayed refunds is tackled by streamlining refund procedures and reducing the time lag. Administrative corruption in this area will also need to be curbed.

- Improving taxpayer services for business appears to offer scope for reducing compliance costs of high cost provisions.
- To further reduce the impact of administration on compliance costs, reducing the discretionary powers of income tax officials, increasing their individual accountability and reducing occasions for direct contact with taxpayers where possible are important.
- Despite possibly low tax evasion by companies, room for better enforcement appears to exist.
- Among specific areas, alleged bribe taking by appellate authorities to give favourable judgments should, perhaps, be guarded against, by regular after the fact reviews of a sample of appeal cases.
- Costs of the policy environment and tax laws are high and require reduction. Only when the budget speech of the Finance Minister, at least for tax policy changes, becomes routine and boring can it be said that costs of policy instability have been reduced. A similar comment applies to frequent administrative notifications.
- To reduce costs of complexity and ambiguity, tax law simplification, including improved legal drafting, is indicated.
- Strengthening advance rulings and extending their scope can also reduce costs of tax ambiguity and complexity.
- With regard to concessions, the large tax benefits companies derive from them suggest that tax simplification by scrapping concessions, especially where the extent of the concession is not justified in terms of achievement of social objectives, is an additional option for lowering compliance costs.
- Efforts to harmonise central and state tax provisions, such as regarding notified backward districts, can also lower compliance costs.
- Regarding legal and tax provisions, an important general finding is that there are five areas related to international transactions that are troublesome (highlighted in bold type in the next sub-section). These areas will become increasingly important as global links of Indian companies grow.
- Detailed examination by the Income Tax Department of high compliance cost areas listed in the next sub-section, and simplification where possible of these provisions and procedures is suggested.

9.3.2 Reform of specific provisions

The following legal and procedural "hot spots" which add to compliance costs have come to light while doing this study;

Legal hot spots include:

- Compulsory financial audit
- **Claiming export concessions, with particular reference to rules, clearances and procedures**
- **Non-resident withholding**
- **Permissions in connection with free trade zones**
- **International tax provisions**
- The Minimum Alternate Tax
- Valuation of perquisites
- Provisions related to company restructuring
- **Discretion of assessing officers in applying newly introduced transfer pricing regulations**
- TDS penalties for withholders and the absence of a time limit for TDS assessment
- Absence of penalties for tax department staff especially concerning delayed refunds and clearances.

Regarding administrative procedures, hot spots identified include:

- Refund procedures and monitoring

- Appeal filing and disposal especially due to the lack of policy to ensure cost effectiveness and increase the department's success ratio.
- Inadequate tax related expertise of appeals tribunals
- The absence of realistic revenue targets for assessing officers – or otherwise modifying their incentive structure
- The limited accountability of assessing officers. This can be improved by tracking past assessment performance of individual assessing officers. In turn, computerisation of personnel records, including assessment work done by officers, will help.
- Inadequacies in the scheduling of assessment hearings, keeping in vie the convenience of taxpayers, resulting in excessive waiting time of assessees or their representatives.
- The slow speed of scrutiny procedures and separation of TDS and corporation tax scrutinies
- Excessive discretion of assessing officers, for example in setting rates for tax deduction at source from fees for professional and technical services under section 194J. One measure to reduce this is by preparing a scrutiny manual which currently does not exist.
- Inadequate training of assessing officers in selected areas identified by audit objections. This can be rectified by focused training, designed after necessary internal inquiry to ascertain the causes of lapses.
- Procedures for grant of tax clearance certificates (Form 34A) under section 230A.
- The frequency of filing required under the 1 in 6 scheme when no tax dues are found in initial returns filed.

Annexes

Annex 1.1 International Evidence of Business Compliance Costs

TABLE A1.2: Main Features of Compliance Costs Studies of Corporations: Taxes Studied and Coverage (in Chronological Order)

Author and Year Published	Tax(es) Studied	Method and Year of Survey	Area Studied	Universe Size	Sample Size	Usable Answers	Response Rate	Universe Coverage
Bryden (1961)¢ #	Corporate Taxes	Mail Survey - 1960	Canada	107387 (5)	500	125	25%	0.12%
Johnston (1963) #	CIT	Face-to-face Interviews- 1960	Ohio	Unknown	6	6	100%	-
Godwin, Hardwick and Sandford (1983)¢ #	PAYE.	Mail survey and (follow up interviews) 1982 Face-to-face interviews and phone follow up (1979)	United Kingdom	10,00,000 (12)	3000 2610	687(13)	22.90% 30%	0.07%
Tauber (1983) and Tiebel (1984) cited in Fischer (1989)	CIT, employer's wage tax (payroll tax)	Mail (questionnaire) survey for business	Germany	N.A	373 businesses in 1983 450 businesses and 2000 personal respondents	373 businesses in 1983 450 businesses and 2000 individuals in 1984	100%	N.A
Sandford (1985)[&]	(i) UK VAT, (ii) Cost to UK employers of collecting PAYE, Income Tax and National Insurance contribution (iii) Irish Wealth Tax, 1975-78.	(i) Mail survey of registered VAT traders supplemented by interviews with traders, accountants and professional advisors. (ii) Mail survey of employers, supplemented by a small number of interviews, 1981-82 (iii) Anonymous data provided from the records of a large firm of Dublin accountants.	UK	(ii) 10,00,000	(i) Over 9000 (ii)3000 employers (3 in every thousand) (iii) 142 individual cases, from which 133 wealth taxpayers (5-6% of total individual wealth taxpayers).	3000	(i) 31% (ii)30%	-
Arlinghaus and Anderson (1986) cited in Slemrod and Blumenthal (1996)	CIT and other taxes on corporations	Mailed surveys to Fortune 500 companies in 1983 and 1986.	USA	500	500	(a) 231 (b) 232	(a) 46.2% (b) 46.4%	46.3%
Canadian Federation of Independent Business (1986) #	Business Income Tax (personal, corporate)	Mail survey – 1983	Canada	Unknown	22438	19208 (14)	85.60%	-

Author and Year Published	Tax(es) Studied	Method and Year of Survey	Area Studied	Universe Size	Sample Size	Usable Answers	Response Rate	Universe Coverage
Arthur D. Little Corporation (1988)¢§	Federal Income Taxes for individuals and businesses, CIT	(i)Diary study (ii)Recall survey (ii) Recall mail (questionnaire) survey	USA	-	(i) 750 individuals (ii)6200 individuals (iii) 4000 partnerships and corporations and their paid tax preparers.	(i) 750 (ii) 4038 (iii)1474	(i)100% (ii) 65.13% (iii) 36.85%	-
Sandford, Godwin and Hardwick (1989)	VAT, PAYE, CIT.	Mail survey-1987	United Kingdom	1,526,000	3000, unknown, unknown	680 318 139	24%	0.2%
Vaillancourt (1989)¢§	Compliance costs of Canadian employers	Mail questionnaire survey, March-May 1987.	Canada	-	4196	385	9.18%	-
Matheu and Angel Gustavo Secchi (1989) §	National, provincial and municipal taxes including social security contributions.	Mail survey.	Argentina	-	-	-	-	-
Harris (1989)§	PAYE, profits tax, VAT, sales tax.	Survey.	Hong Kong	-	-	-	-	-
Freidkes and Gavish (1989)§	CIT, VAT		Israel	-	-	-	-	-
Nicolaissen (1989)§	CIT, VAT		Norway	-	-	-	-	-
Imhof and Snijder (1981) cited in Imhof (1989)§	CIT, VAT, customs administration.		Netherlands	-	-	-	-	-
Gerade, Blondiaux and Vanden Berghe (1989)*§	CIT, VAT, and employers' social security contribution CC of companies	In-depth analysis of 15 companies. Attempt to measure marginal CC.	Belgium	-	15	15	100%	-
Norman and Malmer (1989)*§	Compliance costs of companies in 1993	12 companies in Stockholm area.	Sweden	-	12	12	100%	-
Pope, Fayle and Chen (1990, 1991, 1993, 1994)¢	(i) Public company taxation (ii)Employer taxation (iii) VAT and payroll taxes (iv) CIT, (Only economic costs are included)	Mail surveys	Australia	-	(i)1860 (ii)2739 (iii)2467 (iv)2531	-	(i)17% (ii)27% (iii)24% (iv)34%	-
Pope and Fayle (1991)	Compliance cost of Public Companies' CIT	Mail survey, Aug-Oct,1988.	Australia	21283	1860 (1837 listed and 23 non-listed public companies)	314 (298 Listed and 16 non-listed companies)	16.9%	1.48%
Prebble (1992)¢	Corporate groups subject to controlled foreign companies' regime.	In-depth interviews	New Zealand	-	14	-	100%	-

Author and Year Published	Tax(es) Studied	Method and Year of Survey	Area Studied	Universe Size	Sample Size	Usable Answers	Response Rate	Universe Coverage
Sandford and Hasseldine (1992)¢	Principal business taxes (i)Employer related taxes (including PAYE and FBT), (ii) GST	Two random mail surveys	New Zealand	-	(i) 4743, (ii) 9541	-	Employers' survey: 1887 (39.8%) GST and Business IT: 2954 (31.0%)	-
Pope, Fayle and Chen (1993)	Compliance cost of employment related taxation (employers' PAYE, FBT, Prescribed Payments Tax System (PPS) and payroll tax)	Mail survey in Apr/June-1991.	Australia	745 businesses throughout Australia	-	-	-	-
Malmer (1994)¢ and (1995)	(i)Income tax (ii) VAT, payroll and excise taxes (iii) Corporate tax in 1992-93. Administrative costs	Mail survey. Random sample of 936 companies for (ii) after telephone contact, and tax file analysis	Sweden	-	(i & ii)1000, (iii)936, Tax files 3000	-	(i & ii) 59% (iii) 65%	-
Wallschutzky and Gibson (1993)	Compliance cost of small businesses	Interviews and information from accountants/tax agents and Australian Tax Office (ATO)	Australia	-	-	-	-	-
Allers (1995)¢	Business Income Tax	Mail survey	Netherlands	-	5393	-	20%	-
Wallschutzky (1994)¢	Business Federal and State taxes	Diary check/in-depth interview with small business firms	Australia	-	12	-	100%	-
Ariff et. al. (1995)	CIT	Mailed survey	Malaysia	Listed companies on the Kuala Lumpur stock Exchange	300	48	16%	-
Gunz, Macnaughton and Wensley (1995)	Compliance costs of scientific and experimental development tax credit program	Written survey in spring-summer, 1994, 90-minutes orientation meeting., conference calls	Ontario, Canada	-	51 companies	51	100%	Sample may not statistically represent population of S,R and ED claimants.
Plamondon and Zussman (1996)	Canadian business Taxes (Sales tax, CIT, Payroll taxes, Excise taxes). (c. 1995)	(i) Panel discussions with accounting professionals and representatives of large business; (ii) Survey of small and medium-sized businesses.	Canada	3082	-	1507	49%	-

Author and Year Published	Tax(es) Studied	Method and Year of Survey	Area Studied	Universe Size	Sample Size	Usable Answers	Response Rate	Universe Coverage
Slemrod and Blumenthal (1996)	CIT	Mailed to 1329 of 1672 large corporations in the IRS CEC program	USA	Not ascertainable	1329	365	27.5%	-
Mills (1996)	CIT tax audit costs and tax compliance	Secondary data from the Voluntary Compliance Baseline of the US IRS and financial data from "Compustat". CC data from Blumenthal and Slemrod (1996)	USA	Unknown No. of Manufacturing firms out of 1500 firms in the US IRS Coordinated Examination Program (CEC)	-	116	-	-
Erard (1997)	Federal and provincial CIT, capital taxes	Mailed to all members of the Canadian Income Tax Committee of the Tax Executives Institute, Inc. (1996)	Canada	500 largest non-financial companies	Approx 250	59	Approx 24%	51.8%
Erard (1997a)	Federal and provincial CIT, capital taxes, payroll, sales, and property taxes	Mail survey	Canada	-	Approx 86500	8823	10.2	-
Seltzer (1997)	Federal Income Tax	Case study of Hewlett-Packard	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable
Ariff et. al. (1997)	CIT	Mail survey of listed companies on Stock Exchange of Singapore	Singapore	234	234	46	19.7%	19.7%
Loh et. al. (1997)	See Ariff (1995)							
Collard and Godwin (1999)	Employers for PAYE and National Insurance	Mail survey	UK	-	5195 Employers	1336 (out of 1398)	29.2% (overall response rate: 30.6%)	-
Porter (1999)	Cost of in-house tax departments in 1996	Mail survey of large companies	UK	-	434	156	36%	-
Chan et. al. (1999)	CIT	Mail survey of companies listed on the Hong Kong stock exchange, 1995-96	Hong Kong	496	75	58	11.7%	11.7%
Hudson and Godwin (2000)	Compliance cost of collecting direct taxes in the UK	Mailed stratified random sampling of employers (Aug/Sept-1996)	UK	-	5195 '	-	30.2%	-
Slemrod and Venkatesh (2002)	Large and mid-size companies and tax preparers for 2000.	Mailed stratified random sample of (a) companies with at least US$ 5 mn in assets, (b) tax preparers drawn from	USA	(a) 230,945 (b) 172,553	(a) 2499 (b) 1824	(a) 218 (b) 225	(a) 9.00 (b) 11.95 Total: 10.25	0.094% 0.130%
INDIAN STUDIES OF OTHER TAXES								

Author and Year Published	Tax(es) Studied	Method and Year of Survey	Area Studied	Universe Size	Sample Size	Usable Answers	Response Rate	Universe Coverage
J. Sridharan (1999)	Customs Duty and Central Excise	Questionnaire survey and personal interviews (1992-94)	India, Major southern cities	-	-	-	-	-
Export-Import Bank of India (1998)	Customs duties	Canvassed questionnaire	India	-	-	-	-	-

Notes:

CC: Compliance cost or costs.
CIT: Corporation income tax.
FBT: Fringe benefits tax.
PAYE: Pay-as-you-earn (payroll or withholding) tax.
GST: Goods and services tax.
VAT: Value added tax.
WST: Wholesale sales tax.

