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PRESUMPTIVE TAXATION: INDIA'S OPEN SECRET OF EASY EVASION

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ABSTRACT

Presumptive taxation in India emerged as a streamlined relief mechanism for micro- and small taxpayers overwhelmed by detailed bookkeeping and costly audits. Under this model, eligible businesses and professionals declare income at prescribed percentages of gross receipts, foregoing exhaustive account maintenance. While the regime has expanded the tax base and reduced compliance burdens, it has simultaneously generated persistent revenue leakages. Minimal documentation, inflexible turnover ceilings, and rate differentials incentivize underreporting receipts, fragmenting income across entities, and legal-form arbitrage. The Income Tax Act, 2025 (hereinafter referred to as ITA 2025) embeds presumptive provisions in Section 58, codifies a "higher-of" rule—mandating actual profits be declared when they exceed deemed income—and disallows all deductions and loss set-offs against presumptive earnings. Yet these refinements do little to address the regime's fundamental design flaws: threshold cliffs, antifragility gaps, and digital-versus-cash distortions. This article offers a comprehensive analysis of the scheme's legislative evolution; its core mechanics; principal avenues for abuse; and, in particular, how the 50% deeming rate may be manipulated. It then evaluates ITA 2025's amendments and proposes calibrated reforms—aggregation rules, sectoral safe harbours, data-driven triggers, reimbursement carve-outs, calibrated digital incentives, and flexible entry–exit protocols—that can preserve simplicity while fortifying revenue integrity.

Keywords

Presumptive Taxation, Income Tax Act 2025, Higher-Of Rule, Turnover Thresholds, Tax Base Erosion, Income Fragmentation, Aggregation Rules, Digital Transaction Incentives.

I. INTRODUCTION

Designing a tax regime that captures revenue from millions of small enterprises and professionals without overburdening them or the revenue authorities has long challenged Indian policymakers. Presumptive taxation answers this call by calculating taxable income as a fixed percentage of gross receipts, dispensing with granular books of account. The model has indeed broadened tax coverage, reduced audit volumes, and encouraged voluntary compliance.

However, the very simplicity that makes presumptive taxation attractive also renders it vulnerable. Tax authorities, deprived of detailed financial statements, struggle to verify reported income. Rigid turnover thresholds at ₹2 crore for businesses and ₹75 lakh for professionals create policy "cliffs," prompting behavioural bunching below ceilings. Legal-form eligibility spurs form-shopping, converting genuine economic activities into structures tailored to lighter tax treatment. Timing receipt recognition, splitting income streams across related persons, and embedding personal expenses within client reimbursements amplify leakage.

The Income Tax Act, 2025 consolidates presumptive rules under Section 58 and introduces two key safeguards: a "higher-of" rule requiring declaration of actual profits if they exceed deemed income, and a blanket disallowance of deductions and loss set-offs

against presumptive earnings. While these changes enhance revenue capture at ultra-high margins, they leave intact the regime's core opacity.

This article unfolds in nine parts. Part III outlines statutory foundations. Part IV surveys general abuse vectors. Part V analyses how the 50% deeming rule may be abused. Part VI identifies design features that magnify revenue erosion. Part VII evaluates ITA 2025's amendments. Part VIII proposes targeted reforms. Part IX concludes with strategic recommendations.

II. THE SCHEME IN BRIEF

A. Statutory Foundations

1. Section 44AD of the Income-tax Act, 1961 applies to resident individuals, Hindu undivided families, and partnership firms (excluding LLPs) engaged in eligible business activities with gross receipts or turnover not exceeding ₹2 crore in a financial year. Taxpayers may declare income at 8% of gross receipts, or 6% if receipts are received through banking channels or digital transactions.
2. Section 44ADA extends presumptive taxation to specified professionals—lawyers, accountants, architects, engineers, medical practitioners, technical consultants, and others—whose gross receipts do not exceed ₹50 lakh per annum (raised to ₹75 lakh for certain practitioners). Under this provision, deemed profits are fixed at 50% of gross receipts, with no requirement for books or audit.
3. Section 44AE governs owners of goods carriages. Operators of up to ten vehicles may compute income at prescribed per-vehicle monthly rates rather than actual profits, simplifying compliance for small transport entrepreneurs.

B. Historical Uptake and Revenue Share

Since its 1994 inception, presumptive taxation has expanded rapidly. By FY 2023–24, over 1.2 million taxpayers—roughly 25% of the individual and HUF base—opted for Sections 44AD and 44ADA, contributing approximately 4.8% of net direct tax collections. The regime's draw lies in its no-audit status, predictable liability, and minimal record-keeping costs.

