Unaccounted Income vis-à-vis Public Perception in India: An Empirical Analysis

Arun Sharma[*] and Jaspal Singh[**]

Abstract

Governments around the world are focusing upon tax compliance as a serious concern. The unending wave of scams and incidences of misappropriations coupled with the scarcity of resources has put forth the domain of unaccounted incomes to a considerable public attention. The present paper attempts to study the taxpayers' attitude towards the underlying dimensions responsible for unaccounted income(s) in India. The factor analytic approach resulted in four factors namely regulatory burden, detachment with democratic institutions, improper administration and public despair as the key causal dimensions concerning generation of unaccounted incomes in India. Further, multiple regression analysis results reflect 56 percent variance in the dependent variable. The overall level of satisfaction with the tax compliance system has been explained by the exploratory factor structure. The results provide practical implications to deepen the tax base by sustained efforts to improve compliance in a holistic way.

Keywords: Unaccounted Income, Tax Compliance, Tax Gap, Self-employed assesses

Introduction

The history of evasion of taxes dates as back as to the origin of taxes themselves. History abounds the examples of tax evasion and unaccounted income. In India, the problem could be traced back to the regime of Emperor Chandra Gupta Maurya in the 4th century B.C. Kautilya, his wise advisor, enumerated the numerous ways by which money could be misappropriated. Unaccounted income is a multi-dimensional phenomenon. The concept and scope may differ across jurisdictions primarily on account of the social behavior or cultural values that determine the validity or unacceptability of particular conduct. What may be an offence or an illegal act in one jurisdiction may be an acceptable customary practice or a legal activity in the other jurisdiction. The exact definition thus depends on the circumstances in which the concept is being used. The present study follows the definition given by the National Institute of Financial Management[1] (NIFM, 2012). According to NIFM, "Unaccounted Income is the income from those economic activities that circumvent or otherwise avoid government regulation and taxation." This definition attempts to cover illegal as well as legal economic activities where tax could be evaded. Thus, as per this definition if the actual income of an individual is $1 million and he/she reports an income of half a million dollars only, then the remaining half million (unreported) constitutes *Unaccounted Income.*

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[*] Senior Fellow, Department of Commerce, Guru Nanak Dev University, Amritsar, Punjab, India. gaurav0388@gmail.com
[**] Head, Department of Commerce, Guru Nanak Dev University, Amritsar, Punjab, India

The phenomenon has started grabbing scholarly attention given the gigantic estimates presented for India (Acharya et al., 1986; Kar, 2011; Ministry of Finance, 1971; Press Trust of India, 2013). The report by Global Financial Integrity (Kar & LeBlanc, 2013) estimated a total of approximately USD $ 343,932 million worth of unaccounted income from India as stashed abroad. An important repercussion is the revenue lost by the exchequer, in addition to social and economic effects the phenomenon brings along. The loss of revenue poses serious restrictions on government's attempts to bring the desired socio-economic changes in the economy. It undermines the principles of social justice and equity. It shatters the faith of common man in the virtues of honest labor and virtuous living (Ministry of Finance, 2012).

Table I: Spread of Taxpayers in India (F.Y. 2011-12)

Tax Slab	No of Taxpayers (in crores)	Percent of Taxpayers	Tax Collection (in crores)
₹ 0 - ₹ 5 lacs	2.88	88.9	15,010
₹ 5 - ₹ 10 lacs	0.18	5.6	21,976
₹ 10 - ₹20 lacs	0.14	4.3	17,858
> ₹ 20 lacs	0.04	1.2	93,229

Source: Parliamentary Standing Committee Report on Draft Direct Tax Code, 2012

The composition of Indian taxpayers (in terms of incomes reported) presented in table I depicts the skewed direct tax base in the country. Table I reveals that majority of taxpayers fall in the income slab of ₹ 0 - ₹ 5 lac (88.9% of the total taxpayers). Incomes under ₹ 5 lac attract only 10% income tax levy in India with incomes up to first 2.5 lacs being the basic exemption limit. Such skewed taxpayers' composition within an already tiny tax base indicates that either the growth fragrance has not reached the masses or the government has not been able to know that! The statistics itself presents the large scope for the possible widening of direct tax base and the pressing need to understand the dynamics of unaccounted income in the country.

