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**Report of the
Comptroller and Auditor General
of India**

for the year ended March 2007

Performance Audit

**UNION GOVERNMENT
(DIRECT TAXES)
NO. PA 7 OF 2008**

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Comptroller and Auditor General of India
2008

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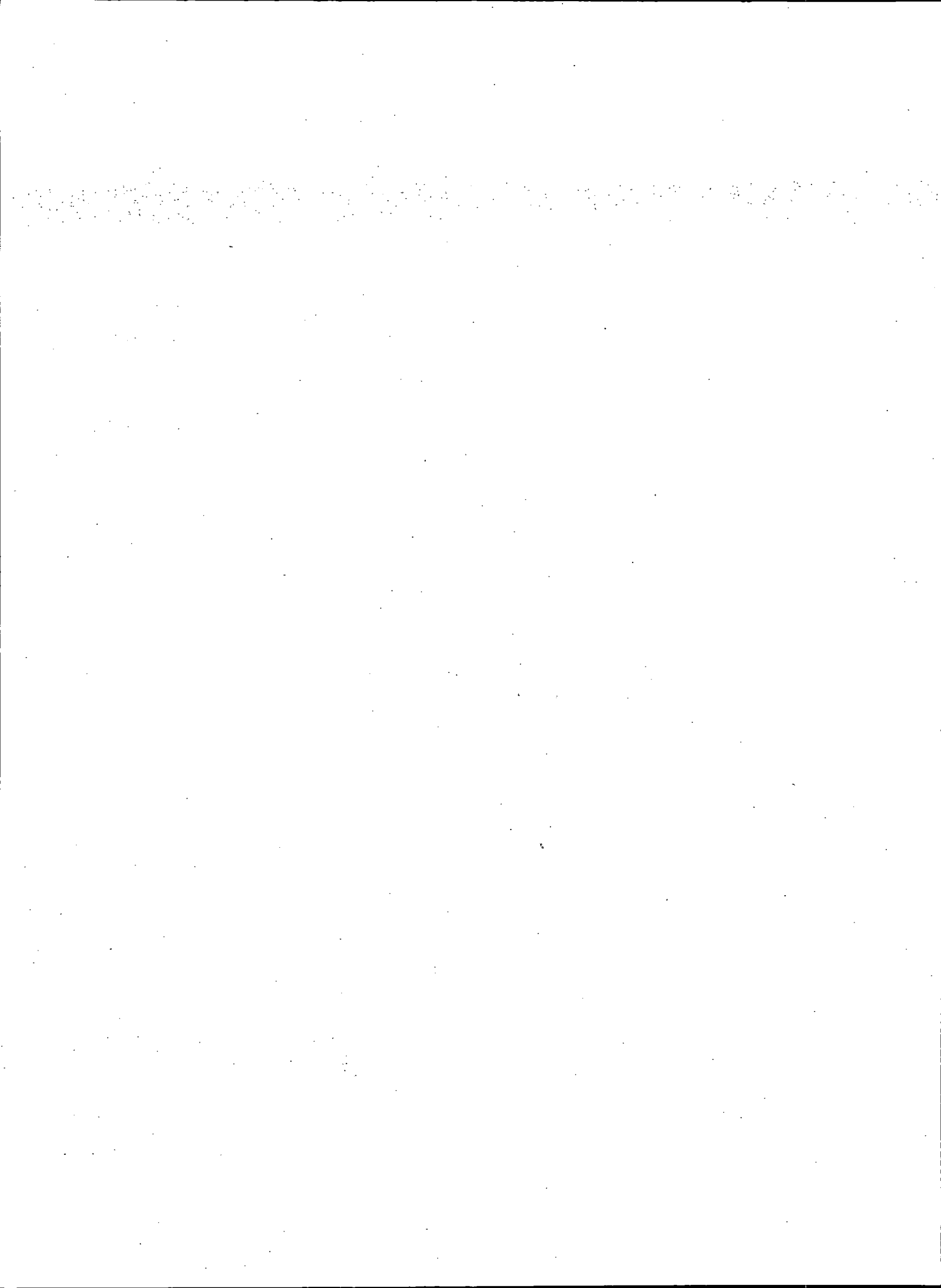
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PREFACE

The report for the year ended March 2007 has been prepared for submission to the President under Article 151(1) of the Constitution of India.

The audit of Revenue Receipts – Direct Taxes of the Union Government is conducted under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. The report presents the results of audit reviews and appraisals of receipts under direct taxes. This report is arranged in the following order:-

- (i) Chapter 1 is a broad based review on assessments of banks.
- (ii) Chapter 2 is a review on appreciation of third party reporting/certification in assessment proceedings.
- (iii) Chapter 3 is a review on assessments relating to infrastructure development (Deductions under section 80IA of the Income tax Act, 1961).

The observations included in this report have been selected from the findings of test audit conducted during 2006-2007 and in earlier years, which could not be covered in the previous reports.



Overview

I. Review on Assessments of Banks

Audit reviewed the assessments of 89 banks including public sector, private and foreign banks for the assessment years 2002-03, 2003-04, 2004-05 and 2005-06 completed after scrutiny up to March 2007 with a view to (i) evaluating compliance with the law and procedural requirements of Income Tax Act, 1961 (ii) to quantify the extent of irregularities, mistakes and omissions in the assessment of banks and (iii) examine if there is any lacuna in the Act.

Audit noticed 318 mistakes in 165 scrutiny assessments involving tax effect of Rs. 2781.38 crore. Audit observed areas with high revenue impact on account of systemic issues such as incorrect allowance of bad debts written off, incorrect allowance of provision for bad and doubtful debts, incorrect depreciation on valuation of investments made by banks etc. Audit also observed cases with potential impact on levy of tax such as non correlation of figures of bad and doubtful debts, deductions towards advances given by rural branches etc. Besides, other irregularities of non-compliance such as incorrect allowance of expense towards exempt income, deductions, income not offered to tax and incorrect set off of losses were noticed.

Audit recommends that:

- The Ministry may strengthen its internal controls such as ensuring regular review of assessments of banks at an appropriate level, that all such cases are checked by internal audit etc.
- The Ministry may prescribe a checklist for the assessing officers requiring them to check that the bad debts to be written off have been debited to the provision for bad and doubtful debt account and that the credit balance of provision for bad and doubtful debt account of earlier years have been considered before allowing the same.
- The Ministry may also consider devising a system where the assessing officer can take cognizance of the credit balance available in the provision for bad and doubtful debt account pertaining to earlier years in respect of banks.
- The Ministry may strengthen its internal controls so that deductions to rural branches of banks are allowed only after suitable verification by the assessing officer so as to safeguard the interests of revenue.
- The Ministry may consider introducing a suitable provision in the statute relating to valuation of investments by banks.

II. Review on Appreciation of Third Party Reporting/Certification in Assessment Proceedings

Audit reviewed the assessment records of corporate and non corporate assesseees (excluding who are salaried) completed during the period from 2004-05 to 2006-07 with a view to (i) ensure that the tax audit reports were complete in themselves to provide sufficient and requisite information to the assessing officer, thereby aiding him in completing the assessment as required under the Act, (ii) determine the extent to which the assessing officers have evaluated and utilised information provided in prescribed reports while completing assessments, and (iii) determine the effectiveness of the Department's internal control mechanism in ensuring that the objective of obtaining a report from a third party (the accountant) is fulfilled.