C. Consolidation Under ITA 2025

The Income Tax Act, 2025 (hereinafter referred to as ITA 2025) integrates Sections 44AD, 44ADA, and 44AE into consolidated Section 58. It retains existing deeming percentages and turnover thresholds while enacting two pivotal clarifications:

i. If actual profits exceed deemed income, the taxpayer must declare the higher figure ("higher-of" rule).
ii. No deductions or loss set-offs—whether intra-head or inter-head—are permissible against presumptive income.

These amendments aim to deter superficial use of presumptive rates when actual margins are substantially higher. Nevertheless, by preserving hard turnover ceilings and audit exemptions, ITA 2025 leaves the fundamental temptations for evasion untouched.

III. HOW PRESUMPTIVE TAXATION INVITES ABUSE

A. Turnover Suppression

Because taxable income is a direct function of declared receipts, cash-intensive entities have strong incentives to understate turnover. In the absence of mandatory ledgers or audited statements, authorities lack corroborative evidence. Seasonal traders—festival caterers, wedding planners—commonly defer or split recognition of receipts around year-end to calibrate eligibility.

B. Receipt Fragmentation

Taxpayers may fragment operations across multiple entities—proprietorships, partnership firms, family trusts—ensuring each unit remains within turnover thresholds. A construction

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consultant with ₹2.5 crore in receipts might split business between two sister partnerships, each just below ₹1.25 crore. The economic substance is unified, yet audit triggers vanish. Existing anti-fragmentation rules rely on subjective notions of "common control" or "common clients," enforced sporadically.

C. Form Shopping

By privileging certain legal forms, the regime invites opportunistic structuring. LLPs fall outside Section 44AD's ambit, while partnerships can qualify for Sections 44AD or 44ADA under tailored conditions. A corporate consultancy may reconstitute as a partnership to benefit from the 50% deeming rate—despite operating identically. Definitions of "eligible business" and "specified profession" leave sufficient ambiguity for legal-form arbitrage.

D. Timing Games

Under the "receipt" principle, taxpayers can time invoices near year-end to manipulate turnover. A medical practitioner might accelerate high-fee procedures before March 31 to maximize presumed income in a low-margin year, then defer routine consultations into the next financial year. Such temporal shaping exacerbates enforcement challenges in the absence of real-time data matching.

E. Fleet Dilution in Transport

Transport operators may assign high-profit routes to a subset of vehicles while transferring underperformers to related parties. Each proprietor maintains presumptive eligibility, yet the aggregated operation enjoys disparate route profitability.

These tactics arise organically from the regime's design: minimal documentation, threshold cliffs, and a deeming formula decoupling tax liability from economic reality.

IV. HOW THE 50% RULE CAN BE ABUSED

i. **Margin Capping in High-Fee Practices:** Professionals in high-margin niches—litigation boutiques, cosmetic surgery centres, celebrity consulting—may treat the statutory 50% deeming rate as an absolute cap on taxable income. Even with ITA 2025's "higher-of" rule, strategic under-invoicing can preserve the presumptive ceiling for years when actual profits exceed 50%.

ii. **Fragmentation of Receipts Across Entities:** A senior practitioner could bifurcate receipts—billing personally up to ₹75 lakh, while routing overflow through a family-controlled nonprofit or Section 8 entity. Each stream separately claims presumptive status, allowing aggregate receipts to surpass ₹1 crore without triggering detailed scrutiny.

iii. **Embedding Personal Expenses in Gross Receipts:** Since expense details are ignored, personal consumption may be embedded within purported reimbursements—luxury travel booked as client-advanced costs, household utilities disguised as office overheads. With only 50% of gross receipts taxed, the effective levy can fall far below intended levels.

iv. **Recharacterizing Remuneration as Professional Income:** Income ordinarily taxed as salary, bonus, or partner's profit share could be rerouted as professional fees in a controlled entity. The 50% deeming rate applies instead of progressive salary rates, potentially reducing total tax liability without altering economic substance.

V. DESIGN FEATURES THAT MAGNIFY LEAKAGE

i. **Low-Visibility Compliance:** With no audit requirement, authorities struggle to reconcile GST, e-invoicing, and banking data against undeveloped ledgers. This information asymmetry hampers verification.

ii. **Threshold Cliffs:** Hard turnover ceilings generate "bunching" just below ₹2 crore or ₹75 lakh, distorting business decisions to remain eligible. Such behavioural clustering is a textbook symptom of discontinuous policy thresholds.

iii. **Payment-Mode Discrimination:** The differential between 6% (digital receipts) and 8% (cash receipts) aims to boost formal

transactions. Yet in genuinely cash-dependent sectors—rural medical camps, local litigation practices—the higher rate incentivizes turnover understatement over digital adoption.

iv. **Entity Carve-Outs and Category Exclusions:** Complex carve-outs—LLPs under Section 44AD, select high-value services, certain transport categories—create a labyrinth of eligibility. Classification games—relabel, repaper, reorganize—thrive in this maze.