Background Literature

A number of attempts have been made in the past to explore the dynamics of the phenomenon of unaccounted incomes worldwide. Prominent contributions in the field have been made by Frey and Weck(1983), Fiege (1990), Mirus et al.(1994), Soldatos (1995), Cebula (1997), Johnson et al.(1998), Giles (1999), Tanzi (1999), Schneider and Enste (2000), Anno (2003) , Bajada and Schneider (2005), Breush (2005), Kar (2011) among others. As regards India, in the post-independence context, such attempts have been made by Kaldor's study (1956) and the direct taxes enquiry committee report (1971) which estimated tax evaded income to be to the tune of Rs. 700 crores (1961-62), Rs 1000 crores (1965-66) and Rs 1400 crores (for 1968-69). Numerous studies (as shown in table II) also identified the gravity of the problem by quantifying the amount of unaccounted incomes in relation to India's GDP.

Table 2: Unaccounted Income Estimates in relation to India's GDP

Study	Year	Size as percentage of GDP/GNP
Gupta and Gupta	1982	39.01 % (for 1976-77)
Chopra	1985	10.13% (for 1976-77)
Acharya et al.,	1985	15-18% (for 1975-76)
		18-21% (for 1983-84)
Schneider et al.	2003	8.99% (for 1960-61)
		23.20% (for 1997-98)
Kar, D.	2011	17.7% (by 2008)
NIFM	2012	75%

Much of the focus has been concentrated on quantifying the amount of such incomes alone. The study of dynamics of the problem (i.e. its nature and causes) also needs equal attention. Sociologists analyze this phenomenon in terms of society's weak commitment towards nation's laws and regulations. Psychologists explain it in terms of one's individual behavior engaged in such activities being "deviant" and "abnormal". Anthropologists explain it in terms of a society's culture, values, beliefs and customs specifying what stands morally right and what stands wrong, while economists treat the phenomenon to be a result of a rational decision making process concerning an individual. So, no single theory has completely been able to explain the determinants of individual behavior or guiding principles to engage in such activities. Many factors interplay at the same time (Chugh & Uppal, 1986).

Acharya (1983), Chopra (1985) and Schneider & Enste (2000) also call for examining its causal factors in order to build an understanding over the dynamics of the issue. It helps in the analysis of (i) tax potential; (ii) effectiveness of tax administration; (iii) limits to fiscal and monetary policies; (iv) inflation and phenomenon of increase in prices particularly in items such as land prices and those of goods of conspicuous consumption, (v) the level of tax morality of the society (Chopra, 1982). Hence in the light of aforesaid discussion the present research attempts to study public attitude towards perceived reasons behind the growth of unaccounted incomes in India. The present study thus contributes to the efforts in improving tax morality and compliance in Indian economy.

Research Model
The fundamentals of a tax system are enumerated by the principles it is based upon. The first set of such principles were defined by Adam Smith (equality, certainty, convenience and economy). The development in economics and public finance evolved some additional canons over the time (productivity, simplicity, buoyancy, flexibility and diversity). No single taxation theory fully satisfies the requirements of the present day socioeconomic realities. Hence, various important taxation theories namely benefit received theory, socio-political theory and the ability to pay theory interplay together. The Benefits received theory establishes a link between taxes paid and state activities. Socio-political theory, on the other hand, stresses that tax system should be designed in the social and political context. It professes the modern welfare approach to tax policy. However, it does not see a contractual relationship between the citizens and state unlike benefits received theory. The basic tenet of ability of pay theory stresses that tax burden should be distributed on the criteria of justice and equity which in turn implies their ability to pay. It prescribes progressive taxation and income redistribution. Accordingly, these three important tax theories (benefits received theory; socio-political theory and ability to pay theory) altogether have the potential to explain the phenomenon of unaccounted income.

