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Taxman should move towards limited scrutiny

Cross-verification of information should be the norm, but detailed scrutiny of income tax returns should be an exception

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Gautam Nayak

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Many persons have been surprised to receive notices from the tax department, asking them to file their income tax returns (ITRs) for an earlier year, giving details of certain transactions. Many taxpayers who have filed their tax returns have also received such

notices, asking for confirmation of such transactions. These notices have become extremely common in the past one year.

Notices, to trace potential tax evaders, have become possible due to various initiatives taken by the income tax department. Earlier, the main source of such information was tax deduction at source (TDS) required on payments of certain incomes, where the TDS returns reflected the Permanent Account Numbers (PANs) of the persons to whom such payments were made. These payments were then aggregated under the PAN of the person to whom payments were made.

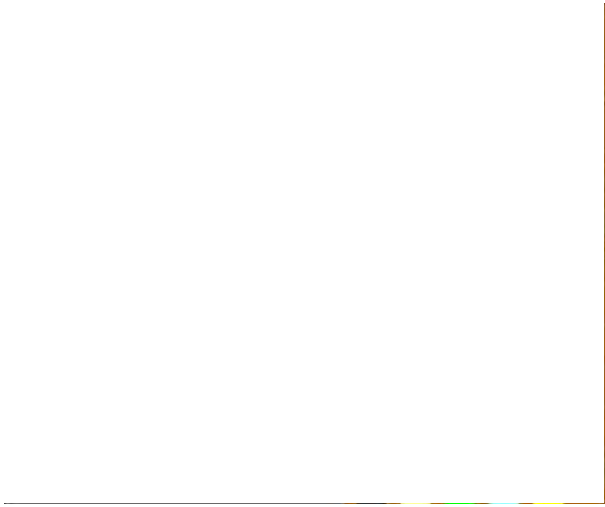
The widening of the scope of information required to be filed through Annual Information Returns (in existence since 2004) from 2016 onwards, has brought about this sea change. A wide variety of transactions are now required to be reported by the counter-party. These include various types of investments of value of ₹10 lakh or more, new fixed deposits with banks, post office or finance companies, or subscription to an issue of debentures, bonds or shares of a company or units of a mutual fund. Buyback of its shares by a company of value exceeding ₹10 lakh also has to be reported. The reportable transactions also include purchase or sale of immovable property of value exceeding ₹30 lakh, and purchase of foreign exchange of ₹10 lakh or more.

Besides the above, certain cash transactions also have to be reported—cash deposits in bank accounts or purchase of bank drafts in cash above certain limits; purchase of goods or services of more than ₹2 lakh in cash (if the seller is liable to tax audit). Insurance companies would, therefore, report receipt of insurance premiums, hotels would report receipt of bills, car or white goods dealers would report sale of cars or white goods, if the payment is made by the customer in cash exceeding the limit.

The tax department would also now have access to the goods and services tax (GST) database, which reflects the sales transactions of entities liable to GST. This would also make the matching process easier for the tax authorities. However, this is being done in a

limited way, and without understanding the nuances of accounting for sales by different types of businesses. The turnover for GST purposes is not necessarily the turnover as per the accounts. There are various items, such as reimbursements, which may form part of turnover for GST purposes, but would not be classified as turnover in the accounts.

Consolidating all this information based on the PAN helps the tax department create a profile of the taxpayer, which can then be compared with the income declared in the tax return, to flag off potential tax evasion. This is certainly a significant deterrent to tax evasion, and to cash transactions.



But is it enough? The biggest problem faced by the tax department in getting complete information is the existence of the large parallel cash economy. If both the entities in a transaction execute it in cash, and do not reflect it in their records, such transactions will not be captured by this system.

For example, if a caterer, decorator or a construction contractor takes certain amount in cash from a customer by under-invoicing his services, and does not report it as his income, it will obviously not reflect in the Annual Information Returns either. Therefore, both the customer as well as the service provider will continue to remain outside the tax net, so far as this additional payment is concerned. Therefore, other methods would have to be adopted to tackle such collusive tax evasion.

A practical difficulty in compliance arises for many taxpayers in cases of investments or purchase or sale of property made in joint names. In most cases, the name of the joint holder is added only for convenience. Notices for the same investment or purchase or sale are received both by the first holder as well as the joint holder, requiring compliance by both the holders for the same transaction, though for tax purposes, the investment, purchase or sale may be by only one of them.

Internationally, such collection and cross-verification of information is the norm, with detailed scrutiny of tax returns by tax officers being the rare exception. In India, we still have a large number of returns being scrutinised in detail, though a concept of limited scrutiny has also been introduced, where the object is only to cross-verify select information. Hopefully, we will see an increased move towards limited scrutiny, or notices for confirmation of information, rather than detailed or complete scrutiny, which consumes substantial time and effort of both the taxpayer and the tax department.

We, of course, still have a long way to go in checking black money. There are still large parts of the informal economy that continue to operate in cash. The tax department needs to focus in that direction, in ensuring that all businesses are run in a tax-compliant manner.

Gautam Nayak is a chartered accountant

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