Audit observed a total of 2874 cases of irregularities having a value of Rs. 849.16 crore with revenue impact of Rs. 665.67 crore (including penalty of Rs. 41.52 crore).

Audit observed cases where action was not taken in terms of the provisions of the Act for furnishing of inadequate information in the tax audit reports. Audit also observed cases where the assessing officers did not take action to make additions or disallowances although there were omissions in the tax audit reports. Further, cases were noticed where the assessing officers did not utilise the information available in the tax audit reports/certificates while finalising assessments.

Audit observed that the internal control mechanism in the Department to ensure that (i) the audit reports/certificates were complete and provided sufficient and requisite information to the assessing officer, (ii) information which is provided in the audit reports is being effectively utilised by the assessing officers and (iii) cases are selected for scrutiny assessment on the basis of tax audit reports, is not effective.

Audit recommends that:

- The Ministry may ensure taking of action in terms of instruction no.1959 and section 288 of the Act, in cases where inadequate/inaccurate information have been furnished in the tax audit reports
- The Ministry may issue instructions to ensure that assessing officers critically examine the tax audit reports along with the connected records and other available evidence so as to make an independent assessment in each case.
- The Ministry may ensure that information as available from the tax audit reports/certificates is effectively utilised in finalising the assessments.
- The Ministry needs to strengthen its internal control and monitoring mechanism to ensure compliance with the instructions, rules, circulars and provisions of the Income Tax Act, 1961.

III. Review on assessments relating to infrastructure development (Deductions under section 80IA of the Income Tax Act)

Audit reviewed the assessment records of the assessee engaged in infrastructure development and claiming deduction under section 80IA of the Income Tax Act completed during the financial years 2003-04 to 2006-07 (upto the date of audit) with a view to (i) determine the extent of underassessment/loss of revenue due to mistakes in assessment, (ii) determine the degree of compliance by the specified undertakings or enterprises with the provisions of the Act, and (iii) derive an assurance that the systems and procedures are sufficient and promote compliance with the provisions of the Act/rules.

During the review audit test checked 685 assessments in company and non company circles involved in the specified infrastructure activity for verifying the claims of deduction under section 80IA of the Act. Audit observed mistakes in 91 cases having a value of Rs. 2037.22 crore and revenue impact of Rs. 932.29 crore.

Audit observed areas with high revenue impact on account of systemic issues such as incorrect allowance of deduction without adjustment of losses and depreciation relating to eligible units, incorrect allowance of deduction on other income, benefit of deduction allowed to ineligible assessee, etc. Audit also observed cases with potential impact on levy of tax such as excess deduction due to non restriction of profits to the reasonable profit derived from captive power plants, etc. Audit study also revealed that major companies providing telecommunication services had either not claimed or could not avail of the deduction under section 80IA provided in the Act as they were either operating under losses or were being assessed under special provisions of the Act which does not take into account deductions under section 80IA.

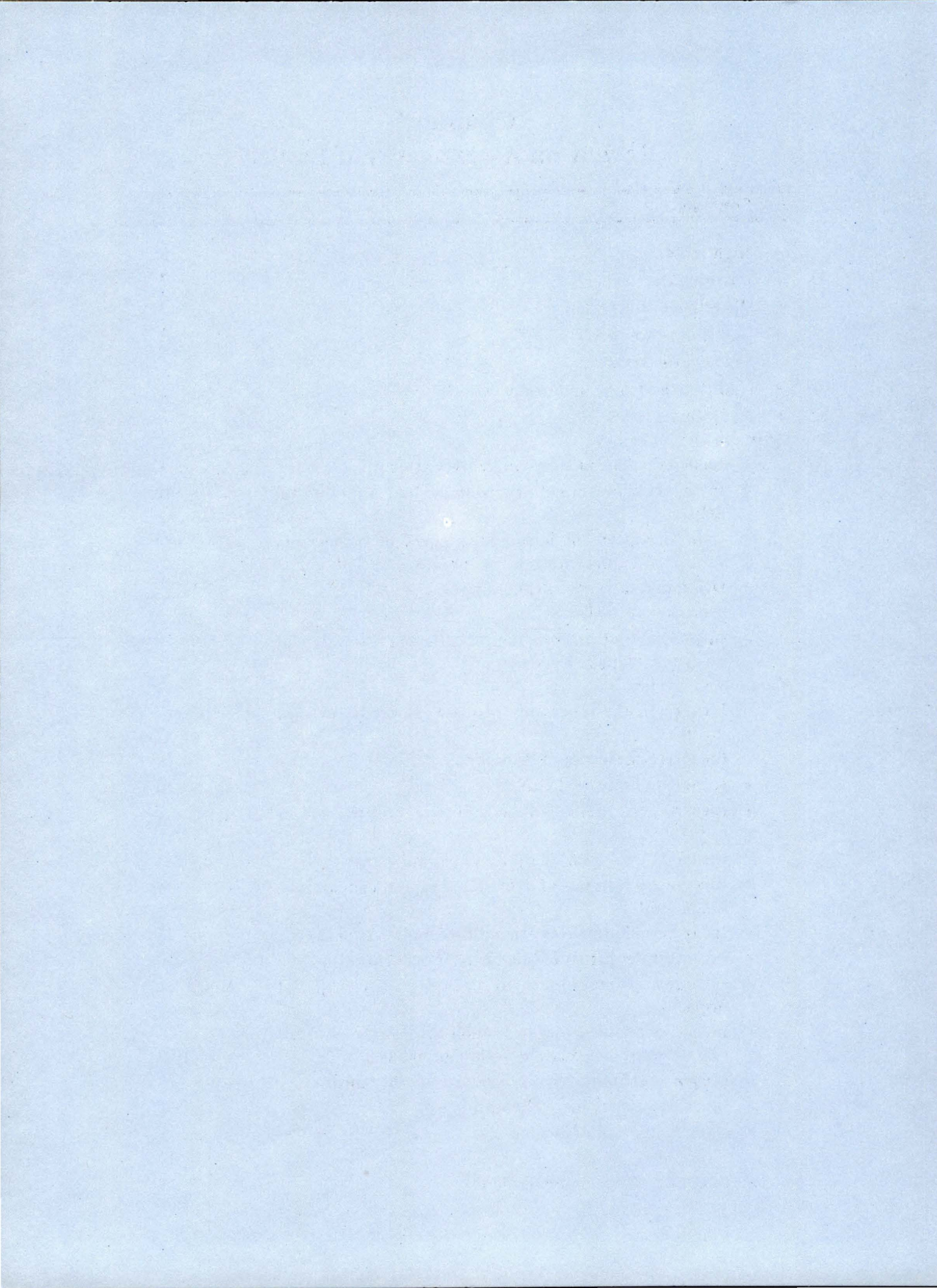
Audit recommends that:

- The Ministry may consider making it mandatory for the assessee availing of 80IA deduction to furnish separate accounts and audit report from the first year of commissioning of the eligible project even for those years in which the deduction was not claimed. Assessment orders should clearly specify the details of losses to be carried forward for set off in future years for the eligible and ineligible units separately.
- The Ministry may consider incorporating a provision in the rules so that the tax audit report in Form no. 10CCB specifies the basis of apportionment/allocation of common expenses especially with regard to composite business where assessee have both eligible and ineligible units.
- The Ministry may strengthen its internal control mechanism to ensure that the assessing officers correctly apply the provisions of the Act in respect of deductions extended to works contractors.
- The Ministry may like to examine the availment of deduction under section 80IA by the specified sectors and also carry out an impact analysis in order to ensure that the policy objectives of the government are achieved.

