

# An Analysis of TDS as a Tool for Minimizing Tax Evasion in India

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## ABSTRACT

The effectiveness of a nation's tax system is closely linked to its ability to prevent revenue leakage and ensure a high level of taxpayer compliance. In India, tax evasion continues to pose a serious obstacle to fiscal stability, necessitating the adoption of robust administrative mechanisms that promote transparency and accountability. Among these mechanisms, Tax Deducted at Source (TDS) has assumed a pivotal role in strengthening the direct tax framework by enabling the collection of tax at the point where income is generated. This paper undertakes a comprehensive analysis of TDS as a policy instrument for minimizing tax evasion in India and evaluates its contribution to enhancing compliance and revenue efficiency.

The study examines the conceptual foundations and operational structure of the TDS system, highlighting how mandatory withholding of tax and third-party reporting create verifiable records of transactions and reduce opportunities for income concealment. By transferring a portion of compliance responsibility from taxpayers to deductors, TDS acts as a preventive control that limits discretionary non-reporting. The paper further assesses the expansion of TDS provisions across a wide range of income categories, including salaries, contractual payments, professional fees, rent, and interest income, and analyzes their role in widening the tax base and ensuring steady inflow of revenues.

In addition, the research evaluates the impact of digitalization initiatives such as electronic filing, centralized processing, and integration of tax information systems in improving monitoring, data matching, and enforcement capabilities. Despite these strengths, the study identifies several challenges, including procedural complexity, compliance costs for deductors, refund delays, and limited effectiveness in informal and cash-intensive sectors.

The paper concludes that while TDS alone cannot eliminate tax evasion, it functions as a crucial preventive mechanism within India's broader tax administration framework. Continuous rationalization of TDS provisions, simplification of procedures, and enhanced use of technology are essential to further strengthen its effectiveness in promoting voluntary compliance and reducing tax evasion.

**KEYWORDS:** Tax Deducted at Source (TDS), Tax Evasion, Tax Compliance, Revenue Efficiency, Digitalisation

## INTRODUCTION

Taxation is one of the most important sources of revenue for any government and plays a central role in financing public services, infrastructure development, and social welfare programs. In a developing economy like India, an efficient and well-administered tax system is essential for achieving sustainable economic growth and maintaining fiscal stability. Over the years, the Indian government has introduced several reforms aimed at strengthening tax administration, improving compliance, and widening the tax base. Despite these efforts, tax evasion continues to remain a major concern, leading to significant loss of revenue and weakening public confidence in the fairness of the tax system.

Tax evasion occurs when individuals or businesses deliberately conceal income, provide false information, or use illegal means to reduce their tax liability. Such practices not only reduce government revenues but also create inequality, as honest taxpayers end up bearing a higher burden. In India, the problem of tax evasion is aggravated by factors such as a large informal sector, widespread cash transactions, complex tax laws, and limited awareness among certain groups of taxpayers. These challenges make it difficult for tax authorities to detect and prevent non-compliance through traditional post-assessment methods alone.

To address these issues, India has increasingly relied on preventive tax collection mechanisms that ensure taxes are collected at an early stage. One of the most significant among these mechanisms is Tax Deducted at Source (TDS). Under the TDS system, a specified percentage of tax is deducted by the payer at the time of making certain payments and is directly remitted to the government. The recipient of income receives credit for the tax deducted, which is later adjusted against their final tax liability. This approach ensures that tax collection takes place alongside income generation, rather than being postponed until the filing of tax returns.

The basic idea behind TDS is to shift part of the responsibility for tax compliance from the income recipient to the payer. Since payers are often more organized and easier to monitor, this system improves the overall efficiency of tax administration. TDS also reduces the dependence on voluntary disclosure of income, which is often unreliable in environments where evasion incentives are high. By creating a record of transactions at the source, TDS establishes a transparent trail that can be used by tax authorities to cross-check income declarations and identify mismatches.

Over time, the scope of TDS in India has expanded to cover a wide variety of income categories, including salaries, interest, rent, professional fees, contractual payments, and commissions. This expansion reflects the government's recognition that withholding taxes are particularly effective in areas where under-reporting is common. The growing share of TDS in total direct tax collections indicates its increasing importance not only as a revenue tool but also as a mechanism for promoting compliance.

Technology has further strengthened the effectiveness of the TDS system. The introduction of electronic filing of TDS returns, online verification of credits, and centralized processing has improved accuracy, reduced manual errors, and enhanced transparency. These digital initiatives enable faster matching of information between deductors and taxpayers, making it easier to detect non-compliance. As a result, TDS has evolved from a simple collection mechanism into an important component of data-driven tax administration.