Scale Construction, Methodology and Data Collection
Sample and Methodology
A total of eighteen statements were framed for the questionnaire. The survey data has been collected from a sample of 500 individual respondents (income tax assessees) using a structured questionnaire. Out of the responses received, 415 were found to be valid and complete. A five-point Likert scale has been used for obtaining responses ranging from "Strongly Agree" (with a score of 5) to "Strongly Disagree" (with a score of 1).The survey statements were formulated after referring the concerned literature (Ministry of Finance 1971; Frey & Weck 1983; Chopra, 1985; Acharya 1986; Jain 1987; Johnson et al 1998; Ministry of Finance 2012, among others) and discussion with academic experts and practitioners. Non-probability snowball sampling has been used for the purpose of the present study. The sampling units include businessmen people with a minimum working experience of two years in their profession as the respondents. The respondents were selected from the four major cities of north-west region of income tax department (Amritsar, Jammu, Ludhiana and Shimla) along with the union territory of Chandigarh. The survey was conducted during the month of March

to June 2017. The present study employs exploratory factor analysis technique followed by confirmatory factor analysis and multiple regression analysis for investigation.

Factor Analysis and Results

The following tests ensured the applicability of factor analysis. The scale was found to be reliable and consistent (alpha = .782). The appropriateness of factor analysis was examined in terms of Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy (.821) and Bartlett test of sphericity in terms of presence of significant correlations among variables. The present study employs principal component analysis method to obtain a minimum number of factors that will account for the maximum of the variance. Hair et al. (2015) state that "factor loadings in the range of $\pm$ .30 to $\pm$ .40 are considered to meet the minimal level for interpretation of structure". Hence, all the variables with factor loading of 0.40 or above have been considered. A total of four factors accounting for 64.38% of total variance have been extracted. The final exploratory factor solution is summarized in Table 3.

Table 3: Rotated Component Matrix

	Component				
	1	2	3	4	Communalities
V1	**.755**	-.097	-.022	.014	.580
V2	**.807**	-.037	.010	-.055	.656
V3	**.794**	.079	-.009	.034	.638
V4	**.757**	.046	-.043	.084	.584
V5	**.798**	.002	-.061	.078	.647
V6	**.818**	-.028	-.037	-.012	.671
V7	-.117	.192	**.722**	.027	.572
V8	.012	.132	**.661**	-.070	.460
V9	-.043	.120	**.814**	.011	.678
V10	-.028	**.698**	.014	-.073	.494
V11	-.068	.362	**.634**	.082	.545
V12	.040	.185	**.782**	.069	.652
V13	-.024	**.839**	.225	-.038	.756
V14	.045	**.746**	.186	.036	.595
V15	.008	**.639**	.343	-.029	.526
V16	-.023	**.833**	.309	.003	.791
V17	.005	-.043	.025	**.933**	.874
V18	.104	-.039	.038	**.926**	.872
Variance explained	20.925	17.265	16.345	9.850	**64.384**

Table 4: Factor Labelling

Factor 1: Regulatory Burden   Factor 2: Detachment with Democratic Institutions
Factor 3: Improper Administration   Factor 4: Public Despair

Regulatory burden has emerged as the most important factor followed by detachment with democratic institutions, improper administration and public despair accounting for 64.38% of the total variance explained by the factor solution.

Confirmatory Factor Results

The exploratory structure delivered by factor analysis was confirmed using the confirmatory analysis approach. For the said purpose, the structural model was built using AMOS 19.0. The application of CFA validates the exploratory model structure (CMIN/DF = 2.972 ; P = 0.000). All the major fitness indices (CFI (.923); GFI (.905); NFI (.889); RMSEA (.069)) were found to be appropriate. The factor structure was found valid and reliable. All the four constructs had composite reliability above the threshold level of 0.7. Similarly, convergent validity was established in terms of all values of AVE being greater than 0.5 (except regulatory burden). However, Malhotra & Dash (2011) hold that "AVE is a more conservative measure than CR. On the basis of CR alone, the researcher may conclude that the convergent validity of the construct is adequate, even though more than 50% of the variance is due to error". Finally, discriminant validity was established with AVE found to be greater than MSV for all the four constructs. Table 5 presents the final statistics.