Chapter I

Review on Assessments of Banks

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Highlights

Audit reviewed the assessments of 89 banks including public sector, private and foreign banks for the assessment years 2002-03, 2003-04, 2004-05 and 2005-06 completed after scrutiny up to March 2007 with a view to (i) evaluating the compliance with the law and procedural requirements of Income Tax Act, 1961 (ii) quantify the extent of irregularities, mistakes and omissions in the assessment of banks and (iii) examine if there is any lacuna in the Act.

(Paragraphs 1.2 and 1.5.2)

Systems issues

Audit noticed mistakes in 53 percent of the scrutiny assessments of banks. Total tax effect of audit observations was nine percent of the tax payable in respect of all assessments of banks seen in audit.

(Paragraph 1.7.1)

Audit noticed mistakes in 46 assessments of banks involving tax effect of Rs. 1,719.78 crore relating to incorrect allowance of bad debts written off and incorrect allowance of provision for bad and doubtful debts. Audit also observed areas with high potential revenue impact on account of systemic issues such as differences in figures of bad and doubtful debts and non verification of advances given by rural branches of the banks.

(Paragraph 1.8.1)

There was excess allowance of bad debts written off to M/s State Bank of India involving short levy of tax of Rs. 1,058.70 crore.

(Paragraph 1.9.4)

Audit noticed mistakes in 12 cases involving tax effect of Rs. 164.41 crore while allowing depreciation on valuation of investments made by banks. In the case of M/s Vijaya Bank, incorrect depreciation allowed without considering the appreciation of investments resulted in short levy of tax of Rs. 117.08 crore.

(Paragraphs 1.14.2 and 1.14.3)

Compliance issues

Incorrect allowance of expenses towards exempt income in 20 cases involved tax effect of Rs. 164.97 crore. In the case of M/s Canara Bank, proportionate expenditure on exempt income was allowed incorrectly resulting in short levy of tax of Rs. 83.04 crore.

(Paragraphs 1.15.3 and 1.15.4)

Incorrect allowance of set off of losses in respect of **M/s Oriental Bank of Commerce** resulted in potential tax effect of Rs. 69.08 crore.

(Paragraph 1.18.4)

Incorrect computation of tax on capital gains made by **M/s ICICI Bank Ltd.** resulted in short levy of tax of Rs. 51.97 crore.

(Paragraph 1.19.2)

In the case of **M/s Standard Chartered Grindlays Bank**, tax was calculated on the returned income instead of assessed income resulting in short levy of tax of Rs. 63.86 crore.

(Paragraph 1.25.5)

Audit recommends that

- The Ministry may strengthen its internal controls such as ensuring regular review of assessments of banks at an appropriate level, that all such cases are checked by internal audit etc.
- The Ministry may prescribe a checklist for the assessing officers requiring them to check that the bad debts to be written off have been debited to the provision for bad and doubtful debt account and that the credit balance of provision for bad and doubtful debt account of earlier years have been considered before allowing the same.
- The Ministry may also consider devising a system where the assessing officer can take cognizance of the credit balance available in the provision for bad and doubtful debt account pertaining to earlier years in respect of banks.
- The Ministry may strengthen its internal controls so that deductions to rural branches of banks are allowed only after suitable verification by the assessing officer so as to safeguard the interests of revenue.
- The Ministry may consider introducing a suitable provision in the statute relating to valuation of investments by banks.

Review on Assessments of Banks

1.1 Introduction

Banks play a very important role in the functioning of the organised financial sector of the economy. The banking system can be broadly classified into the organised and the unorganised banking systems. The unorganized banking system comprises moneylenders, indigenous bankers, landlords, traders, etc. The organized banking system comprises scheduled banks and non-scheduled banks that are permitted by Reserve Bank of India (RBI) to undertake banking business. Scheduled banks are those banks that are included in the Second Schedule of the RBI Act, 1934, subject to certain conditions. A scheduled bank can be a public sector bank, a private bank or a foreign bank. The main sources of revenue for banks are interest from loans and advances, income from government securities and dividend, interest from private sector equity investment and debt instruments, income from trading in shares, guarantee commission, treasury and foreign exchange operations, etc. This review of the income tax assessments of banks under Income Tax Act, 1961 (the Act) has been conducted in view of the growing importance of the banking sector.

1.2 Objective of the review

The review seeks to:

1.2.1 Evaluate the degree of compliance by the public sector banks, private banks and foreign banks, with the law and procedural requirements of the Income Tax Act, 1961.

1.2.2 Quantify the extent of irregularities, mistakes and omissions in the assessment of banks made under various provisions of the Act.

1.2.3 Examine whether there is any lacuna in the Act and its application leading to evasion of tax liabilities.

1.3 Law and procedure

Banking operations are governed by the regulations/guidelines issued by the RBI from time to time. Further, deductions and exemptions available under the Income Tax Act to a company, such as depreciation, carry forward of loss, capital gains, interest income under certain circumstances, etc are applicable to banks as well. However, some of the provisions contained in sections 36(1), 41, 43D, 44C, etc. of the Act have special reference to the admissibility of deductions and exemptions relating to banking companies. These are briefly mentioned below:

1.3.1 Deduction towards bad debts under section 36(1)(vii)

Deduction relating to any bad debt or part thereof written off shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under that clause.

1.3.2 Deduction towards provision for bad and doubtful debts under section 36(1)(viii)

In respect of any provisions for bad and doubtful debts made by a bank, an amount not exceeding 5 percent up to 31 March 2003 and thereafter 7.5 percent of the total income (computed before making any deduction under this clause and Chapter VIA of the Act) and an amount not exceeding 10 percent of the aggregate average advances made by rural branches of such banks computed in the manner prescribed under the Income Tax Rules, 1962, shall be allowed as deduction, while computing the business income of the assessee.

1.3.3 Recovery of bad debts written off taxable under section 41(4)

Section 41(4) of the Act provides that where a deduction has been allowed under section 36(1)(vii) and if the amount subsequently recovered on any such debt or part thereof is greater than the difference between the debt or part of the debt and the amount so allowed, the excess shall be deemed to be the profits and gains of business or profession and is accordingly chargeable to income tax as income of the previous year in which it is recovered.

1.3.4 Interest accrued on bad and doubtful debts under section 43D

In the case of a scheduled bank, income by way of interest on such categories of bad and doubtful debts as may be prescribed (Rule 6EA of Income Tax Rules) having regard to the guidelines issued by the Reserve Bank of India in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said institution for that year or in the previous year in which it is actually received by them, whichever is earlier.