Source: Vaillancourt (1987).
¢ Source: Evans and Walpole (1997).
§: International Fiscal Association (1989).
&: Sandford, Godwin and Hardwick (1989).
'-': Not Available.

TABLE A1.3: Main Features of Compliance Costs Studies Which Included Corporations: Focus Taxes and Coverage (in Chronological Order)

Author/Year of Published	Tax(es) Studied	Costs Included	Comments	Results
Bryden (1961)¢ #	CIT, property tax, custom and excise, etc. and of collecting taxes for business.	Wages and salaries, direct costs, share of overhead and outside fees included. Collection fees were subtracted.	Sample of corporate supporters of the Canadian Tax Foundation. Size distribution of respondents biased towards large firms.	1960 cost of collecting taxes (CIT): 0.56%. CIT was <0.03% of sales. Total compliance/administrative cost of federal and provincial governments: $1.7bn, or 1.2% of tax revenues in Canada. CC highly variable across firms. Proportionately higher for small firms. Costs of minor taxes very high compared to liability.
Johnston (1963) #	CIT	Wages and salaries, some facilities costs and outside fees	Incorporated manufacturing firms	-
Godwin, Hardwick and Sandford (1983)	PAYE	Wages and salaries, value of time of proprietors	The universe is the list of taxpayers compiled by England's Inland Revenue.	PAYE CC are 1% of yield and regressive. Cash flow benefits accrue mainly to larger firms.
Canadian Federation of Independent Business (1986) #	Business Income Tax (personal, corporate)	Outside fees only.	The universe is members of the Federation. They tend to be small Canadian owned businesses. Only firms using outside expertise were retained.	-
Tauber (1983) and Tiebel (1984) cited in Lutz Fischer (1989)	Compliance costs of businesses	Administration costs for the tax system (e.g. Cost of levying tax, income tax assessment costs). Time costs of employers and monetary CC of CIT.	The pre-tax deduction proved to be particularly cost-intensive since pre-taxes in Germany must be divided into non-deductible pre-taxes and deductible pre-taxes..	Compliance costs for companies: DM 40 bn in 1983, or 2.36% of GNP. 1985 administration costs for the tax system: DM 10,295billion, or 2.35% of tax revenue and 0.56% of GNP. Time spent on compliance in 1984: Time spent by employer per employee's wage tax matters: between 0.35 and 6.3 hours. In 1983, employer spent 26 hours per year on own compliance activities. Income tax assessment costs: DM 155 per case and DM 34 for wage tax. 43 hours per year spent by companies on CIT compliance. Total costs: DM 1637 per company per year.
Grapperhaus Commission Report (1985)	Compliance costs especially of small and medium businesses.	Primarily concerned with the employers' costs of withholding income tax and social security payments and premiums for employees in.	336 small and medium enterprises were surveyed	-
Sandford (1985)&	(i) UK VAT, (ii) Cost of UK employers of collecting PAYE IT and National Insurance contribution	-	Sample drawn from two Inland Revenue national PAYE computerised files.	(i) Aggregate CC 1977-78 were a little under 400mn, or about 9% of tax revenue. (ii) Aggregate CC around 450mn or just over 1% of the total income tax plus NI payments
Canadian Federation of Independent Business (1986) #	Business Income Tax (Personal Income Tax, CIT)	Outside fees only.	Universe: members of the Federation. (Mostly small Canadian owned businesses). Only firms using outside expertise surveyed.	-

Author/Year of Published	Tax(es) Studied	Costs Included	Comments	Results
Arlinghaus and Anderson (1986) cited in Slemrod and Blumenthal (1996)	CIT and other taxes on corporations	Internal personnel costs and non-personnel costs, external cost, excluding computers and data processing	Fortune 500 companies in 1983, 1986	Total CC: $1.13bn in 1983; $1.47bn in 1986.
Arthur D. Little Corporation (1988)¢	Federal CIT	Tax preparers' fees, tax paperwork-related activities.	Three national surveys 1. Diary study – 750 individuals recorded daily time for tax paperwork and related activities. 2. Recall survey of individuals – 4,038 responses, 3. Recall survey of partnerships and corporations – 1474 responses. Results relate to the tax year 1983. Projections made for 1984 and 1985.	26.4 hours spent on compliance per individual (range 14.6 hours to 56.3 hours). 2.13 billion hours with a resource cost of $26.7 bn in aggregate. Business CC of federal income tax in 1983 were 2748 million hours.
Sandford, Godwin and Hardwick (1989)	VAT, PAYE, CIT	Time spent by in-house staff on corporation tax, planning work and administration.	Poor response rate due to long and complex questionnaire	Compliance costs and administrative costs of VAT: 3.69% and 1.03% of revenue. Net CC: 0.98% of revenue. Compliance costs of corporation tax: 2.2 % of revenue. Compliance cost ranged from 0.48% of taxable turnover for the smallest firms to 0.01% for the largest.
Matheu and Angel Gustavo Secchi (1989)*§	Compliance activities related to tax payments, withholding, receipts, etc.	Tax CC of companies of national, provincial and municipal tax systems, including social security contributions.	Results based on a few representative companies from different productive sectors. No studies, estimations or calculation s for fiscal CC.	Compliance costs for large companies: 1to 4% of tax payments, withholdings, receipts, etc.; Medium companies: 3 to 5%; small companies: 6 to 9% .
Harris (1989)*§	Costs of compliance of various taxes	Not Applicable	No survey conducted.	Fee for submission of a tax return for a medium sized trading corporation: around HKD 30,000 from a "big eight" firm, less from a smaller accounting firm. Despite the low rate of taxation the cost of collection was 1.46% in the year ended 31 March, 1987 and 1.54% in 1986.
Freidkes and Gavish (1989)*§	Compliance costs of PIT, CIT	CC via payments to tax consultants and bookkeepers. In house includes salary paid to the employees, processing equipment, maintenance of offices, etc.	Tax burden: Tax revenue to GDP ratio peaked (48%) in 1976 and was lowest in (35%) in 1984. In 1985-87, income tax (including capital gains tax) contributed 43% to 45% of total revenue. Expenses on tax compliance of business assessees are tax deductible: Cost of deducting tax at source computed as tariff charges by service bureaus per salary slip.	Net cost of taxpayers: New Israeli Shekels (NIS) 400 million in 1987, or 1.6% of total taxes and compulsory payments; or 2.2% of income and expense tax revenue. Cost of deducting tax at source was: NIS 5 per salary slip per month. Expenses incidentals to salary deductions: NIS 45 million Administrative costs: in 1987 for Corporation income tax: 0.0068%.
Nicolaissen (1989)*§	CIT		Estimates of CC are not based on any survey.	Average CC for corporations: NOK 15,000. Assuming 50,000 corporate taxpayers in 1987, total CC at least NOK 750 million. Administrative costs approx. 7% of CIT revenues and 80% of corporate taxpayers' costs. Corporation income tax: 15.8% (admin: 7%, CC 8.8%) Total CC for PIT+ CIT+ VAT: NOK 5,250 for 1987. For tax system as a whole: NOK 7,000 million, or 2.6%

Author/Year of Published	Tax(es) Studied	Costs Included	Comments	Results
				of total 1987 accrued tax revenues.
Imhof and Snijder (1989) cited in Imhof (1989)§	Compliance costs of small and medium enterprises	Covers wage withholding costs, taxes on business income and VAT	300 small and medium enterprises were surveyed	The average costs of the wage-administration per employee are Dfl. 489, average costs of the VAT-administration are per enterprise Dfl. 3,992. The cost for preparing the return for income tax (self-employed) and the corporation tax varies between Dfl. 489 to Dfl. 1,000. The administrative costs per employee are for big enterprises (>500 staff) Dfl. 661 and that for small and medium enterprises (<500staff) Dfl. 1,264. The costs for tax consultancy (chartered accounts, tax advisor, administration) per employee is Dfl. 56 for Big and Dfl. 511 for small.
Pope, Fayle and Chen (1990, 1991, 1993, 1994) cited in Binh et. al. (2000)¢	(i) Public company taxation (ii) Employer taxation (iii) WST (iv) CIT	Only economic costs are included.	-	(i) Superseded by survey, see (iv) below. (ii) CC 1.4% of PAYE revenue; 10.9% of FBT revenue; 6.6% of PPS revenue and 3.6% of State payroll tax revenue. (iii) 1.9% of wholesale tax revenue. (iv) 22.9% of CIT. All costs regressive.
Pope and Fayle (1991)	Compliance cost of public companies' income taxation	(a) Incidence of taxes and related matters (experiencing an ATO audit, investigations, tax appeals and information accessibility). Company's computational costs, e.g. in-house staff costs, (management, accounting, legal and support staff) and professional fees (tax agents, legal and other). Computational and planning costs including 'increasing capital', asset acquisition or disposals, paying dividends, foreign tax implications, etc.		Compliance costs of public companies regressive. Total gross CC: 11.4 to 23.7% of public companies' tax revenue Computational costs 55% and planning costs 45%.
Sandford and Hasseldine (1992)¢	Principal business taxes (i) Employer related taxes (including PAYE and FBT), (ii) GST	-		Compliance costs are 5 times Inland Revenue Dept administration costs; particularly high for small firms. (i) PAYE and related tax CC: \$195mn in 1990-91 or 1.92% of tax revenue: 90% in-house costs, and 10% fees to tax advisors. (ii) FBT costs: \$8.5 mn, or 1.7% of revenue (iii) GST costs \$453mn, or 7.3% of GST net revenue.
Prebble (1992)¢	Corporate groups subject to controlled foreign companies' regime.	-	-	Economies of scale for very large firms.
Wallschutzky and Gibson (1993)	Compliance cost of small businesses	Compliance cost for specific types of taxes and issues, service and administration provided by Australian Tax	Compliance costs not measured directly	(a) More experienced officers to deal with enquiries (b) Increasing awareness of tax office functions and in educating and

Author/Year of Published	Tax(es) Studied	Costs Included	Comments	Results
		Office (ATO)		assisting small business (c) Unrealistic expectations and lack of commercial flexibility creates major problem for the small business, rather than paperwork associated with taxation
Pope, Fayle and Chen (1993)	Compliance cost of employment related taxation [employers' PAYE, FBT, Prescribed Payments Tax System (PPS) and payroll tax]	The costs of time spent by owners/directors/employees on maintaining tax records and completing tax returns or preparing information for tax agent/accountant; fees paid to professional advisors, such as a tax agent, accounts or lawyers.	-	CC of PAYE in 1989-90: $629 mn, or 1.4% of (gross) PAYE tax revenue. Compliance cost as a % of tax paid regressive: 16.7% (for the smallest remitters) to 0.2-0.4% (for the largest remitters). Internal costs account for 88% and external costs (professional fees) for 12%. CC of FBT in 1989-90: $128 mn, or 10.9% of FBT tax revenue. CC as a % of tax paid regressive, falling from 44% to 3.7%. \ CC of payroll tax in 1989-90: 3.6% of payroll tax revenue. Compliance cost of payroll tax regressive, falling from 33% for small employers to around 1% of tax paid for large employers.
Malmer (1994)¢ and (1995)	(i)Income tax (ii) VAT, payroll and excise taxes (iii) Corporate tax in 1992-93. Administrative costs	Time and money costs	Including for individuals not required to file and following the Swedish tax reform of 1990-91.	Smaller firms more likely to use external advice. Costs highly regressive. The tax reform (and in particular, tax simplification) had reduced CC overall, though CC had increased for employers as a result of the changes. Cost of compliance in % of revenue from relevant tax in 1993: Income-tax (includes individuals): 1.7 Payroll tax: 0.3; VAT: 2.5; Excise duty: 0.1; Total CC: 1.32. Admin costs: 0.65. Total operating cost: 1.97.
Allers (1995)¢	(i) Business Income Tax	-	Non-response bias tested.	(I) Small business costs highest: Total CC 4% of tax revenue.
Ariff, et. al. (1995)	CIT	Internal personnel costs and non-personnel costs, external costs	80 responses after reminders of whom 32 were discarded.	Planning costs represented 58% of total CC. CC was 0.36% of CIT being regressive at 0.596% for small firms, 0.452% for medium firms and 0.321% for large firms.
Gunz, Macnaughton and Wensley (1995)	Compliance costs of tax incentives for scientific and experimental development (SRandED)	Financial and technical record keeping to support an SRandED claim, and the CC associated with the SRandED credits, CC divided into annual CC (costs that occur routinely every year), start-up costs, and audit costs	Compliance costs associated with the SRandED discourage RandD by firms with relatively small SRandED credit claims. 24% of federal RandD spending is delivered through tax credits; another 17% is delivered through grants. Two thirds of CC of the SRandED tax credit program arise from the work of technical and scientific employees. Program may create difficulties for smaller firms by forcing the company principals to divert some of their time from the actual RandD work to tax	The CC of SRandED claims is less than 1% of amount claimed. For firms with claims of less than $200,000 the figure can be 15% or more. Grant costs, as for SRandED credits, are low, aggregating to 2% of the total value of grants. Firms with both grants and SRandED credits have smaller CC per dollar received for grants. The 2% figure omits costs of unsuccessful applicants. Aggregate annual CC for 51 sample firms: $2,5million, or 0.7% of SRandED credits claimed. Varies from 0.1% claimed to 164%. of SRandED credits Annual CC increase with the amount of SRandED credits claimed. Annual