However, the TDS system is not without challenges. Compliance requirements such as timely deduction, deposit, return filing, and issuance of certificates can be burdensome, especially for small businesses and individual deductors. Taxpayers may also face difficulties when excess tax is deducted and refunds are delayed. Moreover, TDS has limited reach in informal and cash-intensive sectors where transactions may not be recorded through formal channels. These limitations raise important questions about how far TDS can go in addressing the broader problem of tax evasion.

Given these circumstances, it is necessary to critically examine the role of TDS as a tool for minimizing tax evasion in India and to assess whether it is achieving its intended objectives in practice.

Despite the wide coverage of the TDS system in India, tax evasion continues to persist across different segments of the economy. This creates a need to evaluate whether TDS is effectively functioning as a preventive mechanism against evasion and to identify the gaps that limit its performance.

The study is needed to understand the practical effectiveness of TDS in reducing tax evasion and improving compliance. It will help highlight operational difficulties, administrative constraints, and policy shortcomings associated with the TDS mechanism. Such an examination is important for suggesting improvements that can strengthen the role of TDS in India's tax system.

The objective of this study is to examine the conceptual and operational framework of the TDS system in India, analyse its role in minimizing tax evasion and promoting tax compliance, assess the major challenges faced in its implementation, and suggest suitable measures to enhance its effectiveness as a preventive tool against tax evasion.

## REVIEW OF LITERATURE

- **(Shome, Parthasarathi, 1996)<sup>1</sup>** This study examined TDS's structural framework, highlighting its function as a tool for "quick and smooth collection" of taxes and not just as a collection mechanism. The authors concluded that creating a strong audit trail through TDS is critical for making tax evasion difficult and minimising the cost of collection.
- **(Murugan and Sekar, 2019)<sup>2</sup>** This study examined how well TDS performed against the fundamental canons of taxation: equity, certainty, and economy. The authors argue that, TDS serves as an essential preventive

measure by obtaining income data at the time of generation, ensuring a regular flow of revenue to the government and has become the backbone of direct tax collection in India.

- **(Manish Kumar, 2025)<sup>3</sup>** This study discusses the future direction of India's tax laws, especially, the proposed Direct Tax Code. This study argues that, integrating TDS with strong digital infrastructure and streamlined regulations will minimize tax evasion in the future by lowering litigation and increasing voluntary compliance.
- **(Ministry of Finance & CBDT, Various Years)<sup>4</sup>** These sources emphasise the relationship between expanded TDS coverage and higher tax buoyancy. This data shows a shift from post-assessment recovery to proactive compliance as information from TDS is now used to prefill Income Tax Return to prevent evasion loops.

## METHODOLOGY

The current study uses the research design of descriptive and analytical to study Tax Deducted at Source (TDS) as an effective tool of reducing tax evasion in India. The research is wholly based on the secondary data and covers a period of 12 financial years, FY 2013-14 to FY 2024-25, thus providing an adequate long-term trend analysis and a structural analysis of the performance of the TDS company.

This study is a quantitative one and focuses on the national data on the macro-level. Its main goal should be to identify trends in TDS collections, their ratio to the total direct taxes, and correlation to the growth of the tax base. The analytical method analyses numerical data with the help of the statistical method like trend analysis, growth rate analysis and ratio analysis.

Since the research uses the national-level financial data, no primary survey or sampling of the respondents is carried out. The sample is the annual financial data of 12 fiscal years (FY 2013-14 till FY 2024-25). The financial year is the unit of analysis, and the data comprises of aggregate values of the TDS collections, total direct tax revenue, and the total number of the income-tax returns submitted.

## SOURCES OF SECONDARY DATA

The data has been collected from official government publications and reliable public sources, including:

- Income Tax Department
- Central Board of Direct Taxes
- Ministry of Finance
- Union Budget documents and Economic Surveys

These sources ensure authenticity, reliability, and consistency in financial reporting.