1.3.5 Head office expenses in the case of foreign banks under section 44C

In the case of an assessee being a non resident, no allowance shall be made in computing the income chargeable under the head "Profits and gains of business or profession", in respect of so much of the expenditure in the nature of head office expenditure as is in excess of the amount computed as under namely:

- (a) an amount equal to 5 percent of adjusted total income¹; or

¹ For definition refer Appendix 1.

(b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee, as is attributable to the business or profession of the assessee in India, whichever is the least,

provided that in a case where the adjusted total income of the assessee is a loss, the amount under clause (a) shall be computed at the rate of 5 percent of the average adjusted total income¹ of the assessee.

1.4 Scope of the review

1.4.1 The review covered all scrutiny assessments of the public sector banks, private banks and foreign banks for the assessment years 2002-03, 2003-04, 2004-05 and 2005-06 completed up to March 2007. Returns for the assessment year 2005-06, where scrutiny assessment was pending, were not included in the review. Returns for assessment years 2002-03 and 2003-04 processed in summary manner and not selected for scrutiny were also included in the scope of the review. Wherever cases of irregularities were noticed, the assessment records of the preceding years have also been examined, to the extent made available. Co-operative banks were excluded from the scope of the review.

1.5 Audit methodology and sample size

1.5.1 A list of banks was prepared from different sources such as Capitaline Plus, a private database available in the market, Reserve Bank of India, Income tax Department, Registrar of Companies etc. The assessment wards/circles where these banks were assessed were identified on the basis of records available with audit as well as with the Income tax Department. The assessment records were then requisitioned and audit checks carried out.

1.5.2 Audit requisitioned all assessments relating to 89 banks so identified pertaining to the assessment years 2002-03 to 2005-06. Two hundred ninety eight scrutiny assessments and 11 summary assessments were produced and subjected to audit scrutiny.

1.5.3 Copies of the draft review reports containing audit observations were issued to the respective Chief Commissioners of Income Tax/Commissioners of Income Tax by the Director General/Pr. Directors of Audit/Pr. Accountants General/Accountants General during the period from June 2007 to July 2007.

1.6 Acknowledgement

1.6.1 Indian Audit and Accounts Department acknowledges the cooperation of the Income tax Department in providing the necessary records and information for audit. The draft review report was issued to the Ministry in November 2007. An exit conference was held in December 2007 with the Central Board of Direct Taxes (Board) to discuss the results of this review. The views expressed by them in the exit conference have been appropriately incorporated in this report.

1.7 Audit findings

1.7.1 Audit noticed 318 mistakes in 165 scrutiny assessments involving tax effect of Rs. 2,781.38 crore. Seventeen of these assessments had been seen by the internal audit wing of the Department but the mistakes were not noticed by them. Audit also observed cases with potential impact on levy of tax such as non correlation of figures of bad and doubtful debts, deductions towards advances given by rural branches etc.

Table no. 1.1: Tax effect of audit observations on assessments of banks

Category	No. of cases checked in audit	Taxable income assessed by the Department (Rs. crore)	Tax payable ² (Rs. crore)	No. of assessments with mistakes	Tax effect (Rs. crore)	Tax effect as percentage of tax payable	Percentage of assessments with mistakes
1	2	3	4	5	6	7	8
Public Sector Banks	104	63988.62	22396.00	58	2216.99	9.9	55.8
Private Banks	94	13171.17	4609.91	57	317.61	6.9	60.6
Foreign Banks	111	11339.24	3968.73	50	246.78	6.2	45.0
Total	309	88499.03	30974.64	165	2781.38	9.0	53.4

1.7.2 It may be seen from Table no. 1.1 above that the proportion of cases with mistakes in scrutiny assessments of banks and the quantum of revenue involved are thus very high. In fact, the total tax effect of audit observations in respect of all banks was nine percent of the tax payable in respect of all assessments of banks seen in audit.

1.7.3 *Audit recommends that the Ministry may strengthen its internal controls such as ensuring regular review of assessments of banks at an appropriate level, that all such cases are checked by internal audit etc.*

1.7.4 In the exit conference, Board accepted the recommendation and stated that administrative review of assessments of banks at the level of Commissioners of Income tax is provided for and that internal audit will check all cases of banks in the new system.

1.7.5 The Department's replies have been received in 90 cases (November 2007) with tax effect of Rs. 1,772.15 crore, accepting audit observations in 39 cases with tax effect of Rs. 395.90 crore. The Department did not accept audit observations in 27 cases involving tax effect of Rs. 138.85 crore. However, it took remedial action in respect of 24 cases and raised demands totalling Rs. 1,084.46 crore. Out of this,

² Tax payable has been calculated at the rate of 35 percent of amount in column 3.

Rs. 1,058.70 crore has also been collected. Replies are still awaited in 228 cases (November 2007). The Department's replies have been incorporated in this report at appropriate places.

1.7.6 The audit observations included in this report categorised by the nature of mistake are depicted in Table no. 1.2 below:

(Rs. in crore)

Table no. 1.2: Mistakes noticed in assessments of banks									
Paragraph no.	Nature of mistake	Public Sector Banks		Private Banks		Foreign Banks		Total no. and tax effect	
		No.	Tax effect	No	Tax effect	No	Tax effect	No	Tax effect
Systems issues									
1.9	Incorrect allowance of bad debts written off	6	1499.82	10	102.96	8	44.44	24	1647.22
1.10	Incorrect allowance of provision for bad and doubtful debts	5	50.33	6	19.41	3	2.82	14	72.56
1.12	Non correlation of bad debts figures in income tax returns of banks with returns furnished to RBI	18	0	15	0	34	0	67	0
1.13	Deduction towards advances given by rural branches of bank	3	3.59	1	0	0	0	4	3.59
1.14	Incorrect allowance of depreciation on valuation of investments made by banks	3	122.29	8	39.52	1	2.60	12	164.41
Compliance issues									
1.15	Incorrect allowance of expense towards exempt income	10	140.21	10	24.76	0	0	20	164.97
1.16	Incorrect allowance of deductions	12	85.53	8	8.24	0	0	20	93.77
1.17	Income not offered to tax	9	76.65	6	2.40	0	0	15	79.05
1.18	Incorrect allowance of depreciation and set off of losses	5	78.67	8	2.48	0	0	13	81.15
1.19	Incorrect computation of tax on capital gains	0	0	1	51.97	0	0	1	51.97
1.20	Incorrect allowance of provisions, capital expenditure & liabilities	8	36.29	10	13.46	1	1.89	19	51.64
1.21	Incorrect allowance of expenditure on investments	2	0.44	4	5.86	2	40.73	8	47.03
1.22	Incorrect deduction of income from securities	2	35.52	1	2.29	1	0.44	4	38.25
1.23	Incorrect computation of income under special provisions	6	13.54	0	0	6	24.0	12	37.54

Paragraph no.	Nature of mistake	Public Sector Banks		Private Banks		Foreign Banks		Total no. and tax effect	
		No.	Tax effect	No	Tax effect	No	Tax effect	No	Tax effect
1.24	Incorrect allowance of deduction towards head office expenses/ interest relating to foreign banks	0	0	0	0	6	27.46	6	27.46
1.25	Incorrect computation of income and other mistakes	31	74.11	29	44.26	14	102.40	74	220.77
1.26 & 1.27	Non adoption of Arm's Length Price and Non recognition of income	2	0	2	0	1	0	5	0
	Total	122	2216.99	119	317.61	77	246.78	318	2781.38

1.7.7 These audit observations are discussed in the subsequent paragraphs. Audit observations with tax effect of Rs. 50 crore and above have been discussed individually in the paragraphs, whereas those with tax effect of between Rs. 50 crore and Rs. 5 crore have been shown in the tables in the body of the review. Audit observations with tax effect of between Rs. 5 crore and Rs. 50 lakh have been shown at **Appendix 2**. The tax effect of other audit observations with money value less than Rs. 50 lakh has been included in the review, although these audit observations have not been individually highlighted. Some interesting cases without money value or with lower money value have also been discussed individually in the review report.