Author/Year of Published	Tax(es) Studied	Costs Included	Comments	Results
			compliance. No universal list of SRandED claimants is publicly available Only a tiny fraction of all corporations make an SRandED claim each year. Firms in the sample account for 30% of total SRandED claims in Canada.	CC as a % of SRandED falls with size of claim. 1. Unlike other studies, for tax expenditures size of the claims determines costs even for large firms. 2. For some tax expenditures, CC mainly reflects work by technical and scientific employees and not accounts staff.
Blumenthal and Slemrod (1996)	CIT	Internal personnel costs and non-personnel costs, external costs		In 1992: 55% of CC for in-house personnel; 30% for in-house other CC. Economies of scale in CC by employment, assets or sales. CC $1,569 per firm. Aggregate 3.2% of taxes of CEC firms. Note: Blumenthal and Slemrod (1995) report 40% of compliance costs of large corporations in the USA is due to foreign source income provisions. The CC percentage was much higher than foreign employees, sales or assets of surveyed companies. Of this, the foreign tax credits was the most burdensome requirement.
Mills (1996)	CIT tax audit costs and tax compliance		Tax return and audit information was obtained from the IRS CEC program and combined with compliance cost data from Blumenthal and Slemrod (1996)	Expenditure on tax planning reduces taxes as a percentage of assets
Plamondon and Zussman (1996)	Tax compliance burden of Canadian business Taxes (Sales tax, CIT, Payroll taxes, Excise taxes)	-	Survey sample designed to be representative of the population of small businesses in Canada in terms of location, sales volume and industry type. Telephone fieldwork from Oct 10 to Oct 22, 1997. Interviewers initially identified and spoke with 3082 individuals, of these 1507 or 49% completed the interview.	CC of Canada's major tax systems was estimated at about $3.4 billion a year, which is 0.4 percent of GDP or 1.5% of tax revenue.
Erard (1997)	Federal and provincial CIT, capital taxes	In-house personnel, in-house non-personnel, and external CC of big business.	Also attitudes and suggestions for reform.	CC C$ 507,000 or 0.8% of profit after tax (but before extraordinary items); 4.6% to 4.9% of taxes paid. CC increases less than proportionately with firm size. Positive association with foreign operations, mining sector, oil and gas sector.
Erard (1997a)	Federal and provincial CIT, capital taxes, payroll, sales, and property taxes	Burden of in-house and external CC of small and medium business ranked on a 4-point opinion scale.	Quantitative information not sought as accurate responses not expected. Mailing to all members of the Canadian Federation of Independent Business (CFIB). CFIB members contain proportionately few small firms. Respondent firms mainly larger CFIB members.	Most small and medium firms rely on tax advisors. Firm opinions: poor co-ordination among governments raises CC. Relatively many firms in construction, other primary, retail, and other personal service sectors and in Quebec perceive high CC.

Author/Year of Published	Tax(es) Studied	Costs Included	Comments	Results
Seltzer (1997)	Federal Income Tax (case study of Hewlett-Packard)	Federal Income Tax CC associated with completion of tax return for MNCs.	A large US, MNC, it required only three full-time tax professionals to complete an accurate tax return.	Time spent accounted for 13% of total HP Corporate Tax Department Budget.
Ariff et. al. (1997)	CIT	Personnel and other in-house costs. External costs. Planning and computational costs	The respondents actually represented groups of companies, so that the total number of legal entities was close to 1000. On this basis the universe size is not ascertainable.	CC 0.302% of turnover. Range: 0.395% , 0.285% and 0.083% for small, medium and large companies. Approximately 1:1 for computation and planning costs with large companies spending more on planning. 60% of costs external with small companies having the highest ratio (77%). Over 50%of respondents felt there was no need for tax system improvements.
Porter (1999)	Cost of in-house tax departments in 1996	Personnel and other in-house costs	Follow up to a 1995 Price Waterhouse survey of 50 large firms to assess tax department prevalence, functions, and performance besides costs.	To employ a particular tax planning technique, tax managers required at least a 76% probability of success. External advisors are used more for "costly" planning/advisory matters. Costs averaged GBP 976,000 of which GBP 355,000 was personnel costs in tax departments, GBP 164,000 was other tax department costs, GBP 225,000 was the cost of tax work in other departments, and GBP 224,000 was the cost of external advisors.
Chan et. al. (1999)	CIT	Personnel and other in-house costs. External costs	The respondents actually represented groups of companies, so that the total number of legal entities was close to 1000. On this basis the universe size is not ascertainable.	Overall CC: 1.26% of sales. 5.41%, 1.17% , 0.21% for small medium and large companies by sales. Elasticity: 0.363. Respondents suggested a separate IT division for overseas activity.
Collard and Godwin (1999)	Compliance cost for employers of PAYE and National Insurance (NI)	The CC in collecting income tax under PAYE and NI contribution. Statutory Sick Pay (SSP) and Statutory Maternity Pay (SMP) activities undertaken by directors, partners, managerial and other staff. Costs include fees paid to bookkeepers, accounts and bureaux, direct costs of computer software and hardware, and shares of overhead costs.	The research was commissioned in Oct1995 and published in Nov1998. A size-stratified random sample of 5195 employers' payrolls originally selected. Sampling fractions were adjusted to obtain broadly similar numbers across size bands.	Compliance costs per employer average 1.3% ranging between 7.9% of total PAYE and NI for the smallest firms by employee strength to 0.14% for the largest firms. Cash flow benefits exceed compliance costs for firms with 1000 or more employees on their payroll. Automation or outsourcing was cheapest for firms with 50 or more employees.
Hudson and Godwin (2000)	UK Employers CC for PAYE, National Insurance Contributions, Statutory sick pay, and statutory maternity pay.	CC of PAYE in the UK	Stratified random sampling of 5195 employers' payrolls, based on the number of taxpayer records in each band, to ensure roughly equal numbers across size bands.	Mean compliance costs per employee: GBP 330 for small firms with one employee to GBP 5 for large firms with 5000+ employees. Aggregate: 1.3% of revenue from PAYE. Payment frequency, "disturbance variables", "complexity variables" have a significant positive effect on compliance costs. There is only weak evidence that choice of techniques (manual, computerised, with in-house software, outsourced) effects compliance costs.

Author/Year of Published	Tax(es) Studied	Costs Included	Comments	Results
Slemrod and Venkatesh (2002)	Small and mid-size companies and tax preparers (2000)	Internal personnel costs and non-personnel costs, external costs	Tax preparers asked to estimate CC for hypothetical firms. All respondents asked about high CC provisions, activities avoided due to tax complexity, tax shelters and suggestions for simplification. Separate estimates of pre-filing, filing and post-filing costs by activity. Sample has several "pass through entities" which pay no tax, raising estimated CC as a % of tax.	CC Regressive. High CC areas: depreciation rules; Alternate Minimum Tax. 58.7% CC on internal personnel, 16.5% other internal. 68.5% CC for federal taxes; 25.5% state/local taxes; 6.0% foreign taxes. Mean CC $254,451(adjusted for bias: $134,995); median CC $114,705; Total CC: $29.9 bn (26.9% - 28% of tax paid). Costs are 10-11 times the CC estimates in Slemrod and Blumenthal (1996) for large firms.
INDIAN STUDIES OF OTHER TAXES				
Sridharan (1999)	Customs Duty and Central Excise	(a) Collection costs of Custom Duty (CD) and Central Excise Duty (CED) including wages and salaries paid to revenue staff; accommodation, establishment charges, etc. (b) CC for CD includes salaries of customs clearance workers/workers looking after Excise matters, establishment charges, accommodation costs, litigation costs, costs of tax related books, etc.	Separate questionnaires for importers/exporters/manufacturers of excisable goods, distributed at major ports, airports, cargo complexes and Excise Commissionerates in major southern cities including Chennai, Visakhapatnam, Bangalore, Hyderabad, Vishakapatnam, Coimbatore and Madurai.	Compliance costs of Rs 2.05 bn and administrative costs of Rs. 2.5 bn, or 0.096% of GDP. For Custom duty, administration costs were 1% of duty collected and CC were only 0.4% of duty collected. For Central Excise Duty, administrative costs were 0.71% of duty collected and CC were 0.37% of the duty collected. CC are regressive.
Export Import Bank of India (1998)	Customs duties and formalities	NA ("exporter's transactions costs")	NA	8% to 10% of total export earnings for pharmaceuticals and textiles.

Annex 3.1 Study Methodology and Recommendations for Future Studies

The scope of the project was expanded beyond the original terms of reference from those specified in the Planning Commission letter of November 10th, 1999 to include,

- Bribe and harassment costs, making this study probably the first of its kind to deal with these sources of compliance costs.
- Psychic costs, making it only second study (after Diaz and Delgado, 19 for Spain), which attempts to measure these costs.
- An attempt to assess the Marginal Efficiency Costs of Funds (MECF) of compliance requirements, making it the first study to attempt this assessment.

Design phase consultations and focus group meetings

In the background phase, the following activities were performed.

- The team prepared seven background papers, which were discussed with external experts. These are listed in Chattopadhyay and Das-Gupta (2002).
- A design seminar at the NIPFP in April, 2000 provided further feedback on the study design.
- The team visited the University of Bath, Centre for Fiscal Studies from July 24 to July 31, 2000. A total of four meetings were held with Bath University experts, including Professors Cedric Sandford, David Collard, Roger Bowles and Dr. Michael Goodwin. The team members also met with Professor John Hasseldine of the University of Nottingham.
- A meeting was also held with Messrs. Crown Agents, London to discuss the study design with tax experts there, including former senior officials of the Australian Tax Office and HM Inland Revenue.
- A video conference was arranged by the World Bank, New Delhi on August 24, 2000. The conference added value to the project in terms of feedback from World Bank tax experts.
- One of the external consultants to the project, Professor Joel Slemrod, of the Michigan Business School visited NIPFP from October 11 to 16, 2000. During the several meetings with the team, many valuable comments on the background papers, questionnaires, methodology and statistical analysis techniques were made by him.
- Professor Richard Bird, the other external expert, also sent his valuable comments on background papers and the methodology.
- Focus group meetings to discuss the draft company questionnaire were held at The Associated Chambers of Commerce and Industry of India (ASSOCHAM), New Delhi on February, 1, 2001, at PHD Chamber of Commerce and Industry (PHDCCI), New Delhi on February, 26, 2001 and at the Madras Chambers of Commerce and Industry (MCCI), Chennai, on March 15, 2001.
- For tax professionals, focus group meetings were held with the Chamber of Income Tax Consultants (CITC) and the Bombay Chartered Accountants' Society (BCAS) at Mumbai on March 21, 2001. These are discussed in Chattopadhyay and Das-Gupta (2002). However, a crucial focus group meeting with the Indian Chartered Accountant Institute (ICAI), did not materialise despite repeated requests.

Steps taken to distribute questionnaires

- 20 draft questionnaires were initially distributed through FICCI (in lieu of a focus group meeting which they expressed inability to organise) through no responses were received, despite reminders.
- A project website was constructed (http://www.nipfp.org.in/compliancecost/) which included downloadable copies of the company questionnaire.
- Postage paid "Business Reply Envelopes" were included with all mailed questionnaires.

- ASSOCHAM, CII, MCCI, and PHDCCI undertook to forward questionnaires to their members and provide publicity for the study in their newsletters/websites (including a hyperlink in the PHDCCI website).
- The NIPFP obtained formal permission to mention the endorsement of the study of ASSOCHAM, PHDCCI and MCCI in the covering letter with the questionnaire (Annex 3.2).
- Team members also met several trade associations to brief them about the project and request them to distribute questionnaires among their members in May, 2001. Associations included:

  Federation of All India Automobile Spare Parts Dealers' Association
  Federation of Indian Plywood & Panel Industries
  Overseas Construction Council of India
  Indian Entrepreneurs & Manufacturers Association
  Federation of Engineering Industries of India
  Federation of Indian Mineral Industries
  Sponge Iron Manufacturers Association.
  Electronic Component Industries Association

- Nearly 1200 company questionnaires were distributed through these associations which were ultimately forwarded to members with a covering letter from their associations or chambers. Though several participants at meetings suggested that companies would not mind completing the NIPFP questionnaire despite there being great suspicion of the government's intentions, the end result does not support this, since the response rate was abysmally low.

Sample size and response rate

23 company responses were received to mailed questionnaires out of which 6 questionnaires had to be discarded. 28 more responses resulted from hand delivered questionnaires after personal contact. No distinguishing between questionnaires delivered through the post-office and hand-delivered to associations is possible, as Business Reply envelopes were identical to those used in the general mailing. Details are in Tables A3.1.1 and A3.1.2.