When simplicity sacrifices accuracy, the revenue cost is only one dimension; the more enduring loss is taxpayer confidence. Honest filers, witnessing ease of opportunistic structuring, question regime fairness.

VI. DOES ITA 2025 PRESERVE PRESUMPTIVE TAXATION?

i. **Consolidation of Provisions:** ITA 2025 reorganizes presumptive rules under Section 58, unifying small business, specified profession, and transport operator provisions without altering turnover or rate thresholds.

ii. **Higher-Of Rule and Disallowance of Deductions:** By mandating actual profit declaration when it exceeds deemed income, ITA 2025 narrows egregious margin-capping gaps. It also disallows all deductions and loss set-offs against presumptive income, closing off prior intra- and inter-head liberalities.

iii. **Equity and Revenue Implications:** While the "higher-of" rule enhances revenue capture at ultra-high margins, it leaves foundational opacity untouched. Blanket deduction disallowances risk overtaxing low-margin practitioners with legitimate expenses. Fiscal estimates suggest only a 2–3% uptick in direct tax yields from these tweaks—insufficient to offset systemic leakages, conservatively pegged at over ₹20,000 crore annually.

VII. CLOSING THE LEAKS WITHOUT KILLING SIMPLICITY

A. Antifragmentation and Aggregation Rules

- **Proposal:** Aggregate gross receipts and turnover across controlled entities, related persons, and common-client networks for eligibility and threshold tests.
- **Effect:** Neutralizes receipt fragmentation while preserving benefits for genuine small taxpayers.

B. Dynamic Sectoral Safe Harbours

- **Proposal:** Establish profession-specific deeming rates anchored in credible empirical margin data, subject to periodic review by a committee of tax officials, industry representatives, and independent economists.
- **Effect:** Aligns proxy rates with economic realities—reducing both over- and under-taxation across sectors.

C. Data-Driven Bright-Line Triggers

- **Proposal:** Leverage AIS, GST, and e-invoicing data to flag taxpayers whose receipts cluster just below thresholds or exhibit high client concentration. Trigger limited-scope reviews based on objective indicators rather than blanket audits.
- **Effect:** Enhances detection of behavioural distortions without reimposing heavy compliance across the board.

D. Reimbursement and Passthrough Cost Carve-Outs

- **Proposal:** Mandate separate disclosure of reimbursements and client-advanced costs; exclude documented passthrough amounts from gross receipts for presumptive computation.
- **Effect:** Eliminates a major conduit for embedding non-business expenses within taxable receipts.

E. Calibrated Digital Incentives

- **Proposal:** Retain the digital-receipt incentive but narrow the rate differential (e.g., 7% vs. 8%) and set a sunset timeline. Pair with targeted support—mobile POS deployment, subsidized internet—for regions with genuine connectivity gaps.
- **Effect:** Sustains digitization momentum while reducing turnover understatement in cash-centric areas.

F. Flexible Entry–Exit with Safeguards

- **Proposal:** Allow entering and exiting the presumptive regime with a brief cooling-off period and prescribed disclosures rather than punitive audit triggers. Reserve in-depth scrutiny for taxpayers with pattern-based flags.
- **Effect:** Balances taxpayer flexibility with deterrence against serial arbitrage.

VIII. CONCLUSION AND STRATEGIC ROAD MAP

Presumptive taxation was designed as an expression of trust—a system where small taxpayers enjoy simplicity and fairness, and revenue authorities focus on real abuse. Instead, its current design rewards rapid label-switching, receipt shaping, and 50%-cap gaming. ITA 2025's retention of hard turnover ceilings and minimal documentation keeps the regime vulnerable.

To honour the constitutional promise of equality and bolster the fiscal base, policymakers must look beyond rate tweaks. They must target structural enablers of evasion via aggregation rules, sectoral safe harbours, data-matching triggers, reimbursement carve-outs, calibrated digital incentives, and flexible yet guarded entry–exit protocols. Achieving these demands active parliamentary oversight, continuous stakeholder engagement, and dynamic monitoring of behavioural patterns.

A truly equitable presumptive regime will be as simple to comply with as it is arduous to game—a testament to the state's trust in honest filers and its resolve to close off every rapid lever of arbitrage.

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