Systems issues

1.8 Bad debts written off and provision for bad and doubtful debts

1.8.1 Deductions allowed to banks under section 36(1)(vii) and 36(1)(vii)(a) are the most significant deductions available under the Act and aggregate deductions allowed under these provisions in the assessments of banks seen in audit were Rs. 18,163 crore and Rs. 21,809 crore respectively. Audit attempted to analyse the extent to which these deductions had been correctly allowed by assessing officers while completing the assessments of banks. Audit noticed mistakes in 46 assessments of banks involving tax effect of Rs. 1,719.78 crore which are discussed at paragraph 1.9 '**Incorrect allowance of bad debts written off**' and 1.10 '**Incorrect allowance of provision for bad and doubtful debts**' below. Audit also observed areas with high potential revenue impact on account of systemic issues such as differences in figures of bad and doubtful debts and non verification of advances given by rural branches, which are discussed at paragraph 1.12 '**Non correlation of bad debts figures in income tax returns of banks with returns furnished to RBI**' and paragraph 1.13 '**Deduction towards advances given by rural branches of bank**'.

1.9 Incorrect allowance of bad debts written off

1.9.1 Section 36(1)(vii) of the Act provides that deduction on account of bad debts which are written off as irrecoverable in the accounts of the assessee can be allowed only if the assessee had debited the amount of such bad debts to the provision for bad and doubtful debt account as per the provisions of section 36(2)(v). Further, as per section 36(1)(viia), the deduction on account of bad debts shall be limited to the amount by which such debt exceeds the credit balance in the provision for bad and doubtful debts account.

1.9.2 Section 36(2)(i) also provides that no deduction shall be allowed unless such debt has been taken into account in computing the income of the previous year in which such bad debt is written off or of an earlier previous year or represents money lent in the ordinary course of business or money lending which is carried on by the assessee.

1.9.3 Audit noticed that the above provisions were not complied with while allowing deduction towards bad debts written off in 24 cases involving a tax effect of Rs. 1,647.22 crore. Four such cases are illustrated below:

1.9.4 In Maharashtra, Mumbai City 2 charge, assessments of a public sector bank, **M/s State Bank of India**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in November 2005 and March 2006 after allowing deduction of Rs. 2,309.88 crore and Rs. 2,450.87 crore for bad debts written off and deduction of Rs. 1,368.78 crore and Rs. 2,509.82 crore towards provision for bad and doubtful debts respectively. Audit scrutiny revealed that the provision for bad and doubtful debts account against which the deductions for bad debts were written off and allowed contained brought forward credit balances only and did not include the current year's provisions of Rs. 1,368.78 crore and Rs. 2,509.82 crore. Allowable deductions for bad debts written off after adding the current year's provision for bad and doubtful debts worked out to Rs. 941.10 crore and Rs. 1,276.89 crore for these two assessment years respectively. Thus, there was excess allowance of bad debts written off of Rs. 1,368.78 crore and Rs. 1,173.97 crore for the two assessment years respectively involving aggregated short levy of tax of Rs. 1,058.70 crore.

1.9.4.1 The Department did not accept the audit observation and stated that the provision allowed in the current year was meant for setting off future bad debts, and therefore could not be set off against the current year's bad debts. Department's reply is not acceptable since the provisions of clause (vii) to section 36(1) and clause (v) to section 36(2) clearly provides that only excess of bad debts over and above the provision for bad and doubtful debts account created for the purpose under clause (viia) to section 36(1) is allowable. Subsequent verification of records, however, revealed that the Department had revised the assessment under section 263 in March 2007 by disallowing excess bad debts and also recovered the entire demand of Rs. 1,058.70 crore. Further, the Department had taken the same stand as that of audit, while passing the order under section 263.

1.9.5 In Maharashtra, Mumbai City 2 charge, assessment of a public sector bank, **M/s Bank of India**, for the assessment year 2004-05 was completed after scrutiny in December 2005 allowing deduction of Rs. 132.94 crore towards bad debts written off after reducing Rs. 375.96 crore towards provision for bad and doubtful debts. Audit scrutiny revealed that no bad debts had been allowed in the assessment years 2002-03 and 2003-04 as these were only technical write offs made in the head office. However, the provision for bad and doubtful debts was allowed to the extent of Rs. 269.03 and Rs. 348.80 crore for the assessment years 2002-03 and 2003-04 respectively. Thus, at the end of assessment year 2003-04, credit balance of Rs. 617.83 crore was available in the provision for bad and doubtful debt account. While allowing bad debts of Rs. 508.90 crore for assessment 2004-05, the opening balance available in the provision for bad and doubtful debts account of Rs. 617.83 crore was not considered. This resulted in underassessment of income of Rs. 132.94 crore involving short levy of tax of Rs. 47.69 crore besides not carrying forward a credit balance of Rs. 484.89 crore (Rs. 617.83 crore –Rs. 132.94 crore) in the provision for bad and doubtful accounts involving potential tax effect of Rs. 173.95 crore.

1.9.5.1 The Department accepted (April 2007) the audit observation.

1.9.6 In Maharashtra, Mumbai City 2 charge, the assessment of a public sector bank, **M/s Bank of Baroda**, for the assessment year 2003-04 was completed after scrutiny in March 2005 by allowing a deduction of Rs. 534.68 crore for bad debts. Audit noticed that at the end of the assessment year 2002-03, credit balance of Rs. 333.67 crore was available in the provision for bad and doubtful debt account. While allowing bad debts of Rs. 534.68 crore for assessment year 2003-04, the opening balance of Rs. 333.67 crore available in the provision for bad and doubtful debt account was not considered. This resulted in underassessment of income of Rs. 333.67 crore involving potential short levy of tax of Rs. 122.62 crore.

1.9.6.1 The Department accepted (April 2007) the audit observation.

1.9.7 In West Bengal, Kolkata II charge, assessment of a public sector bank, **M/s Allahabad Bank**, for the assessment year 2003-04 was originally completed after scrutiny in March 2006 and revised in April 2006 determining a total income of Rs. 157.14 crore. Audit scrutiny revealed that the assessee had claimed Rs. 219.09 crore (Rs. 176.28 crore debited in the profit and loss account towards bad debt written off and Rs. 42.81 crore from the 'movement of provisions for NPA' as shown in the balance sheet) as deduction towards bad debt written off. The assessing officer had disallowed Rs. 42.81 crore on the ground that it did not exceed the credit balance in the provision for bad and doubtful debt account of Rs. 943.34 crore. However, bad debts of Rs. 176.28 crore also did not exceed the amount of credit balance in the provision for bad and doubtful debt account but these were not disallowed. Omission to add back Rs. 176.28 crore resulted in under assessment of income of Rs. 176.28 crore involving tax effect of Rs. 64.78 crore.