Table A3.1.1: Questionnaires mailed to individuals and responses received

	Numbers	% of initial sample
Addresses received from database	3500	74.47
of which addresses found incomplete	1000 (approx)	21.28
Net received	2500 (approx)	53.19
Add questionnaires mailed or hand delivered to industry associations	1200	25.53
Total addresses available/ questionnaires mailed or hand delivered to industry associations	3700 (approx)	78.72
Number not deliverable by post offices	206	4.38
Memo:		
Questionnaires hand delivered after individual contact	200	4.26
of which responses received	28	

TableA3.1.2: Response Rate to Questionnaires Distributed

	Mailed, etc.	Hand delivered after contact
Questionnaires mailed or hand delivered to industry associations (net of returned by Post Offices)	3700	
Questionnaires hand-delivered after contact		200

Responses received	23	28
Responses discarded	6	0
Gross response rate (%)	0.62	14.00
Net Response rate (%)	0.46	14.00
Overall Net Response Rate (%)	**1.15**	

Universe coverage:

If we take our intended sample to be 6400, the intended sample coverage comes to be 1.91 percent since the total number of companies was 3,34,261 per CAG (2002). However, the eventual coverage, at 45, turned out to be 0.0135 percent or 13-14 out of every 10,000 companies.

Question by question response rate

Table A3.1.3 below provides response rates to groups of questions in the company questionnaire. The total responses column provides the number of responses for the 45 companies (averaged over questions in the group). This is expressed as a percentage in the overall response rate column. The maximum response rate is for the questions on basic information about the company and the lowest is for the group which deals with corruption, bribery and non-filing.

Table A3.1.3: Response Rates for Question Groups: Summary

	Average Response Rate	
	Total responses	Overall Response rate
Who files IT return (in-house, tax advisor)	35.17	78.15
Burden of IT laws and advisor costs	30.37	67.48
Compliance activity and internal costs	23.91	53.13
Benefits from compliance activity	38.50	85.56
Income and tax payment details	26.20	58.22
Impression of the IT Department and	35.20	78.22
Psychic costs	22.00	48.89
Bribes, tax evasion and non-filing	15.47	35.13
Company information	41.14	91.43
Overall Average	**29.77**	**66.24**
Notes: Total number of questionnaires received is 45 for all types.		

Data Limitations

Data requested through two consultants to the team, who were from the Income Tax Department, proved to be unobtainable. For these purposes, data available from CAG (2002) and earlier years is too superficial to use adequately. Data requested included requests for sample based information on :

- Number of appeal cases pending in the court (all levels) broken down by duration and nature of dispute, average time required for appeals, fees charged by courts and representatives.
- Companies scrutinised, with duration, outcome and coverage.
- Administrative procedures, wit time information and documentary requirements to examine cases where large tax concession were claimed including export concession, backward area incentives.
- Similar information on various permissions and clearances.
- Details of TDS cases and action against non-compliant tax deductors.
- Information on MAT cases and resulting disputes.

Annex 3.2 Covering Letter and Questionnaire Sent to Companies

NATIONAL INSTITUTE OF PUBLIC FINANCE AND POLICY

Dear Chief Executive Officer/Chief Tax Officer,

Given our very complicated income tax, cumbersome tax procedures, an Income Tax Department which many perceive to be unhelpful and corrupt, the compliance cost of the Income Tax in India is probably higher than in developed countries. Yet no systematic study has been done in India to measure the time and money companies like yours spend to comply with their income tax obligations.

With computerization and administrative reforms in the Income Tax Department having gained momentum following the importance given to them by the Hon'ble Finance Minister, an unprecedented window of opportunity has opened to make reduction of taxpayer compliance costs to make reduction of taxpayer compliance costs an essential part of ongoing and future reform proposals.

The NIPFP, India's leading independent research institute on government finances, has undertaken a comprehensive study of taxpayer compliance costs. Yours is one of 5000 randomly selected companies for this survey. The attached questionnaire will help us gather vital information on your company's costs of compliance with the Income Tax. The information you provide is **anonymous and confidential**. It will be used only for the study and will not be revealed to any other person, organization or government department. Please spare some of your valuable time to fill out the questionnaire to help the NIPFP help your company by recommending compliance cost reducing reforms to the government.

Please complete and return the questionnaire in the pre-paid envelope provided. We would be most grateful if you could do so within 14 days to enable our study to be completed quickly. Thank you.

Yours faithfully,

Saumen Chattopadhyay

P.S. This study has been endorsed by ASSOCHAM, MCCI, PHDCCI.

The questionnaire can also be completed ONLINE at http://www.nipfp.org.in/compliancecost/compliance.htm.
In case you need any clarification please e-mail/telephone/write to the following:

D. BHATNAGAR	SAUMEN CHATTOPADHYAY	ARINDAM DAS-GUPTA
011-338-8297(EVENING)	011-652-8955 (EVENING) 9810421616 (MOBILE)	020-566-0280

NATIONAL INSTITUTE OF PUBLIC FINANCE & POLICY
18/2 SATSANG VIHAR MARG
NEW DELHI 110067
PHONES: 011-656-9303, 656-9286, 656- 9780/4 (DAY)
E-MAIL: compliancecost@hotmail.com

NATIONAL INSTITUTE OF PUBLIC FINANCE AND POLICY

SURVEY OF BURDEN OF INCOME TAX COMPLIANCE COSTS OF COMPANIES

Please provide information about activities/payments, DURING the period APRIL 1, 2000 to MARCH 31 2001 whether or not they relate to the financial year 2000-2001.

PART I. BURDEN OF INCOME TAX LAWS AND PROCEDURES

Q1 How does your company complete its tax return? *(Mark Ö)*

In house				
The company's paid advisor* completes it		→	Fees paid DURING the period 1-4-00 to 31-3-01	Rs.______________

* Advisor: Chartered Accountants, lawyers or other tax professionals engaged <u>AND PAID</u> by the company.

Q2 How many pages/cms of documents did your company submit with its income tax return(s) DURING 1-4-00 to 31-3-01?

_________pages **OR** _________centimetres

Q3 If the company engaged tax advisor(s) for income tax compliance work during the period 1-4-00 to 31-3-01, what were the main reasons for this? *(Mark Ö)*

	Very Important	Quite important	Neutral	Quite un-important	Un-important	No opinion
Laws change frequently and it is difficult to keep abreast of the latest position without professional help						
The company's tax affairs are too complex to deal with without professional help						
There is limited expertise about applicable tax administration procedures in house						
The company was not sure if tax officials would provide courteous and prompt guidance to them						
The company wanted to reduce its tax burden and so needed expert advice						
The company wanted to ensure that its tax documents and calculation were perfect						
Others (please specify)						

Tasks involved in complying with the income tax (including TDS) fall roughly into 4 categories:

a. ***Keeping records and filing returns****: Saving, creating, and filing necessary receipts and records; setting up and maintaining tax accounting systems; collecting forms and materials; preparing special schedules, attachments, and worksheets; preparing information for financial statements; assembling, copying, and mailing or handing over documents to tax authorities; etc.*

b. ***Research and Planning****: Sending executives for training, providing in-house training, evaluating the tax consequences of various activities such as hiring decisions, raising capital, engaging in particular forms of expenditure; evaluating the costs and benefits of various tax concessions; choosing accounting and inventory valuation methods, types of forms to file; etc.*

c. ***Scrutiny*** *of your company's tax return of income by tax officers including appearing before assessing officers, complying with additional information demands, etc.*

d. ***Obtaining clearances****, No Objection Certificates, rates for no-resident tax withholding, rulings, etc from income tax authorities.*

e. ***Appeals/revisions, litigation*** *and related tasks.*

Please restrict your cost estimates in Q4 to Q7 to amounts spent for the CORPORATION INCOME TAX and TAX DEDUCTION AT SOURCE ONLY and not total costs.

Q4 Please indicate the **fees paid to tax advisors** by your company, if any, for income tax-related work during the period 1-4-00 to 31-3-01.

	On a regular basis	Occasionally, for special advice
Accounting professionals/firm	Rs.________________	Rs.______________
Legal professionals/firm	Rs.________________	Rs.______________
Other	Rs.________________	Rs.______________
TOTAL	Rs.________________	

Q5 (a) Please indicate how important the contribution of each of these activities is your company's **in house costs of complying with income tax obligations** including expenditure on employees, postage, photocopying travel, fax, office space rental/maintenance, etc. ***(Mark Ö)***

(b) In case any of the activities below is undertaken for your company by paid **tax advisors**, please indicate the approximate expenditure during the period 1-4-2000 to 31-3-2001

Activity for which cost was incurred by the company	Very Important	Quite important	Average	Quite un-important	Un-important	Cannot Say	Payments to tax advisors/external professionals
Keeping records and maintaining account books							Rs.___________
Of which on compulsory financial audits (under Section 44AB of the Income Tax Act)							Rs.___________
Of which for tax deduction at source for employees							Rs.___________
Of which TDS other than for employees							Rs.___________
Research and tax planning for the present and future, including purchase of tax guides, etc.							Rs.___________
Of which to avail of exemption u/s 10A or 10B							Rs.___________
Of which to avail of other tax concessions							Rs.___________
Expenditure on **training** of employees in tax matters/ participation in external seminars							Rs.___________
Completing your tax return and **submitting your corporation tax return in the tax office**; filling up tax *challans* and depositing taxes/*challans* at a bank							Rs.___________
Completing and submitting TDS returns and depositing TDS							Rs.___________
Expenses for obtaining a **Permanent Account Number** (PAN)							Rs.___________
Appearance before the tax authorities to obtain a tax refund							Rs.___________
Appearing before the tax authorities and preparing explanations for **scrutiny assessment**							Rs.___________
Costs related to appeals/revisions and other **litigation initiated by you**							Rs.___________
Costs related to appeals/revisions and other **litigation initiated by the Income Tax Department**							Rs.___________
Cost of **providing assistance to employees** for their individual tax compliance requirements							Rs.___________

Others – Please specify: (*Note: possibilities include penalty, rectification, prosecution, etc)*							Rs.___________

Q6 Some companies overpay income taxes in order to avoid charges of concealment of income, preferring to claim refunds in case claims are not disallowed. In case you company received a refund due to overpayment of taxes **during 1-4-2000 to 31-3-2001** please indicate the amount of such refund.

Rs.___________

Q7 What were your company's estimated **in house costs (both within and outside tax/accounts departments) for complying with the Income Tax** (i.e. on the activities in Q5) during 1-4-2000 to 31-3-2001 under each of the following heads?

On employees, including salaries, allowances, perquisites, health insurance, etc.	Rs.___________
Computers and data processing	Rs.___________
Accounts/Records preparation, storage and retrieval	Rs.___________
Photocopying, postal and fax expenses, etc.	Rs.___________
Travel and conveyance	Rs.___________
Office space/services at market rental value	Rs.___________
General supplies, stationery and consumables	Rs.___________
Purchase of tax publications and journals	Rs.___________
Additional costs incurred to enable the company to avail of tax incentives not covered above (e.g. to avail of concessions for special export zones or free trade zones)	Rs.___________
Others (please specify)	Rs.___________
TOTAL	Rs.___________

Q8 Please indicate what percentage of **total company expenditure as per its profit and loss statement during 1-4-2000 to 31-3-2001** the total costs as in Q4 PLUS Q7 represent.

_____________%

Q9 What compliance requirements of the Income Tax laws and income tax administrative procedures are most burdensome to your company? *Provision*	Applicable to the company? *(Mark Ö)*	→	Time taken and/or advisors costs to comply with income tax requirements *(Mark Ö)*			→	Approximate cost *(% of total in Q4 + Q7)*
			High	Average	Low		
Tax collection at source							_____________%
Tax deduction at source for non-employees							_____________%
Tax deduction at source for employees							_____________%
Non-resident withholding (u/s 195, etc)							_____________%
International tax provisions							_____________%
Taxes on deemed dividends							_____________%
Claiming export related benefits (e.g. under sections 80HHC, 80HHE,10A, or 10B, etc.)							_____________%

Valuation of perquisites to employees					______%
Income accruals					______%
Minimum Alternative Tax (u/s 115JA or 115JB)					
Audit requirements under Section 44AB					______%
Loss carry forward and set off					______%
Inconsistencies with the Companies Act or any other applicable legislation including depreciation provisions, establishment costs in connection with free trade zones, etc.					______%
Others (please specify)					______%

Income tax administrative procedures

Refunds					______%
Method of accounting for income tax purposes (e.g. u/s 132, 145A)					______%
Completing and filing corporation tax returns and depositing tax *(as in Q5)*					______%
Accounting for TDS, completing and filing TDS returns *(as in Q5)*					______%
Scrutiny assessment procedure					______%
Obtaining clearances, approvals and permissions from Income Tax authorities (e.g. u/s 37 I)					______%
Appeals and litigation					______%
Others (please specify)					______%

Q10 Please indicate if you agree or disagree with the following statements. Due to income tax compliance requirements: (Mark √)

	YES	NO
The company's Income statements and balance sheets are better prepared		
The company is better able to detect employee malfeasance (due to auditing requirements u/s44AB)		
Asset management is improved		
Stock and inventory control is improved		
Asset and stock valuation are improved		
There is better control on the company's borrowing and repayment of loans		
The company earns interest between TDS and remitting TDS to the government		
Other advantages (please describe)		

PART II: TAX PAID DURING THE YEAR

Q11 What **total tax** did your company pay **DURING 1-4-00 to 31-3-01**, including Income Tax, Central Excise, Customs, State Sales Tax, Octroi, Property Tax, etc?

