Article Title "Cheques and balances: Permitting tax authorities to conduct raids without due process will be disastrous"

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Having elections to decide who is to govern us meets only the most basic definition of a democracy. But at a deeper level, democracies require checks and balances in governance. Otherwise, no matter how free and fair the elections, they would be autocracies with periodic changes of leadership.

The proposal in this year's budget to amend Section 132 of the Income Tax (IT) Act is an example. The amendment would do away with the requirement for IT officials to demonstrate they had "reason to believe" that violations existed, or that the assessee would not comply, before conducting a search and seizure "raid".

The danger in this is obvious. Without having to show they had good reasons for raids, there is nothing to prevent IT officials from conducting them arbitrarily. Harassment and rent seeking – the term economists use for corruption – are sure to follow.

Nevertheless, it is worth taking stock of the opposite arguments as well. Checks and balances are meant to prevent the autocratic, mindless, or subjective exercise of authority, but not to block its legitimate, justifiable application.

So where does the Indian government's crackdown on IT evaders stand? The statistics clearly show that the pace has been considerably stepped up in the past two years. For instance, the number of raids in the first half of 2016, at 148, was nearly triple of the 55 in the first half of 2015.

Similarly, cash, jewellery and other assets seized during raids in the first seven months of 2016, at Rs 330 crore, was more than 300% of the same period in 2015. And unpaid taxes surrendered by assessees in 2016 were Rs 3,360 crore, a more than 50% increase over 2015.

But these are paltry figures. Only 37 million of India's 1.3 billion people filed tax returns in 2015-16. They included barely 41% of the 42 million people employed in the formal sector and only a third of the 56 million engaged in the informal sector. This is exacerbated by the large number of tax cases tied up in disputes. As of last year, the tally of disputed cases was nearly 67,000 in the Supreme and High Courts, 1.53 lakh in the Income Tax Appellate Tribunals, and 3.7 lakh with Income Tax Commissioners (Appeals).

On top of that, at least for this year, there will undoubtedly be a spike on account of demonetisation. The unprecedented number and amount of deposits since November 8 have led to speculation about the laundering of black money.

In fact, this represents a unique opportunity for tax authorities, with a vast new database to scrutinise for possible tax evasion. If done swiftly, there is immense potential for not only identifying and confiscating black money, but also bringing large numbers of new assessees into the tax net.

However, it was never going to be easy to rapidly scale up such scrutiny or, indeed, conduct raids. It is not simply a matter of allocating more resources for it, but also having to deal with judicial hurdles. As the Finance Bill explains, “certain judicial pronouncements have created ambiguity in respect of the disclosure of ‘reason to believe’ or ‘reason to suspect’ recorded by the income tax authority to conduct a search under Section 132.”

But therein lies the rub. If judges have imposed constraints on raids because of unconvincing reasons to believe they were justified, then it is almost inevitable they will find fault with altogether doing away with all justification! Though the executive and legislative branches may decide to abjure cumbersome procedural requirements in the interest of efficiency, that must pass the test of natural justice and constitutional guarantees in order to deter the judicial branch from overturning it.

The answer to dealing with judicial hurdles in stepping up tax enforcement does not lie in throwing the baby out with the bath water. The aim of simplifying procedural hurdles for tax officials, though a worthy one, cannot be the sole objective. Rather, it must be balanced with certain features that would prevent raids from being conducted whimsically.

Some democracies are able to achieve this balance. In the US, for instance, Supreme Court judgments over decades have chipped away at arbitrariness in issuing warrants, conducting raids, etc requiring objective criteria to be demonstrated that there existed “probable cause” as justification.

India needs similarly simple, unambiguous and objective criteria to establish prima facie justification for a search and seizure. In any event, raids must be a last resort, only if there is demonstrable risk of the assessee absconding or destroying evidence.

Stipulating objective prerequisites for IT raids in India must not be convoluted. Tip offs from pre-defined credible sources, data algorithms to correlate expenditure and income for identifying tax fraud, and other similar measures would fit the bill. Even the routine integration of findings by the government’s other, non-IT investigative agencies – instead of today’s case-to-case consideration – is much needed.

Using the principles of checklist management, IT officials could be given an objective list of items to be ticked off that would serve as a record of due process having been followed prior to a raid. And surely the finance ministry has the expertise to craft such a checklist that would pass judicial muster.