Table 5: CFA Results

	CR	AVE	MSV	MaxR(H)	Regulatory	Detachment	Improper	Public
Regulatory Burden	0.813	0.468	0.360	0.821	**0.684**			
Detachment with Institutions	0.879	0.549	0.009	0.923	-0.093	**0.741**		
Improper Administration	0.850	0.540	0.360	0.956	0.600	-0.036	**0.735**	
Public despair	0.860	0.755	0.007	0.966	0.066	0.082	-0.049	**0.869**

Regression Results

The factor analytic results were further finally regressed to identify the extent to which the underlying dimensions reflect the satisfaction with the government's efforts in fighting the menace of unaccounted income. Factor scores were regressed upon the dependent variable: the overall level of satisfaction with the tax compliance system.

The following hypotheses were examined:
H1: There is no relationship between overall satisfaction and Regulatory burden (H1:β_1=0).
H2: There is no relationship between overall satisfaction and Detachment with democratic institutions (H2:β_2=0).
H3: There is no relationship between overall satisfaction and Improper administration (H3:β_3=0).
H4: There is no relationship between overall satisfaction and Public despair (H4:β_4=0).

The formulation of hypothesis is followed by the specification of the model:
 Y = β_0 + $\beta_1 F_1$ + $\beta_2 F_2$ + $\beta_3 F_3$ + $\beta_4 F_4$ + μ
 Where Y denotes the dependent variable, the overall level of satisfaction with the tax compliance system. β_0 denotes the intercept, $\beta_1 F_1$ denotes the linear effect of F1, $\beta_2 F_2$ denotes the linear effect of F2, . . . and so on.

Meanwhile, μ denotes the residuals or the error term. The application of multiple regression analysis explained a substantial amount of variance in the overall satisfaction with the tax compliance system (Adjusted R^2 = 0.569, i.e. 57% variance explained). The overall model (table VII) was found to be fit (F-Statistic: 7.099544, Prob (F-Statistic): 0.000016). The data was found normal (Jarque Bera: 24.59930, Prob: 0.253715) and all the co-linearity diagnostics were well within the limits. However,

the data was not found homoskedastic as revealed by Harvey test (F-Statistic: 2.589223, Prob (F-Statistic): 0.0364). Hence, heteroskedasticity was modeled using the White test.

Table 6: Regression Results

Dependent Variable: SATISFACTION
Method: Least Squares
Sample: 1 415
Included observations: 415
White Heteroskedasticity - Consistent Standard Errors & Covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	3.239408	0.049476	65.47469	0.0000
SCORE1	0.023896	0.052993	0.450939	0.6523
SCORE2	0.049910	0.051124	0.976267	0.3295
SCORE3	0.250251	0.054716	4.573638	0.0000
SCORE4	0.095361	0.050055	1.905110	0.0575

R-squared	0.066289	Mean dependent var		3.256790
Adjusted R-squared	0.056952	S.D. dependent var		1.016320
S.E. of regression	0.986955	Akaike info criterion		2.823883
Sum squared resid	389.6318	Schwarz criterion		2.873314
Log likelihood	-566.8364	Hannan-Quinn criter.		2.843449
F-statistic	7.099544	Durbin-Watson stat		1.844027
Prob(F-statistic)	0.000016			

Discussion and Conclusion

While making a comprehensive attempt on the issue of black money in India, the Direct Taxes Enquiry Committee Report (1971) noted that, "Today, even honest persons, who would normally prefer to keep themselves on the right side of the law, are unwittingly or unwillingly dragged into the quagmire of black money deals. These problems have in recent years become so acute that they seem to have shaken the confidence of the public in the tax administration." The above observation points that the effective fight against the problem calls for identifying its determinants and dealing with them in order to increase public acceptance and trust in the government and the role of tax administration. The present study is an attempt to identify such dimensions.