Rs______________

Q12 How much **income tax** did your company pay DURING the period 1-4-00 to 31-3-01?

Tax deducted at source (TDS)	Rs____________
Advance tax	Rs____________
Self-Assessment tax	Rs____________
Extra tax assessed by the Government	Rs____________
Penalty	Rs____________
Interest	Rs____________
TOTAL PAYMENTS	Rs____________
Refund Received	Rs____________

Q13 What are the major **Income Tax concessions** your company availed of and the consequent tax saving DURING the period 1-4-00 to 31-3-01?

	Availed of? *(Mark Ö)*	→	Tax saving
Export related (Sections 80HHB, 80HHC, 80HHD, 80HHE, 10A, 10B).			Rs____________
Accelerated depreciation or 100% depreciation on select assets			Rs____________
Backward area/new industry/Infrastructure related (Sections 10C 80HH, 80HHA, 80-IA, 80-IB)			Rs____________
Others (please specify)			Rs____________

Q14 Was your company under scrutiny by the Income Tax Department DURING the period 1-4-00 to 31-3-01? (Mark √)

YES ☐ NO ☐

Q15 Please indicate the number of assessment years (AYs), if any, in dispute before different authorities

Authority	For Tax	For Penalty/Interest
Commissioner (Appeals)		
Income Tax Appellate Tribunal (ITAT)		
High Court/ Supreme Court		
TOTAL AYs		

PART III: FISCAL ATTITUDES

Q16 Do you think that the amount of income tax paid by the company ought to be: (Mark √)

Greatly reduced	Somewhat reduced	About the same	Somewhat increased	Greatly increased	No opinion

Q17 Imagine a private firm, on payment, is able to offer your company a guarantee of immunity in the event that it is found in violation of the law, due to existing AMBIGUITIES in Income Tax provisions. If you accept this offer, what service charges (as a % of tax paid by your company) would the company be willing to pay?

The company would be willing to pay_______ % over and above corporation tax paid to the government as service charges.

Offer not accepted *(Mark Ö)* ☐

Q18 Imagine that income tax laws are made EASY FOR COMPANY OFFICERS TO UNDERSTAND and SIMPLE TO COMPLY WITH but at the same time taxes are increased. How much extra tax would the company be willing to pay?

The company would be willing to pay_______ percent extra tax.

Cannot say *(Mark Ö)* ☐

Q19 Imagine the Government legally guarantees that there will be ABSOLUTELY NO CHANGE in Income tax laws and no new notifications for the next 5 years, but, in return, your company has to agree to a small increase in its taxes. If you agree to this proposal, how much extra tax would the company be willing to pay?

The company would be willing to pay_______ percent extra tax.

Cannot say *(Mark Ö)* ☐

Q20 The government collects taxes from you and provides various public services in areas such as health, education, law and order, infrastructure, etc. In your estimate, how much benefit is your company able to

No opinion *(Mark Ö)* ☐

derive from the government **as a % of tax paid by it?** (Mark X on the scale below)

0% 20% 40% 60% 80% 100% 120% 140% 160% 180% 200%

Q21 In your opinion, what percent of companies engaged in similar business activities as yours DO NOT FILE corporation tax returns or fail to pay any corporation tax? (Mark √)

0%	1% - 25%	26% - 50%	51% - 75%	76% - 100%	No opinion

Q22 In your opinion, what percent of income is DELIBERATELY UNDERREPORTED by companies in similar business activities as yours? (Mark √)

0%	1% - 25%	26% - 50%	51% - 75%	76% - 100%	No opinion

Q23 What is your best guess as to the percentage of tax evading companies engaged in similar business/professional activities against whom the income tax department **initiates penalty** proceedings? (Mark √)

0% - 5%	6% - 10%	11% - 20%	21% - 30%	31% - 40%	41% -50%	51% - 75%	Above 75%	No opinion

Q24 Has your company been harassed, directly or indirectly, by Income Tax officials? (Mark √) YES ☐ NO ☐ No comment ☐

Q25 Do you think that companies engaged in similar business/professional activities as yours have to sometimes pay an extra UNOFFICIAL amount (whether in cash or by way of free goods or services) to officials of the Income tax department, directly or indirectly? (Mark √) YES ☐ NO ☐ No comment ☐

IF YOU ANSWERED "NO" OR "NO COMMENTS" TO Q25, PLEASE SKIP TO Part IV.

Q26 What is your estimate of the total unofficial payments made by such companies during a year?

No Comment (*Mark* Ö) ☐

As a percentage of taxes saved	___________ %
OR As a percentage of taxes paid	___________ %
OR In rupees	Rs _______________

Q27 What benefits, in your opinion, do such companies expect from such unofficial payment? (Mark √ in each row below)

	Very Important	Quite important	Neutral	Quite un-important	Un-important	No opinion
Saving of tax liability						
To obtain tax refunds						
Prevention of harassment from the tax officials						
No immediate benefits but building -up long-term relations with tax officials for future						
On the advice of tax advisors - benefits unknown						

Q28 How satisfied are you with your interaction with the Income Tax Department? (Mark √)

Very Satisfied	Quite Satisfied	Neutral	Quite dissatisfied	Very dissatisfied	No opinion

PART IV. COMPANY INFORMATION

a. In which city/town in India does your company file its income tax return? (Address **NOT** required) ☐

b. What is the year of establishment of your company?

c. What was the approximate total number of full time employees in your company during the period 1-4-2000 to 31-3-2001?

d. What was the approximate number of part-time employees and casual/ workers in your company (in terms of equivalent full-time employees) during 1-4-2000 to 31-3-2001?

e. What was the approximate book value of your company's assets at the end of the period 1-4-2000 to 31-3-2001?

Rs. ______________________

f. What was your company's approximate turnover/ gross receipts during the period 1-4-2000 to 31-3-2001?

Rs. ______________________

g. What was your company's profit as per your profit and loss account (before tax and dividends) during the period 1-4-2000 to 31-3-2001?

Rs. ______________________

h. Please indicate the sector of your company's primary business (Mark √)

Forestry, fishing and agriculture related		Mining and quarrying	
Manufacturing		Electricity, gas and water supply	
Construction		Wholesale and retail trade	
Hotels and restaurants		Transport and storage	
Communications		Banking, insurance and financial services	
Real estate services, and developers/ owners of dwellings		Recreational services, cultural services and entertainment	
Business services (excluding computer services, software and related services)		Computer services, software development and related services	
Other (please specify)			

OPEN ENDED QUESTIONS *(please use the bottom of the page and the space on the reverse if needed)*

In case you feel income tax compliance is costly for you in money/time terms, what particular features of income tax laws and administration are responsible?

Are there any other matters or concerns you would like to bring to the attention of the study team?

OPTIONAL: If you are willing to further contribute to this study or wish to receive a copy of the study report, please give your name, address and telephone numbers.

I would be willing to answer further questions *(Mark Ö)* ☐

I would like a summary of the study results *(Mark Ö)* ☐

Name	______________________
Position	______________________
Name of company	______________________
Address	______________________
	______________________
Telephone(s)	______________________
E-mail	______________________

Thank you for completing the questionnaire and helping us to suggest reforms to reduce taxpayer cost of compliance to the government.

The results of the study will be available with the NIPFP by August 2001.

PLEASE MAIL THE QUESTIONAIRE IN THE POSTAGE-PAID ENVELOPE PROVIDED TO:

COMPLIANCE COST PROJECT
NATIONAL INSTITUTE OF PUBLIC FINANCE AND POLICY
18/2 SATSANG VIHAR MARG, JNU POST OFFICE,
NEW DELHI 110067

Annex 3.3 The Cost of Compliance Cost Studies of Companies in India

The cost of preparing this report is in Table A3.2.1 below. Chattopadhyay and Das-Gupta (2002) estimated the cost of the first of the three companion compliance costs studies for individuals in India. The only cost for the second report is the cost of analysis and report writing since the data were collected at the same time as data for the first report. So the cost of this report is residually estimated at Rs.1,86,118.

Table A3.2.1: The Cost of Compliance Cost Study of Companies in India (in rupees)	
1. Total sanctioned amount for three compliance cost studies	22,14,950
2. The cost of compliance cost studies of individuals in India*	19,78,832
3. Cost of writing the report: Compliance costs and compliance behaviour	50,000
4. Cost of the income tax compliance cost of Indian corporations (=1-2-3)	1,86,118
Note: * As reported in Chattopadhyay and Das-Gupta (2002).	

Annex 3.4 Correlation Between Scaling Variables

In figures A3.4.1 to A3.4.10, the relation between various pairs of the five variables used to scale compliance costs is shown (in log-log graphs). Though no pair of scale variables is very highly correlated, correlations between turnover, employment and book value of assets are highest.

Figure A3.4.1 Book Value of Assets versus Employment

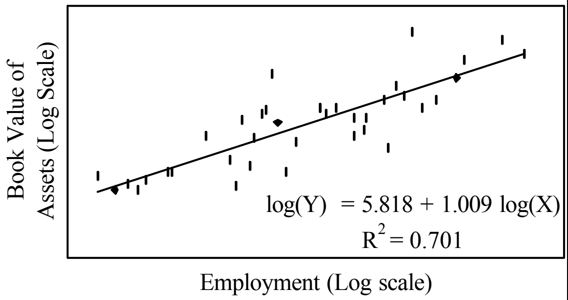


Figure A3.4.2 Turnover versus Employment

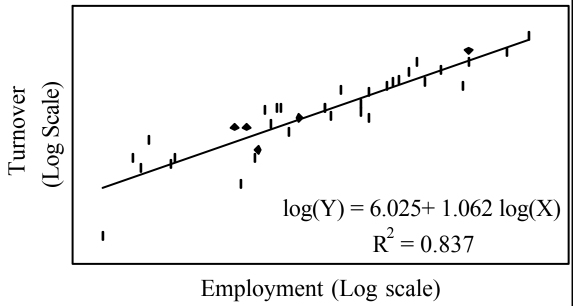


Figure A3.4.3 Tax Paid versus Employment

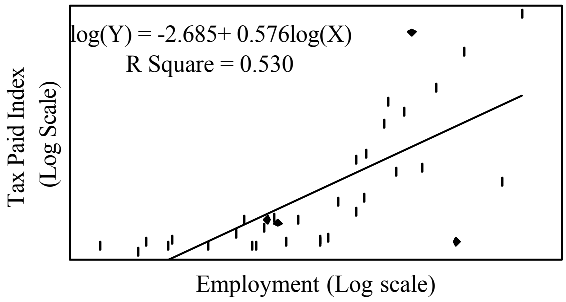


Figure A3.4.4 Profit BeforeTax/Loss versus Employment

Figure A3.4.5 Profit Before Tax/Loss versus Turnover

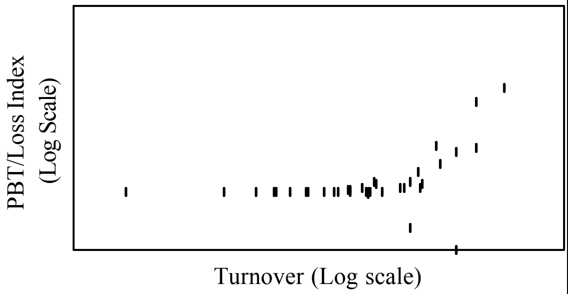


Figure A3.4.6 Turnover versus Book Value of Assets

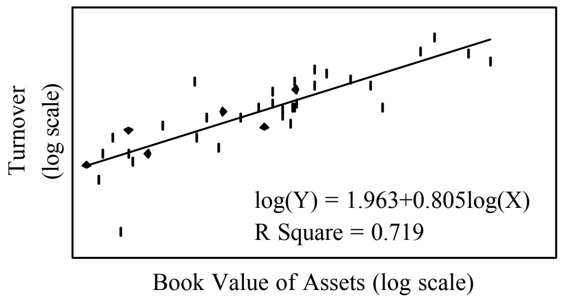


Figure A3.4.7 Profit Before Tax/Loss versus Book Value of Assets

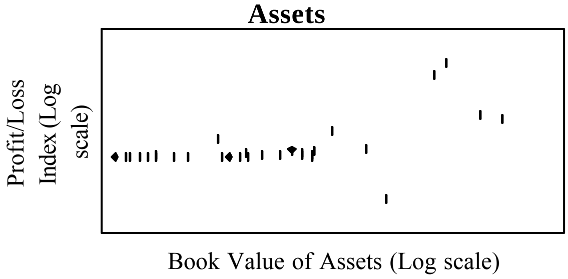
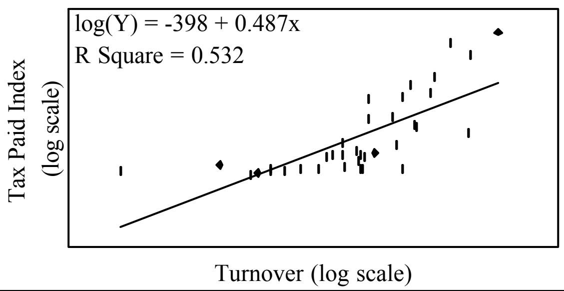


Figure A3.4.8 Tax Paid versus Turnover



To enable profit before tax and tax paid, both of which include negative observations, to be graphed in a double-log graph they were linearly scaled to exclude negative observations by applying the transformation $x_{index} = 0.1 + \frac{x - x_{min}}{x_{max} - x_{min}}$. The transformation first scales all observations between 0 and 1 and then adds 0.1 to all observations to avoid the zero value. The scaled profit before tax and scaled tax paid indices have a moderate correlation with each other. On the other hand the tax index has only a mild correlation with the other three scale variables, while PBT is uncorrelated with other variables.