1.9.8 Five cases are shown in Table no. 1.3 below:

(Rs. in crore)

Table no. 1.3: Incorrect allowance of bad debts written off				
Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Banks				
1.	M/s United Bank of India, Kolkata II	2002-03 143(3)	Deductions of Rs. 130.53 crore on account of bad debts written off and Rs. 51.11 crore on account of provision for bad and doubtful debt were allowed. Deduction of bad debts should have been limited to the amount by which it exceeded the provision for bad and doubtful debt which was not done. This has resulted in excess deduction of bad debts written off to the extent of Rs. 79.42 crore. The Department has taken remedial action under section 263 of the Act in March 2007.	18.25
2.	M/s State Bank of Saurashtra, Bhavnagar, Ahmedabad-VI	2002-03 143(3)/250	While giving effect to an appellate order, deduction of Rs. 98.53 crore on account of bad debts written off was allowed without taking into account the credit balance of Rs. 39.40 crore in the provision for bad and doubtful debts account, which resulted in excess allowance of deduction of Rs. 39.40 crore.	13.83
Private Banks				
3.	M/s ICICI Bank, Mumbai-City 3	2004-05 143(3)	While allowing bad debts written off of Rs. 492.25 crore, credit balance of Rs. 129.13 crore available in the provision for bad and doubtful debts account was not reduced.	46.32
Foreign Banks				
4.	M/s Standard Chartered Bank, Mumbai DIT(IT)	2003-04 143(3)	While allowing bad debts of Rs. 264.75 crore, credit balance of Rs. 44.21 crore available in the provision for bad and doubtful debts account was not reduced. The Department accepted (May 2006) the audit observation.	18.57
5.	M/s Citi Bank, Mumbai DIT(IT)	2004-05 143(3)	While allowing bad debts of Rs. 31.25 crore, credit balance of Rs. 59.99 crore available in the provision for doubtful debts account was not considered	17.04

1.9.9 Ten cases are featured at serial numbers 1 to 10 of Appendix 2.

1.9.10 Incorrect allowance of technical write off of bad debts

1.9.10.1 Under section 36(1)(viiia) of the Act, the bank shall, at its option, be allowed deduction in respect of any provision made by it for any assets classified by RBI as doubtful assets or loss assets in accordance with the guidelines issued by it in this behalf, for an amount not exceeding 5 percent of the amount of such assets shown in the books of account on the last day of the previous year. As per the RBI Circular dated 1 July 2005, banks may write-off advances at Head Office level (technical write off), even though the relative advances were still outstanding in the

books of branches of the banks. No deduction towards bad debts is, however, allowable in the Income Tax Act unless such debts are written off as irrecoverable in the books of accounts of the assessee. There is no provision in the Act to allow technical write off of bad debts.

1.9.10.2 Audit noticed that the above provisions were not complied with in one case where deduction in respect of technical write off of bad debts was allowed as shown in Table no. 1.4 below:

(Rs. in crore)

Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
M/s Bank of Rajasthan Ltd, Mumbai City 3	2003-04 2004-05 143(3)	Incorrect allowance of technical write off of bad debts resulted in under assessment of income of Rs. 75.89 crore and Rs. 43.12 crore for the assessment years 2003-04 and 2004-05 respectively.	43.36

1.10 Incorrect allowance of provision for bad and doubtful debts

1.10.1 Section 36(1)(viiia)(a) of the Act provides that deduction on account of provision for bad and doubtful debts is allowable for an amount not exceeding 7.5 percent of the total income (computed before making any deduction under this clause and Chapter VIA of the Act). Provided that the bank shall, at its option, be allowed deduction in respect of any provision made by it for any assets classified by RBI as doubtful assets or loss assets in accordance with the guidelines issued by it in this behalf, for an amount not exceeding 5 percent of the amount of such assets shown in the books of account on the last day of the previous year.

1.10.2 In the case of foreign banks, deduction allowable under this clause is five percent of the total income computed before making any deduction under this clause and chapter VIA.

1.10.3 Audit noticed that the above provisions were not complied with while allowing deduction towards provision for bad and doubtful debts in 14 cases involving tax effect of Rs. 72.56 crore.

1.10.4 Three cases are shown in Table no. 1.5 below:

(Rs. in crore)

Table no. 1.5: Incorrect allowance of provision for bad and doubtful debts

Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Bank				
1.	Indian Overseas Bank, Chennai- I	2001-02 to 2003-04 143(3)	Total income for deduction on account of provision for bad and doubtful debts was computed before set off of brought forward losses. This has resulted in under assessment of income of Rs. 78.39 crore.	28.80
2.	M/s Indian Overseas Bank, Chennai I	2004-05 143(3)	Deduction of Rs. 252.26 crore on account of provision for bad and doubtful debts was allowed which included the floating provisions of Rs. 58.10 crore towards unidentified doubtful assets. Deduction for unidentified doubtful assets was not allowable.	20.84
Private Bank				
3.	M/s ING-Vysya Bank Ltd, Bangalore- I	2004-05 143(3)	Deduction of Rs. 25.89 crore towards provision for bad and doubtful debts was allowed though the assessee had provided an amount of Rs. 10 lakh towards bad and doubtful debts only. The omission to restrict the deduction to the extent of provision created resulted in underassessment of income of Rs. 25.79 crore.	12.31

1.10.5 Four cases are featured at serial numbers 11 to 14 of Appendix 2.

1.11. Thus, audit observed the maximum number of mistakes with highest revenue impact under the provisions relating to bad debts written off and provision for bad and doubtful debts. The most common mistake committed by assessing officer was that either the bad debts written off were not debited to the provision for bad and doubtful debt account of the assessee or the credit balance of provision for bad and doubtful debt account of earlier years was not considered while allowing the bad debts written off.

1.11.1 *Audit recommends that the Ministry may prescribe a checklist for the assessing officers requiring them to check that the bad debts to be written off have been debited to the provision for bad and doubtful debt account and that the credit balance of provision for bad and doubtful debt account of earlier years have been considered before allowing the same.*

1.11.2 In the exit conference, Board accepted the recommendation and stated that the concern of the checklist will be taken care of while preparing the Manual of Internal Audit.

1.11.3 *Audit recommends that the Ministry may also consider devising a system where the assessing officer can take cognizance of the credit balance available in the provision for bad and doubtful debt account pertaining to earlier years in respect of banks.*

1.11.4 In the exit conference, Board agreed to examine the issue.

1.12 Non correlation of bad debt figures in the income tax returns of banks with the returns furnished to RBI

1.12.1 The operations of the banking sector are regulated by the Reserve Bank of India under the powers given to it under the RBI Act, 1934. As per the RBI Circular dated 1 July 2005, banks are required to furnish a report on non performing assets (NPA) as on 31st March each year after the completion of audit. In this report the banks are required to show all the details about the NPAs including the amount of bad debts written off.