## TOOLS AND TECHNIQUES USED

The study employs the following analytical tools:

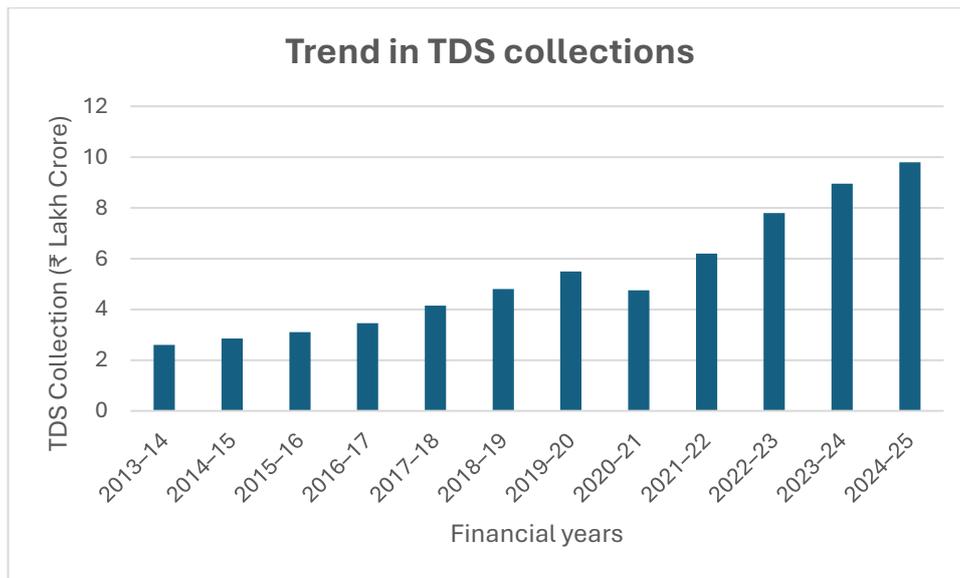
- Trend analysis
- Percentage analysis
- Compound Annual Growth Rate (CAGR)
- Ratio analysis (TDS as a percentage of total direct tax collections)
- Comparative year-wise growth analysis

Ratio analysis plays a central role in determining the relative contribution of TDS to overall tax revenue and assessing its effectiveness as a compliance mechanism.

**ANALYSIS & INTERPRETATION**

1. Trend in TDS collections (Lakh Crore).

Financial Year	TDS Collection (₹ Lakh Crore)
2013-14	2.6
2014-15	2.85
2015-16	3.1
2016-17	3.45
2017-18	4.15
2018-19	4.8
2019-20	5.5
2020-21	4.75
2021-22	6.2
2022-23	7.8
2023-24	8.95
2024-25	9.8



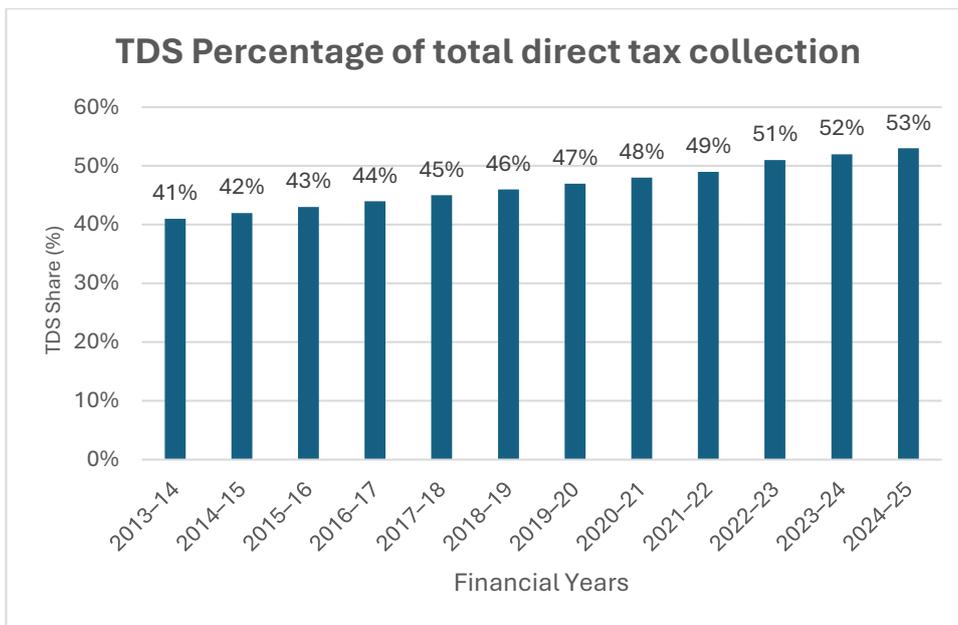
(Source: Central Board of Direct Taxes (CBDT), *Time Series Data – Direct Taxes*, Ministry of Finance, Government of India.)