Figure A3.4.9 Tax Paid versus Book Value of Assets

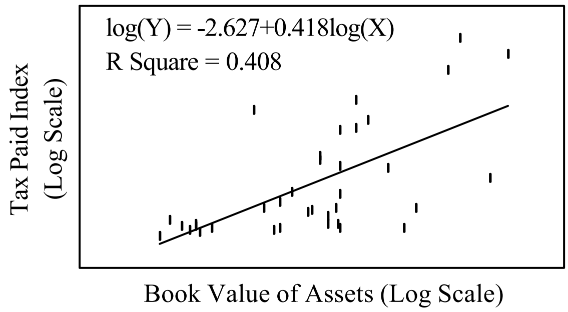


Figure A3.4.10 Tax Paid versus Profit Before Tax

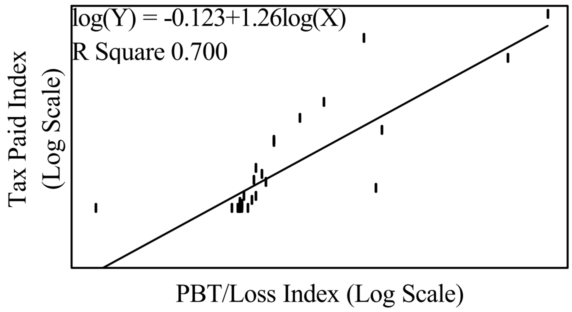


Table A3.4.1: Correlation Matrix For Scaling Variables and Total Compliance Costs

	Profit Before Tax/Loss	Tax Paid	Book Value of Assets	Employment	Turnover	Total Compliance Costs
Profit Before Tax/Loss	1.000	0.946	0.503	0.520	0.923	**0.791**
Tax Paid	0.946	1.000	0.639	0.364	0.839	**0.834**
Book Value of Assets	0.503	0.639	1.000	0.325	0.528	0.415
Employment	0.520	0.364	0.325	1.000	0.796	0.233
Turnover	0.923	0.839	0.528	0.796	1.000	**0.669**
Total Compliance Costs	0.791	0.834	0.415	0.233	0.669	1.000

Table A3.4.1 presents the correlation between pairs of scale variables and scale variables and compliance costs. The information in the table is potentially different from that in the graphs here and in Chapter 3.2.1 since correlations in the table assume a linear relation whereas the graphs are log-log. The table suggests that the linear correlations between total compliance costs and tax paid, profit before tax and turnover, in that order, are most reliable. This differs from the double-log correlations reported in Chapter 3.2.1, which suggest a stronger correlation between compliance costs and book value of assets or turnover, besides taxes paid.

Annex 3.5 Compliance Costs of Companies: Additional Information

Table A3.5.1 shows that manufacturing firms make up almost half the sample, while financial sector firms make up another 15 percent. Though no attempt to ascertain the exact sectoral distribution of firms in the population was made, given the small sample size, the latter is not representative of the corporate sector in India as a whole.

Table A3.5.1: Primary Business Sectors of Sample Companies	
	Number of responses
Forestry, fishing, and agriculture related	2
Manufacturing	19
Construction	3
Hotels and restaurants	0
Communications	2
Real estate services	0
Business services	1
Mining and quarrying	2
Electricity, gas and water supply	3
Wholesale and retail trade	4
Transport and storage	1
Banking, insurance and financial services	7
Recreational services	3
Computer services, software development	3
Others	1
Total number of responses	**43**

Tables A3.5.2 to A3.5.9 provide additional information on the ratio of compliance costs to different scale variables, with companies classified by employee strength or turnover. The trend in all tables is broadly, but never strictly, regressive for groups of firms in the different tables, except the tables for compliance costs as a percentage of tax.

Table A3.5.2: Legal Compliance Costs as a Percentage of Profit Before Tax
(Companies classified by employee strength)

No. of Employees	Below 20	21-100	101 to 500	501 to 1000	Above 1001
Average	6.38	9.87	2.08	1.79	1.23
Minimum	1.29	1.21	0.45	0.66	0.025
Maximum	15.52	30.00	4.07	3.60	9.78
Standard Deviation	6.40	10.35	1.64	1.09	3.02
Coefficient of Variation	1.00	1.05	0.79	0.61	2.46
No of observations	4	6	6	5	10

Table A3.5.3: Legal Compliance Costs as a Percentage of Profits Before Tax
(Companies classified by turnover)

Turnover	Below Rs. 2 crore	Rs 2 to 50 crore	Rs 50 to100 crore	Rs 100 to 500 crore	Over Rs 500 crore
Average	7.71	6.03	1.75	3.20	0.13
Minimum	2.75	0.45	0.54	0.22	0.025
Maximum	15.52	30.00	4.07	9.78	0.34
Standard Deviation	5.47	9.02	1.28	3.92	0.11

Coefficient of Variation	0.71	1.50	0.73	1.22	0.85
No of observations	4	10	6	8	6

Table A3.5.4: Legal Compliance Costs as a Percentage of Book Value of Assets
(Companies classified by employee strength)

No. of Employees	Below 20	21 to100	101 to 500	501 to 1000	Above 1001
Average	4.68	1.58	0.13	1.06	0.68
Minimum	0.53	0.09	0.01	0.24	0.001
Maximum	7.76	6.92	0.22	2.35	4.48
Standard Deviation	3.01	2.37	0.09	0.78	1.46
Coefficient of Variation	0.64	1.50	0.73	0.74	2.15
No of observations	4	8	6	5	9

Table A3.5.5: Legal Compliance Costs as a Percentage of Book Value of Assets
(Companies classified by turnover)

Turnover	Below Rs. 2 crore	Rs 2 to 50 crore	Rs 50 to100 crore	Rs 100 to 500 crore	Over Rs 500 crore
Average	4.13	1.68	0.27	1.06	0.09
Minimum	0.52	0.08	0.01	0.04	0.001
Maximum	7.76	6.92	1.08	4.48	0.36
Standard Deviation	3.09	2.34	0.37	1.56	0.16
Coefficient of Variation	0.75	1.39	1.34	1.47	1.81
No of observations	4	11	7	7	5

Table A3.5.6: Legal Compliance Costs as a Percentage of Tax
(Companies classified by employee strength)

No. of Employees	Below 20	21 to 100	101 to 500	501 to 1000	Above 1001
Average	119.65	37.16	60.52	14.40	56.02
Minimum	14.66	3.16	1.83	2.03	0.110
Maximum	392.47	132.08	289.13	41.61	438.00
Standard Deviation	182.25	48.72	102.77	17.18	144.52
Coefficient of Variation	1.52	1.31	1.70	1.19	2.58
No of observations	4	6	7	5	9

Table A3.5.7: Legal Compliance Costs as a Percentage of Tax
(Companies classified by turnover)

Turnover	Below Rs. 2 crore	Rs 2 to 50 crore	Rs 50 to100 crore	Rs 100 to 500 crore	Over Rs 500 crore
Average	117.10	23.28	51.18	68.67	1.17
Minimum	3.16	1.83	1.11	0.44	0.110
Maximum	392.47	54.41	289.13	438.00	4.42
Standard Deviation	162.02	17.92	105.84	150.88	1.83
Coefficient of Variation	1.38	0.77	2.07	2.20	1.56
No of observations	5	9	7	8	5

Table A3.5.8: Legal Compliance Costs as a Percentage of Turnover (Companies classified by employee strength)					
No. of Employees	Below 20	21 to100	101 to 500	501 to 1000	Above 1001
Average	0.78	0.67	0.15	0.23	0.07
Minimum	0.06	0.06	0.02	0.09	0.003
Maximum	1.94	2.07	0.44	0.39	0.50
Standard Deviation	0.85	0.71	0.14	0.14	0.15
Coefficient of Variation	1.08	1.06	0.99	0.58	2.08
No of observations	4	7	7	5	10

Table A3.5.9: Legal Compliance Costs Per Employee (Companies classified by turnover)					
Turnover	Below Rs. 2 crore	Rs 2 to 50 crore	Rs 50 to 100 crore	Rs 100 to 500 crore	Over Rs 500 crore
Average	13225.50	7804.21	3268.34	3768.18	402.54
Minimum	629.29	290.14	769.23	257.65	46.531
Maximum	35272.73	26500.00	4543.48	12225.00	866.67
Standard Deviation	16288.91	9880.75	1338.85	5075.49	321.27
Coefficient of Variation	1.23	1.27	0.41	1.35	0.80
No of observations	4	11	6	7	6

Annex 3.6 Aggregation Methodology

There are 12 steps in the aggregation procedure, which are now described.

1. The sample is broken up into size groups, ensuring that there are at least 3 observations per group, separately for (a) book value of assets ("assets") and (b) turnover. This yields 8 and 9 groups respectively.

2. Group boundaries are then defined with respect to the mid-points between the highest and lowest firms in the previous step.[85]

3. After excluding 7 firms with estimated effective tax rates in excess of 500 percent, the remaining 6627 *private sector* firms in PROWESS are classified into the same groups as for sample firms, separately for assets and turnover.

4. For the study sample, means for each group and 95 percent confidence intervals are computed separately for turnover and assets. This is done for the ratio of (a) legal compliance costs to size (L, L_{-5}, L_{+5}) and (b) net compliance costs to size (N, N_{-5}, N_{+5}).

5. The "restricted confidence intervals" L_{low} and L_{high} are computed as $L_{low} = \max(0.8L, L_{-5})$ and $L_{high} = \min(1.2L, L_{+5})$. For net compliance costs, the same procedure is followed, except where N is negative, in which case $N_{low} = \max(1.2N, N_{-5})$ and $N_{high} = \min(0.8N, N_{+5})$.That is upper and lower estimates are kept at 20 percent above or below the estimated mean unless the confidence interval is smaller than this.

6. Similar group means and restricted confidence intervals are computed for PROWESS companies for assets and turnover.

7. Per firm compliance cost estimates in rupees are computed as, for example, $\text{sales}_{\text{PROWESS}}$ times L for each group of companies. Lower and upper estimates based on the restricted confidence intervals are also estimated.

8. These estimates are then multiplied by the number of PROWESS companies in each group and added across groups to get the aggregate compliance cost estimate for PROWESS companies (reduced to crores of rupees).

9. Ratios of total compliance costs to scale variables are then computed.

10. All 12 estimates from these computations are reported in Tables A6.1.1 to A6.1.6 and in the chapter.

11. To arrive at an overall rupee estimate (to enable it to be added to the refund cost figure), the tax share of PROWESS companies relative to the government budget figure of total corporation tax collections for 2000-01, rather than the number of firms, is used as there is no information on the size distribution of non-PROWESS companies. Since PROWESS companies account for the bulk of taxes, omitted companies are likely to be very small compared to PROWESS companies in terms of their profit before taxes. Given the regressivity of compliance costs, reported compliance cost estimates are, therefore, likely to be biased downward.

12. The final estimates add refund costs to aggregate costs.

The approximate regressivity of both legal and net compliance costs can be seen in Tables A3.6.1 to A3.6.4. Tables A3.6.5 through A6.3.8 provide additional information on PROWESS companies relative to population data.

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[85] For example, if the largest observation in Group 2 by turnover has a value Rs 19 lakh and the smallest observation in Group 3 has a value of 23 lakh, the Group 2 – Group 3 boundary is set at Rs 21 lakh.