1.12.2 In order to verify the correctness of deductions in respect of bad debts written off and allowed in the assessment orders for the assessment years 2003-04 and 2004-05, audit called for the details of bad debts written off from RBI shown by the banks in their NPA returns. In March 2007, RBI furnished the details of NPAs written off by the banks as on March 2003 and March 2004. Audit correlated the above figures of bad debts written off in NPA returns with the corresponding figures of bad debts written off allowed in the income tax assessment orders in respect of 39 banks involving 67 assessments.

1.12.3 Audit noticed that in 64 assessments, figures of bad debts allowed in the income tax assessment orders were different from those shown by the banks in their NPA returns furnished to RBI. In 21 assessments, deductions allowed in respect of bad debts written off in the income tax assessment orders exceeded the corresponding figures furnished by the banks to RBI in their NPA returns by Rs. 1,469.74 crore. In 43 assessments, deductions allowed in respect of bad debts written off in the income tax assessment orders were lower than the corresponding figures furnished by the banks to RBI in their NPA returns by Rs. 5,157.09 crore.

1.12.4 Thus, there appears to be a wide variation in the figures of bad debts written off as furnished in NPA returns to RBI and the deductions allowed in the assessment orders.

1.12.5 *In view of the quantum of revenue involved in the deductions for bad and doubtful debts written off, audit recommends that the Ministry may examine the issue of the wide variations in the figures reported in NPA returns to RBI and the income tax returns.*

1.12.6 In the exit conference, Board stated that the issue would be examined.

1.13 Deduction towards advances given by rural branches of bank

1.13.1 Section 36(1)(viii)(a) of the Act provides that deduction in respect of provision for bad and doubtful debts not exceeding ten percent of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner shall be allowed. Rural branches have been defined as the branch of the bank situated in a place which has a population of not more than ten thousand according to the last preceding census of which the relevant figures have been published before the first day of the previous year.

1.13.2 The method for computing aggregate average advances is prescribed under Rule 6ABA of the Income Tax Rules, 1962 according to which the amounts of advances made by each rural branch as outstanding at the end of the last day of each month in the previous year shall be aggregated separately and the sum so arrived at in the case of each such branch shall be divided by the number of months. The aggregate of the sums so arrived at in respect of each of the rural branches shall be the aggregate average advances made.

1.13.3 Audit observed that deductions towards advances given by rural branches of the following banks were allowed without correlating with the population figures, aggregate average advances and monthly outstanding advances as discussed in Table no. 1.6 below:

(Rs. in crore)

Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Amount of deduction for rural advances claimed
1	M/s Indian Overseas Bank, Chennai I	2001-02 to 2004-05 143 (3)	Details regarding population of places where rural branches were located, aggregate average advances and monthly outstanding advances were not available.	583.82
2	M/s Indian Bank, Chennai I	2002-03 2004-05 143 (3)	Details regarding population of places where rural branches were located, aggregate average advances and monthly outstanding advances were not available.	217.92
3	M/s Tamil Nad Mercantile Bank Ltd, Madurai I	2001-02 to 2004-05 143 (3)	Details regarding population of places where rural branches were located, aggregate average advances and monthly outstanding advances were not available.	50.88
Total				852.62

1.13.4 One case is shown at serial number 15 of Appendix 2.

1.13.5 In the absence of details regarding population of places where rural branches were located, aggregate average advances and monthly outstanding

advances, the correctness of the deductions allowed could not be ascertained in audit.

1.13.6 *Audit recommends that the Ministry may strengthen its internal controls so that such deductions are allowed only after suitable verification by the assessing officer so as to safeguard the interests of revenue.*

1.13.7 In the exit conference, Board stated that the issue would be examined.

1.14 Incorrect allowance of depreciation on valuation of investments made by banks

1.14.1 As per the RBI guidelines dated 16 October 2000, the entire investment portfolio of the banks is required to be classified under three categories viz. Held to Maturity (HTM), Held for Trading (HFT) and Available for Sale (AFS). Investments classified under HTM category need not be marked to market and are carried at acquisition cost unless these are more than the face value, in which case the premium should be amortised over the period remaining to maturity. In the case of AFS and HFT categories, the depreciation/appreciation is to be aggregated scrip wise and only net depreciation, if any, is required to be provided for in the accounts.

1.14.2 Audit noticed non-compliance of the above RBI guidelines in 12 cases involving tax effect of Rs. 164.41 crore while allowing depreciation on investments/computation of income on investments made by banks. One such case is illustrated below:

1.14.3 In Karnataka, Bangalore Large Taxpayer Unit charge, the assessments of a public sector bank, **M/s Vijaya Bank**, for the assessment years 2003-04, 2004-05 and 2005-06 were completed after scrutiny in March 2006 and August 2006 after allowing depreciation on investments under AFS and HFT category at Rs. 97.38 crore, Rs. 39.49 crore and Rs. 424.82 crore respectively. The assessment for the assessment year 2003-04 was revised after giving effect to CIT (Appeals) order in March 2007 for an income of Rs. 121.07 crore. Audit scrutiny revealed that the assessee bank has provided for only gross depreciation instead of net depreciation in the accounts in violation of the RBI guidelines, ignoring the appreciation of investments under this category. The omission to consider appreciation of investments while allowing depreciation has resulted in under assessment of income of Rs. 97.38 crore, Rs. 39.49 crore and Rs. 172.32 crore respectively for the assessment years 2003-04, 2004-05, and 2005-06 involving short levy of tax and interest aggregating Rs. 117.08 crore for these assessment years.

1.14.4 Two cases are discussed in Table no. 1.7 below:

(Rs. in crore)

Table no. 1.7: Incorrect allowance of depreciation on valuation of investments made by banks

Sl. no.	Assessee and CIT Charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Private Banks				
1.	M/s J&K Bank Ltd., Jammu	2002-03 2003-04 143(3)	In the assessment year 2003-04, the assessee has ignored the appreciation of Rs. 20.77 crore on investments held for trading and claimed depreciation of Rs. 15.86 crore which was allowed. Since appreciation exceeded the depreciation figure, depreciation of Rs. 15.86 crore was not allowable as per RBI guidelines.	8.88
2.	M/s Bank of Rajasthan Ltd, City Central 3, Mumbai	2003-04 to 2005-06 143(3)	In the assessment years 2003-04 and 2004-05, while allowing depreciation in value of investments of Rs. 5.56 crore and Rs. 11.81 crore, appreciation of Rs. 12.56 crore and Rs. 9.63 crore respectively were ignored. In the assessment year 2005-06 depreciation in value of investments of Rs. 63.93 crore was allowed which included an amount of Rs. 6.77 crore being amortisation made on securities held under the HTM category. However, the net depreciation in the value of investments allowable worked out to only Rs. 29.98 crore after adjusting appreciation of Rs. 15.64 crore and amortisation made on securities held under the HTM category of Rs. 6.77 crore.	23.76

1.14.5 Six cases are shown at serial numbers 16 to 21 of Appendix 2.

1.14.6 Audit noticed that although the assessing officers consider the RBI guidelines relating to valuation of investments by banks at the time of processing the income tax assessment, there is no provision in the Income Tax Act or the Rules to this effect.

1.14.7 *Audit recommends that the Ministry may consider introducing a suitable provision in the statute relating to valuation of investments by banks.*

1.14.8 In the exit conference, Board agreed to examine the issue.

Compliance issues

1.15 Incorrect allowance of expense towards exempt income

1.15.1 Section 14A of the Act provides that for the purpose of computing total income under the Act, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income, which does not form part of the total income.