Interpretation: The collections of TDS show a strong increasing parameter throughout the 12 years period. A temporary fall can be seen in FY 2020-21, which is caused by the economic slowdown as a result of the pandemic. However, the recovery is acute after the pandemic, and the rise has begun in FY 2021-22. This trend reflects the strength and structural integrity of TDS mechanism.

2. TDS Percentage of total direct tax collection

Financial Year	TDS Share (%)
2013-14	41%
2014-15	42%
2015-16	43%

2016–17	44%
2017–18	45%
2018–19	46%
2019–20	47%
2020–21	48%
2021–22	49%
2022–23	51%
2023–24	52%
2024–25	53%



(Source: Ministry of Finance, Government of India, Union Budget Documents (Receipts Budget), various years.)

Interpretation: The rate of TDS in total direct taxes has been on the upward trend of 41 to 53 percent throughout the study pointing towards a structural change of using tax sources as a source of taxation and less dependency on voluntary payment of such taxes. The increasing ratio shows that there is greater compliance and less area of concealing income.

**Interpretation of Return Filing:**

There is an increase in the number of income-tax returns that have been submitted and this shows an increase in the tax base. TDS has been integrated with PAN-based digital systems enhancing the accuracy of reporting and reducing the possibility of tax evasion.

**DISCUSSION**

The results highlight that Tax Deducted at Source (TDS) has this time around become a central tool in addressing the Indian tax evasion issue. TDS collections have experienced a steady increase in the 12 years under study (FY 2013 -14 to FY 2024 25) interrupted by a short-lived constriction in the pandemic period. The growing part of the total direct tax revenue occupied by the TDS which currently constitutes 41-53 percent testifies to its growing structural significance in the taxation system.

TDS is a prevention means used to forego tax at the income generating point. It has less discretion and chances of underreporting as compared to self-assessment or voluntary payment systems. The gradual increase in the number of requests in terms of the income-tax returns also confirms the thesis that TDS helps to grow the tax base and enhance the compliance behaviour.

The research contributes to the existing knowledge on the topic of public finance and taxation by providing empirical data that prove the presence of withholding-tax systems can significantly reduce evasion in underdeveloped economies. It supports theoretical hypotheses that source-based taxation increases transparency, attributes to the improvement of traceability and a stable income stream to government.

Trying to make more implications as a policy, the outcome of this means that developing TDS coverage, empowering digital reporting, and including financial database, can add more compliance power. The quantitative information analysis proves the opinion that the preventive mechanisms of taxation are more effective than the purely punitive enforcement measures.

Overall, the study confirms that TDS is not a simple revenue-gene-gathering instrument but a tactical compliance framework that enhances fiscal stability, openness, as well as responsibility of the Indian taxation framework.

## CONCLUSION

This study examined Tax Deducted at Source (TDS) as a critical administrative mechanism for minimizing tax evasion in India and strengthening overall tax compliance. The analysis of twelve years of national-level data reveals a consistent upward trend in TDS collections, along with a rising share of TDS in total direct tax revenue. These findings clearly indicate that TDS has evolved into one of the most reliable pillars of India's direct tax system. By ensuring that tax is collected at the point of income generation, TDS reduces dependence on voluntary self-reporting and significantly limits opportunities for income concealment.

The results further demonstrate that TDS functions not only as a revenue collection tool but also as a preventive compliance mechanism. Its integration with digital platforms and PAN-based reporting systems has enhanced transparency, traceability, and cross-verification of income data, thereby improving the ability of tax authorities to detect non-compliance. The steady growth in income-tax return filings alongside increasing TDS collections supports the argument that source-based taxation contributes to the expansion of the tax base and encourages formalization of economic activity.

However, the study also recognizes that TDS alone cannot eliminate tax evasion. Challenges such as compliance burden on deductors, refund delays, and limited effectiveness in cash-intensive and informal sectors restrict its full potential. Therefore, TDS should be viewed as a core component of a broader anti-evasion strategy rather than a standalone solution.

Overall, the study concludes that TDS plays a decisive role in strengthening fiscal stability, promoting transparency, and fostering a culture of compliance in India. Continuous rationalization of TDS provisions, further digital integration, and simplification of procedures will be essential to enhance its effectiveness in the future.

## Scope for Future Research

Future studies may examine the sector-wise effectiveness of TDS, assess taxpayer perceptions regarding compliance burden, and analyze the impact of emerging technologies such as artificial intelligence and real-time reporting on the efficiency of TDS. Comparative studies between India and other developing economies may also provide valuable insights into best practices in withholding tax systems.

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