Table A3.6.1: Legal Compliance Costs of PROWESS Companies as a % of Gross Fixed Assets

Groups: 8										
Range min (>)	0	0.36	1.08	5.5	16.27	34.95	79.87	1362.51	Total CC (Rs cr)	% of Tax Paid
Range max (≤)	0.35	1.07	5.49	16.26	34.94	79.86	1362.50			
NIPFP Nos	4	3	4	4	4	8	6	4		
PROWESS Nos	408	417	1355	1552.00	1011.00	821.00	1005.00	58.00		
PROWESS %	6.16	6.29	20.45	23.42	15.26	12.39	15.17	0.88		
PROWESS PBT Weight	1.47	1.23	0.86	0.53	0.39	0.32	0.26	0.25		
PROWESS Sdev	0.10	0.21	1.27	3.09	5.22	12.19	249.73	6434.26		
PROWESS LCL	0.13	0.67	3.09	9.77	23.57	51.66	264.67	3543.11		
PROWESS Ave	0.14	0.69	3.15	9.92	23.89	52.49	280.11	4428.89		
PROWESS UCL	0.15	0.71	3.22	10.07	24.21	53.32	295.55	5314.67		
NIPFP CC Sdev	2.23	3.62	2.90	1.00	0.50	0.27	0.33	0.02		
NIPFP CC LCL	2.79	3.31	2.76	0.83	0.40	0.25	0.22	0.01		
NIPFP CC Ave	**3.49**	**4.14**	**3.44**	**1.04**	**0.50**	**0.31**	**0.27**	**0.02**		
NIPFP CC UCL	4.19	4.97	4.13	1.25	0.60	0.37	0.33	0.02		
Agg CC LCL	1.53	9.30	115.19	125.93	94.68	104.47	581.50	28.13	1061	8.0
Agg CC Ave	**2.05**	**11.97**	**147.14**	**159.89**	**119.96**	**132.69**	**769.27**	**43.95**	**1387**	**10.5**
Agg CC UCL	2.62	14.77	180.36	194.85	145.89	161.76	974.01	63.28	1738	13.2

Notes:
CC: Compliance Costs.
LCL: Adjusted lower confidence limit.
UCL: Adjusted upper confidence limit.
Agg: Aggregate for PROWESS companies

Table A3.6.2: Legal Compliance Costs of PROWESS Companies as a % of Turnover

Groups: 9											
Range min (>)	0	1.44	4.85	25.41	42.07	71.46	154.06	652.41	2604.64	Total CC (Rs cr)	% of Tax Paid
Range max (≤)	1.43	4.84	25.4	42.06	71.45	154.05	652.4	2604.63			
NIPFP Nos	3	4	6	3	6	3	7	4	3		
PROWESS Nos	1157	869	1828	629	611	656	680	165	32		
PROWESS %	17.5	13.1	27.6	9.5	9.2	9.9	10.3	2.5	0.5		
PROWESS PBT Weight	1.15	0.83	0.59	0.39	0.36	0.31	0.25	0.25	0.25		
PROWESS Sdev	0.43	0.97	5.95	4.76	8.22	23.24	131.49	456.34	10514.03		
PROWESS LCL	0.52	2.85	12.63	32.83	54.65	103.50	295.12	1086.65	5754.52		
PROWESS Ave	0.54	2.91	12.90	33.20	55.31	105.28	305.00	1156.27	7193.14		
PROWESS UCL	0.57	2.98	13.17	33.57	55.96	107.06	314.89	1225.90	8631.77		
NIPFP CC Sdev	0.67	0.86	0.42	0.04	0.12	0.176	0.171	0.013	0.006		
NIPFP CC LCL	1.04	0.55	0.48	0.06	0.12	0.175	0.114	0.016	0.007		
NIPFP CC Ave	**1.30**	**0.69**	**0.60**	**0.07**	**0.15**	**0.219**	**0.142**	**0.020**	**0.009**		
NIPFP CC UCL	1.42	0.83	0.72	0.08	0.17	0.263	0.171	0.024	0.010		
Agg CC LCL	6.2	13.73	110.6	12.1	38.8	119.0	228.7	29.1	12.6	570.9	4.3
Agg CC Ave	**8.1**	**17.55**	**141.2**	**15.4**	**49.1**	**151.4**	**295.4**	**38.8**	**19.7**	**736.5**	**5.6**
Agg CC UCL	9.3	21.52	173.1	16.0	59.6	184.7	366.0	49.3	28.3	907.8	6.9

Notes: See Table A3.6.1.

Table A3.6.3: Net Compliance Costs of PROWESS Companies as a % of Gross Fixed Assets

Groups: 8										
Range min (>)	0.0	0.36	1.1	5.5	16.3	35.0	79.9	1362.5	Total CC (Rs cr)	% of Tax Paid
Range max (≤)	0.4	1.07	5.5	16.3	34.9	79.9	1362.5			
NIPFP Nos	4	3	4	4	4	8	6	4		
PROWESS Nos	408.0	417.00	1355.0	1552.0	1011.0	821.0	1005.0	58.0		
PROWESS %	6.2	6.29	20.4	23.4	15.3	12.4	15.2	0.9		
PROWESS PBT Weight	1.5	1.23	0.9	0.5	0.4	0.3	0.3	0.3		
PROWESS Sdev	0.1	0.21	1.3	3.1	5.2	12.2	249.7	6434.3		
PROWESS LCL	0.1	0.67	3.1	9.8	23.6	51.7	264.7	3543.1		
PROWESS Ave	0.1	0.69	3.2	9.9	23.9	52.5	280.1	4428.9		
PROWESS UCL	0.2	0.71	3.2	10.1	24.2	53.3	295.6	5314.7		
NIPFP CC Sdev	1.31	2.09	1.81	0.67	0.08	0.25	0.36	0.08		
NIPFP CC LCL	1.48	2.09	1.46	0.47	0.07	0.09	-0.02	-0.09		
NIPFP CC Ave	**1.85**	**2.61**	**1.83**	**0.59**	**0.09**	**0.11**	**-0.01**	**-0.08**		
NIPFP CC UCL	2.22	3.13	2.19	0.71	0.11	0.13	-0.01	-0.06		
Agg CC LCL	0.8	5.86	61.2	71.5	16.8	37.6	-41.4	-188.2	-35.7	-0.27
Agg CC Ave	**1.1**	**7.54**	**78.1**	**90.8**	**21.3**	**47.8**	**-36.5**	**-196.0**	**14.2**	**0.11**
Agg CC UCL	1.4	9.31	95.8	110.7	25.9	58.3	-30.8	-188.2	82.4	0.62

Notes: See Table A3.6.1.

Table A3.6.4: Net Compliance Costs of PROWESS Companies as a % of Turnover

Groups: 9											
Range min (>)	0.0	1.44	4.9	25.4	42.1	71.5	154.1	652.4	2604.6	Total CC (Rs cr)	% of Tax Paid
Range max (≤)	1.4	4.84	25.4	42.1	71.5	154.1	652.4	2604.6			
NIPFP Nos	3	4	6	3	6	3	7	4	3		
PROWESS Nos	1157.0	869.00	1828.0	629.0	611.0	656.0	680.0	165.0	32.0		
PROWESS %	17.5	13.11	27.6	9.5	9.2	9.9	10.3	2.5	0.5		
PROWESS PBT Weight	1.1	0.83	0.6	0.4	0.4	0.3	0.3	0.3	0.3		
PROWESS Sdev	0.4	0.97	6.0	4.8	8.2	23.2	131.5	456.3	10514.0		
PROWESS LCL	0.5	2.85	12.6	32.8	54.7	103.5	295.1	1086.6	5754.5		
PROWESS Ave	0.5	2.91	12.9	33.2	55.3	105.3	305.0	1156.3	7193.1		
PROWESS UCL	0.6	2.98	13.2	33.6	56.0	107.1	314.9	1225.9	8631.8		
NIPFP CC Sdev	0.08	0.11	0.26	0.04	0.08	0.12	0.15	0.08	0.03		
NIPFP CC LCL	0.47	0.17	0.30	0.01	0.07	-0.06	0.04	-0.09	-0.04		
NIPFP CC Ave	**0.55**	**0.21**	**0.37**	**0.01**	**0.09**	**-0.05**	**0.05**	**-0.08**	**-0.04**		
NIPFP CC UCL	0.17	0.23	0.45	0.01	0.11	-0.04	0.07	-0.06	-0.03		
Agg CC LCL	2.8	4.10	68.6	1.7	23.8	-37.5	87.7	-164.2	-81.6	-94.6	-0.72
Agg CC Ave	**3.5**	**5.24**	**87.6**	**2.2**	**30.1**	**-31.8**	**113.3**	**-145.6**	**-85.0**	**-20.5**	**-0.16**
Agg CC UCL	1.1	5.89	107.4	2.7	36.6	-25.9	140.4	-123.5	-81.6	63.0	0.48

Notes: See Table A3.6.1.

Table A3.6.5: PROWESS Aggregates (Rs crore)

Profit Before Tax	Gross Fixed Assets	Turnover	Tax Provision: PROWESS	Total Corporation Tax Revenue in 2000-01
25171.94	625652	778848	13184	35696

Table A3.6.6: Comparison of Population, PROWESS and NIPFP Sample Sizes

	CAG (2002) data on company population, 2000-01 (Dept of Company Affairs figures)	Population adjusted to match CAG (2002) total assessees	PROWESS Sample Size, 2000-01	NIPFP Sample Size
Public Sector Firms	1266	1266	419	1
Private Sector Firms	563775	328936	7026 (adj: 6627)	41
of which foreign companies u/s 591 of Companies Act	1141	1141	0	0
of which not for profit associations registered as companies	2918	2918	0	0
TOTAL	569100	334261	7445	42
	Tax Provision: PROWESS (Rs crore)	Tax Provision Share: PROWESS (%)	Prorated taxes to match total corporation tax (Rs crore)	Ratio of prorated total to PROWESS private companies
Private sector	13184	43.86	18321	1.390
Public sector	16875	56.14	17375	
Total	30059	100.00	35696	2.707

Note: Rs 500 crore of taxes has been added to the CMIE public sector figure after discussion with Arbind Modi who has compiled data on 36,000 companies for the Kelkar Committee (2002). According to him, public sector companies not in the CMIE data base paid almost no corporation tax. These figures are not used in aggregate estimates.

Table A3.6. Effective Tax Rates of PROWESS Companies

Effective Tax Rates (ETR)	Number of companies	% of companies
Loss	2851	43.0
0	868	13.1
0-10	782	11.8
10-20	625	9.4
20-30	383	5.8
30-40	603	9.1
40-50	279	4.2
50-60	82	1.2
60-70	41	0.6
70-80	30	0.5
80-90	10	0.2
90-100	28	0.4
>100	65	0.7
Ratio of Average ETRs	-0.7	
Average Effective Tax Rate of Profit Making Firms	23.07	
Sample Size	6627	100.0

Annex 4.1 Additional Information on Compliance Costs and their Determinants

SUMMARY OF REGRESSION EXPERIMENTS

Regression methodology

Since it was impossible to include all potential determinants of compliance costs in one regression, given 45 observations or less with missing values, the approach adopted by Sala-i-Martin (1998) was followed. The approach avoids specification searches by running regressions with a core set of determinants and other potential determinants included a few (here 2) at a time. Summary tables of the entire distribution of coefficient estimates and significances are then reported. However, insignificant regressions are excluded. Selection criteria adopted were that at least one variable other than the constant should be significant and that the regression should have at least 5 degrees of freedom.

Variables used in statistical inference experiments

Dependent variables

1. Total compliance costs per employee
2. Total compliance costs as a percentage of gross tax
3. Total compliance costs as a percentage of profit before tax (PBT)
4. Total compliance costs as a percentage of turnover.
5. Total compliance costs as a percentage of the book value of assets.

Core Independent variables

The scaling variable for different dependent variables corresponded to the scale variable chosen in regressions. Thus core variables were:

Core group 1: PBT (in Rs crore), total assessment years in dispute, size measured by number of employees.

Core group 2: PBT (in Rs crore), assessment years in dispute, size measured by turnover (in Rs crore).

Core group 3: PBT (in Rs crore), assessment years in dispute, size measured by the book value of assets (in Rs crore).

Additional independent variables

1. Tax savings group (Group 1): Tax saving from: (a) export concessions, (b) accelerated depreciation, (c) backward area incentives, (d) other.
2. Other tax provisions group (Group 2) Only provisions with at least 25 responses were chosen. These are all score variables with scores of 1 to 5. A high value signifying that the respondent considers them of importance for compliance costs. The provisions are: (a) Compulsory financial audit (under section 44AB), (b) Minimum Alternate Tax (MAT), (c) TDS for employees, (d) TDS for non-employees, (e) Non-resident withholding, (f) valuation of perquisites.
3. Burdensome administrative procedures group (Group 3): Only procedures with at least 25 responses were chosen These are all score variables with scores of 1 to 5. A high value signifying that the respondent considers them of importance for compliance costs. The procedures are: (a) To obtain refunds, (b) Filing of tax return, (c) TDS, (d) scrutiny.
4. Psychic cost group (Group 4): Willingness to pay for (a) tax simplicity and (b) tax stability (in Rupees).
5. Age of the company in years.

6. Number of pages of documents submitted with income tax return
7. Harassment dummy (harassed =1)
8. Opinion about the income tax rate (should be greatly reduced=5, should be greatly increased=1)
9. Impression about IT Department (Very satisfied=5, very dissatisfied=1)
10. Percentage of income deliberately under-reported by similar firms
11. A dummy variable for "who prepares the company's tax return" (in-house= 1; tax advisor = 1)
12. Mumbai city dummy (Mumbai = 1).
13. Manufacturing/non-manufacturing dummy (manufacturing = 1).
14. Time devoted to appeals and litigation ('high'=3,'average'=2, 'low'=1, not applicable =0).
15. Other size determinants were also included in regressions even with different scaling variables.

Groups 1 to 4 did not survive selection criteria. Nor did the underreporting percentage (10) or the dummy variable for tax return preparation (11)

Results

These are reported in Table A4.1.1. Of the 5 significant determinants having largely the same sign:

(a) The number of assessment years disputed appears to lower compliance costs, which contradict tables in the text and is also unexpected.

(b) The book value of assets appears to be the only scale variable with a largely uniform size. According to this variable, compliance costs are regressive.

(c) Harassment raises compliance costs in almost all regressions.

(d) Among types of firms, manufacturing and old firms appear to have lower compliance costs, *cet. par.*, though the difference is not statistically significant.

(e) The number of pages filed with tax returns is positively related to compliance costs, though the variability of this indicator is high.