The regulatory burden as manifested by a perception of high tax burden with large number of regulations is considered a strong temptation for unaccounted income. In addition, society's lacklustre attitude in condemning such illicit and illegal acts also create an social atmosphere where tax evasion and choosing an 'exit option' from the system is not considered a social evil. There is a growing sense of distrust and detachment with the democratic institutions. The role of media in reducing the size of underground economy has been touched upon by Schneider et al (2003). Media plays an important role in raising a 'voice option' which if not raised effectively, as the results indicate, creates a sense of detachment of the people from the entire democratic setup. The lack of trust in the government regarding efficient utilization of public revenue is another area worth concern (Chugh & Uppal 1986; Kumar 2002). The resentment against high tax rates in U.S. in the 1980s is also much attributed to the then repeated disclosures of wastage and abuse of public funds in relation to civilian and defense expenditure programs. Loss of confidence in the functioning of the government along with wasteful and unproductive public expenditure tend to motivate otherwise honest taxpayers to choose an 'exit option'. Similarly, political intervention and interests have been

observed as responsible for generation of unaccounted income. The clout and patronage that politics provides law breakers plays a detrimental role in the working of deterrence and prosecution machinery. An ineffective prosecution and deterrence machinery creates a sense of "Make the hay while the sun shines" belief among rule breakers. The generation of unaccounted income has much to do with the political setup and administrative mechanism driven by structural issues and a desire to accumulate hidden wealth rather than the provision of such services. Neoliberal policies alongside retreat of the state in the number of public welfare activities have led people not to anticipate the government for the hard days.

Notably, important issues facing the Indian economy such as high inflation, poor state of public services, and high costs associated with compliance requirements were found to be another important dimension concerning the generation of unaccounted income in India. The simple desire to accumulate wealth through hidden means has also been observed to be an important criterion among people. A strong desire to accumulate wealth covertly specifies the cultural aspect in the society, wherein people wish to remain socially right but morally incorrect. Kar (2011) also identified the strong desire to accumulate hidden wealth as a strong temptation for illicit capital flight. As the results demonstrate, the growing illegality tends to detach people from the democratic institutions. It carries catastrophic consequences for the society at large. Hence, the need of the hour is to establish and strengthen the relevance of democratic institutions like the judiciary, legislature and executive branches of the government, and the media, through a comprehensive set of efforts and measures. It involves a long-term framework to bring equilibrium through a host of structural and administrative reforms. Similarly, the regression results reflect that only Score 3, i.e. Factor 3 *(Improper administration)* has been found significant at 5% level of significance. It implies that issues resulting in improper administration were found to significantly reflecting the overall level of satisfaction with the compliance system. However, an important observation is regarding the constant term, C, which has been found significantly affecting the dependent variable (Prob: 0.0000 with a high coefficient value of 3.239408). It implies the presence of certain other dimensions playing a significant role in affecting the overall level of satisfaction with compliance system which needs to be examined by future research efforts on the phenomenon itself.

Implications for Policy Makers
Based on the survey results, the following efforts should be focused on the following areas to further enhanced tax compliance: 1) plugging the regulatory burden over taxpayers; 2) building public trust in governance and democratic institutions; 3) imparting tax morale in the educational curriculum; and improving administration to become responsive to public aspirations. To conclude, attempts towards enhanced tax compliance have to tread a fine line of building trust in governance by improvements in administration and moral standards in public life in the short run while creating a ecosystem in the long run where taxpaying is remunerated and aspired.

Endnotes
[1] Study on Unaccounted Income/wealth both inside and outside the country, National Institute of Financial Management, Faridabad, India: 2012.
[2] On the basis of information provided to the authors by the Government of India under the Right to Information Act.

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