Table A4.1.1: Summary of Regression Results for Legal Compliance Costs

Ordinary Least Squares Linear Regressions	Legal compliance costs as a % of book value of assets	Legal compliance costs as a % of turnover	Legal compliance costs as a % of gross tax	CC per employee	CC:profit before tax	Average % of positive coefficients	Average % of t-statistics > 1.7
No of regressions	33	62	82	91	56		
Percentage of coefficients that are positive							
No. of assessment years disputed	**27.27**	**4.84**	**0.00**	**2.20**	**0.00**	**6.86**	**59.50**
Book value of Assets in Rs.	**0.00**	**30.00**	**3.57**	**17.39**	**0.00**	**10.19**	**45.09**
Mumbai	**100.00**	**0.00**	**100.00**	**100.00**	**100.00**	**80.00**	**45.00**
Tax should be reduced	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**	**41.86**
Harassed	**100.00**	**100.00**	**40.00**	**100.00**	**100.00**	**88.00**	**38.00**
Turnover in Rs.	50.00	14.29	14.81	2.94	31.58	22.72	35.48
Number of Employees	*60.00*	*14.29*	*7.41*	*2.94*	*27.78*	*22.48*	*31.25*
Manufacturing	*0.00*	*0.00*	*5.00*	*0.00*	*0.00*	*1.00*	*25.50*
Profit before tax in Rs.	15.15	59.68	42.68	94.51	58.93	54.19	22.99
Appeal Burden	100.00	0.00	0.00	64.71	100.00	52.94	22.20
Impression about ITD	33.33	0.00	100.00	0.00	75.00	41.67	19.05
Age of firm	*0.00*	*0.00*	*25.00*	*0.00*	*7.69*	*6.54*	*17.67*

Pages enclosed with return	*12.50*	*100.00*	*100.00*	*100.00*	*100.00*	*82.50*	*8.79*
Percentage of t-statistics at least equal to 1.7							
No. of assessment years disputed	3.03	82.26	92.68	51.65	67.86		
Book value of Assets in Rs.	94.74	15.00	57.14	21.74	36.84		
Mumbai	0.00	0.00	100.00	100.00	25.00		
CIT to be reduced	0.00	17.65	16.67	75.00	100.00		
Harassed	0.00	100.00	0.00	0.00	90.00		
Turnover in Rs.	75.00	9.52	0.00	82.35	10.53		
Number of Employees	40.00	14.29	0.00	85.29	16.67		
Manufacturing	33.33	0.00	15.00	54.17	25.00		
Profit before tax in Rs.	33.33	4.84	0.00	71.43	5.36		
Appeal Burden	33.33	0.00	0.00	17.65	60.00		
Impression about ITD	0.00	95.24	0.00	0.00	0.00		
Age of firm	60.00	8.33	0.00	20.00	0.00		
Pages enclosed with return	0.00	16.67	0.00	27.27	0.00		
Average R Square	0.34	0.42	0.41	0.35	0.45		

Note: **Bold:** Relatively high proportion significant and with single signed coefficients.
Italics: Relatively high proportion with single signed coefficients.

Activities contributing to compliance costs: Percentage distributions of responses

The table below gives the percentage distribution of responses concerning the importance of different activities to compliance costs. This table is the counterpart to Table 4.4.

Table A4.1.2: Importance of Activities Contributing to Internal Costs *(Percentage Distribution)*

	Very Important	Quite Important	Average	Quite Unimportant	Unimportant	Can't say
Maintaining account books (MAB)	70	13	13	0	4	0
Information asked for during scrutiny assessment	58	35	5	0	3	0
MAB: for compulsory financial audit under section 44AB	56	28	13	0	3	0
Completing and submitting tax returns	56	28	15	0	0	0
Completing and submitting TDS returns	56	26	13	3	3	0
MAB: for employee TDS	45	30	20	5	0	0
MAB: TDS other than for employees	45	30	20	0	5	0
Litigation initiated by the IT Department	43	23	15	3	13	5
Others	43	14	0	0	43	0
Litigation initiated by the company	41	32	7	0	15	5
To obtain a tax refund	40	43	15	0	0	3
Providing assistance to employees	16	13	21	24	26	0
To obtain a PAN number	16	11	26	18	29	0
Research and tax planning (RP)	14	21	45	3	14	3
RP: for other tax concessions	11	19	43	8	16	3
RP: for exemption under sections 10A and 10B	4	0	33	13	42	8
Tax related training for employees	0	26	38	13	23	0

Annex 5.1 Explanation of CAG Audit Objection Categories

Incorrect valuation of closing stock: “Under the Income Tax Act, 1961, the income of an assessee from business or profession shall be computed in accordance with the method of accounting regularly employed by the assessee. It has been judicially held that any system of accounting which excludes for the valuation of closing stock-in-trade all costs other than the cost of raw material is likely to result in a distorted picture of the true state of business for the purpose of computing its chargeable income.”

Incorrect computation of income of financial corporations: “Under the Income Tax Act, 1961, as amended with effect from 1 April 1992, by Finance (No.2) Act, 1961, in the case of a public financial institution or a scheduled bank or a State Financial Corporation, or State Industrial Corporation, the income by way of interest in relation to such categories of bad or doubtful debts as may be prescribed, having regard to the guidelines issued by RBI and subsequently clarified in March 1993 with reference to Section 43(D) of the Income Tax Act, 1961, that such debts shall be chargeable to tax in the previous year in which it is credited by the public financial institution or the scheduled bank or the State Financial Corporation or State Industrial Corporation to its Profit and Loss Account for that year or as the case may be in which it is actually received by that institution or bank or corporation whichever is earlier.”

Incorrect carry forward/set off of losses: “Under the Income Tax Act, 1961, where the net result of the computation under the head ‘Profits and gains of business or profession’ is a loss to the assessee and such loss including depreciation can not be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year /years to be set off against the profits and gains of business or profession.”

Over-assessment (and under-assessment) of income and tax: “Under the Income Tax Act, 1961, an assessment may be completed in a summary manner after, inter alia, rectifying any arithmetical error in the return, accounts and accompanying documents. In a scrutiny assessment, the assessing officer is required to make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment.”

Incorrect allowance of depreciation: “Under the Income Tax Act, 1961, deduction on account of depreciation on block of plant and machinery and other assets is admissible at the prescribed rates while computing the business income of the assessee if these are owned by the assessee and used for the purpose of business during the relevant previous year.”

Incorrect application of rates of depreciation: “Depreciation is calculated on the cost of written down value of the assets according to the rates prescribed in the Income Tax Rules 1962. Where any asset falling within a block of assets is acquired by the assessee during the previous year and is put to use for the purpose of business or profession for a period of less than one hundred and eighty days in that previous year the deduction in respect of such asset shall be restricted to fifty percent of the amount calculated at the percentage prescribed in respect of the block of assets comprising such assets.”

Incorrect carry forward/ set off of unabsorbed depreciation/investment allowance: “Under the Income Tax Act, 1961, where for any assessment year unabsorbed depreciation, or investment allowance under the head ‘profits and gains of business or profession’ cannot be set off against any other income in the relevant assessment year, such unabsorbed investment allowance shall be carried forward to the following assessment year and shall be setoff against the profits and gains of any business or profession and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off up to a maximum of eight assessment years, immediately succeeding the assessment year for which it was first computed.”

Incorrect allowance of relief in respect of profits from export business: “Under the Income Tax Act, 1961,an assessee being an Indian Company or other assessee, resident in India, engaged in the business of export is entitled to a deduction equal to the profits derived from the export of goods or merchandise if the sale proceeds are received in convertible foreign exchange. Where the export out of India is of goods or merchandise manufactured or processed by the assessee and also of trading of goods, the profit derived from such export shall be the aggregate of the adjusted profits in proportion to the export turnover in relation to the manufacturing/processing of goods and in relation to the trading activity, the amount arrived after deducting the direct and indirect costs of the trading from the export turnover of the activity. The profit so arrived at shall be further increased by ninety percent profit on sale of licenses and export incentives in the ratio of export turnover to total turnover."

Source: CAG (2002)

Annex 6.1 Definitions of Variables Used in Regressions in Chapter 6

Sl.	Variable	Question Number and Question in *World Business Environment Survey*	Values
1	Bribes to IT Officials (always = 5)	Q14. (c) "Do firms like yours typically need to make extra, unofficial payments to public officials to deal with income tax officials?"	5="always, 4="Usually", 3="Frequently", 2 ="Sometimes", 1="Seldom", 0="Never"
2	Problem: IT regulations/ administration (no = 0, major = 3)	Q7:"Please judge on a four point scale how problematic are these different regulatory problems for the operation and growth of your business (Please do not select more than 4 obstacles as 'major obstacles') ": (g) Income tax regulations/administration	0="No Obstacle", 1="Minor Obstacle", 2="Moderate Obstacle", 3="Major Obstacle".
3	Obstacle: High taxes (no = 0, major = 3)	Q7 :"Please judge on a four point scale how problematic are these different regulatory problems for the operation and growth of your business (Please do not select more than 4 obstacles as 'major obstacles')": (h) High taxes".	0="No Obstacle", 1="Minor Obstacle", 2="Moderate Obstacle", 3="Major Obstacle".
4	Affordability of Courts	Q11: "In resolving business disputes, do you believe your country's system to be affordable?" (collinear with 'honest/uncorrupt', 'quick', 'fair/impartial').	5="always, 4="Usually", 3="Frequently", 2 ="Sometimes", 1="Seldom", 0="Never".
5	Govt/ bureaucracy helpful to business (very helpful = 5)	Q9: "Please rate your overall perception on the relation between government and/or bureaucracy and private firms on the following scale. "All in all, for doing business I perceive the state as"	5="very helpful", 4="mildly helpful", 3="neutral", 2="mildly unhelpful", 1="very unhelpful".
6	Listed	Listed or non listed on a stock exchange	Listed = 1, else 0.
7	Manufacturing	Manufacturing/non-manufacturing	Manufacturing = 1, else 0.
8	Market competition (0 = none)	Q30: "Regarding your firms major product line, how many competitors do you face in your market?"	a) 0=none b) 2="3 or fewer" and c) 5="more than 3".
9	Problem: General government regulations (no = 0, major = 3)	Q34: "How problematic are the factors listed below for the operation and growth of your business? (Please do not select more than 3 obstacles as 'major obstacles')": (c) General government regulations	0="no obstacle", 1="minor obstacle", 2="moderate obstacle", 3="major obstacle".
10	Policy instability / uncertainty (no = 0, major = 3)	Q34: "How problematic are the factors listed below for the operation and growth of your business? (Please do not select more than 3 obstacles as 'major obstacles')" : (h) Policy instability / uncertainty	0="no obstacle", 1="minor obstacle", 2="moderate obstacle", 3="major obstacle".
11	Problem: IT (no = 0, major = 3)	Q34: "How problematic are the factors listed below for the operation and growth of your business? (Please do not select more than 3 obstacles as 'major obstacles')" : (d) Income taxes	0="no obstacle", 1="minor obstacle", 2="moderate obstacle", 3="major obstacle".

12	Efficiency of government	Q33: "How would you rate the efficiency of government in delivering services?" : Central government.	6="very efficient", 5="efficient", 4="mostly efficient", 3="mostly inefficient", 2="inefficient", 1="very inefficient".
13	Obstacle: Competitors' tax avoidance	Q32: "How serious a problem are the following practices of your competitors for your firm?": (a) They avoid sales tax or other taxes	4="major obstacle", 3="moderate obstacle", 2="minor obstacle", 1="no obstacle".
14	Corruption	Q34: "How problematic are the factors listed below for the operation and growth of your business? (Please do not select more than 3 obstacles as 'major obstacles')": (i) Corruption.	3= "major obstacle", 2="moderate obstacle", 1="minor obstacle", 0="no obstacle".
15	Problem: Domestic producers sell below your prices (major = 3)	Q32: "How serious a problem are the following practices of your competitors for your firm?": (d) Domestic producers unfairly sell below prices.	4="major obstacle", 3="moderate obstacle", 2="minor obstacle", 1="no obstacle".
16	Integrity & efficiency of IT Department	Q1: "Please rate the overall quality, integrity and efficiency of services delivered by the following public agencies or services: " (d) Income tax department.	6="very good", 5="good", 4="slightly good", 3="slightly bad", 2="bad", 1="very bad".
17	Infrastructure quality index	"Please rate the overall quality, integrity and efficiency of services delivered by the following public agencies or services: " (f) Roads Department/Public Works, (g) Telephone Service, (h) Electric Power Company and (i) Water Supply	6="very good", 5="good", 4="slightly good", 3="slightly bad", 2="bad", 1="very bad".
18	Quality, integrity, efficiency of President, PM, Cabinet, Parliament	Please rate the overall quality, integrity and efficiency of services delivered by the following public agencies or services: " (n) Central Government leadership (President/PM/Cabinet), (o) Parliament	6="very good", 5="good", 4="slightly good", 3="slightly bad", 2="bad", 1="very bad".
19	Sales off the books (%)	Q28: "Recognizing the difficulties many enterprises face in fully complying with taxes and regulations, what percentage of total sales would you estimate the typical firm in your area of activity keeps 'off the books'?"	None at all, 1-10%, 11-20%, 21-30%, 31-40%, 41-50%, More than 50% (specify________%)
20	Sales growth	Q35: "Please estimate the growth of your company's sales, investment, exports, employment and debt over the last one year".	Sales growth in %
	Full Time Employees	General Information: i: "Company size "	Number of full time employees.

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