1.15.2 Further, section 10(23G) of the Act provides that any income by way of dividend or interest from investments made by way of shares or long-term finance advanced to any enterprise or undertaking wholly engaged in the infrastructure business shall not be included in taxable income. Section 10(15) and 10(33) of the Act provides that income by way of interest, premium on redemption or other payment on such securities issued by Central Government or any income arising from transfer of capital assets being a unit of the Units Scheme 1964 shall not be included in the total income. Section 80M of the Act provides that where the gross total income of a domestic company in any previous year includes any income by way of dividend from another domestic company, there shall be allowed in computing the total income of such domestic company, a deduction of an amount of dividend from another domestic company.

1.15.3 Audit noticed that the above provisions were not complied with while allowing deduction on account of exempt income in 20 cases involving tax effect of Rs. 164.97 crore. One case is illustrated below:

1.15.4 In Karnataka, Bangalore Large Tax Payers Unit charge, assessments of a public sector bank, **M/s Canara Bank**, for the assessment years 2002-03 and 2004-05 were completed after scrutiny in February 2005 and March 2006 determining incomes of Rs. 1,144.89 crore and Rs. 1,675.53 crore respectively. These were revised to Rs. 946.05 crore and Rs. 1,159.12 crore while giving effect to CIT (Appeal) orders in April 2006 and November 2006 after allowing Rs. 108.91 crore and Rs. 163.47 crore on account of income exempt under section 10(23G) for the two assessment years respectively. Audit scrutiny revealed that the assessee bank earned exempt interest income through long term finance advanced to infrastructure enterprise/companies and expenditure to earn such income should have been disallowed. The omission to disallow proportionate expenditure on the interest earned on long term finance advanced to infrastructure enterprise/companies resulted in under assessment of income by Rs. 95.84 crore and Rs. 136.12 crore for the assessment years 2002-03 and 2004-05 respectively with aggregate short levy of tax of Rs. 83.04 crore.

1.15.5 Four cases are shown in Table no. 1.8 below:

(Rs. in crore)

Table no. 1.8: Incorrect allowance of expense towards exempt income				
Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Bank				
1.	M/s Vijaya Bank, Bangalore-I	2003-04 to 2005-06 143(3)	Proportionate expenditure on income earned on long term finance made to infrastructure enterprises was not disallowed which resulted in incorrect allowance of expense towards exempt income of Rs. 23.04 crore, Rs. 15.02 crore and Rs. 22.01 crore in the three assessment years respectively.	21.88

Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
2.	M/s State Bank of Hyderabad, Hyderabad III	2002-03 2003-04 143(3)	Proportionate expenditure in respect of exempt income under section 10(23G) based on total exempt income to be disallowed works out to Rs. 24.35 crore and Rs. 15.76 crore against the amounts disallowed of Rs. 4.37 crore and Rs. 4.53 crore worked out by the Department on the basis of operating expenses which resulted in under assessment of income of Rs. 19.98 crore and Rs. 11.23 crore in these two assessment years respectively.	12.27
3.	M/s Syndicate Bank, Mangalore	2004-05 2005-06 143(3)	Proportionate expenditure not disallowed on income earned on long term finance made to infrastructure enterprises resulted in incorrect allowance of expense towards exempt income of Rs. 7.20 crore and Rs. 18.13 crore respectively.	9.76
Private Bank				
4.	M/s ING Vysya Bank Ltd., Bangalore-I	2003-04 2004-05 143(3)	Proportionate expenditure not disallowed on income earned on long term finance made to infrastructure enterprises resulted in incorrect allowance of expense towards exempt income of Rs. 19.47 crore and Rs. 13.16 crore respectively.	14.52

1.15.6 Eleven cases are shown at serial numbers 22 to 32 of Appendix 2.

1.16 Incorrect allowance of deductions

1.16.1 Section 43B(b) of the Act envisages that deduction towards contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees is allowable in computing total income of the assessee only on actual payment basis.

1.16.2 Section 35DDA of the Act provides that where an assessee incurs any expenditure by way of payment of any sum to an employee at the time of his retirement in accordance with any scheme of voluntary retirement, one fifth of the amount so paid shall be deducted in computing the profit and gains of the business and the balance shall be deducted in equal instalments for each of the four immediately succeeding years.

1.16.3 Audit noticed that the above provisions of the Act were not complied with in 20 cases involving tax effect of Rs. 93.77 crore. Four such cases are shown in Table no. 1.9 below:

(Rs. in crore)

Table no. 1.9: Incorrect allowance of deductions

Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Banks				
1.	M/s Andhra Bank, Hyderabad I	2001-02 & 2002-03 143(3)	Deduction of Rs. 59.28 crore paid through pension and gratuity fund in the assessment year 2001-02 and Rs. 20.53 crore towards pension fund in the assessment year 2002-03 covered under VRS was allowed in full instead of one fifth as required u/s section 35DDA of the Act. The Department has accepted (April 2007) the audit observation and taken remedial action.	29.06
2.	M/s Indian Overseas Bank, Chennai I	2001-02 2002-03 143(3)	Deduction of Rs. 87.26 crore towards gratuity and pension paid as a part of the benefits under VRS was allowed in full instead of one fifth as required u/s 35DDA of the Act.	23.44
3.	M/s Indian Bank, Chennai I	2001-02 143(3)	Deduction of Rs. 51.51 crore towards amount of gratuity, pension and leave encashment paid as a part of the benefits under VRS was allowed in full instead of one fifth as required u/s 35DDA of the Act.	16.29
4.	M/s State Bank of Hyderabad, Hyderabad III	2002-03 to 2004-05 143(3)	Deduction of Rs. 31.10 crore towards VRS was restricted to Rs. 26.14 crore under section 35DDA of the Act, based on actual expenditure incurred for assessment year 2001-02. However, in each of the assessment years 2002-03 to 2004-05, deduction of Rs. 31.10 crore was not restricted to Rs. 26.14 crore resulting in excess allowance of deduction of Rs. 4.96 crore in each of assessment years .	5.77

1.16.4 Twelve cases are shown at serial numbers 33 to 44 of Appendix -2**1.17 Income not offered to tax**

1.17.1 Section 41(4) of the Act provides that where a deduction has been allowed under section 36(1)(vii) and if the amount subsequently recovered on any such debt or part thereof is greater than the difference between the debt or part of debt and the amount so allowed, the excess shall be deemed to be the profits and gains of business or profession and accordingly, chargeable to income tax as income of the previous year in which it is recovered.

1.17.2 Section 41(1) of the Act provides that where an allowance or deduction has been made in the assessment for any year in respect of loss/expenditure or trading liability incurred by the assessee and subsequently during any previous year, the amount was obtained by way of remission or cessation of liabilities thereof (in cash or any other manner), then the income realised should be treated as profits chargeable to tax.

1.17.3 Section 43D of Act, provides that income by way of interest on such categories of bad and doubtful debts as may be prescribed (Rule 6EA of Income Tax Rules, 1962) having regard to the guidelines issued by the Reserve Bank of India in relation to such debts, shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said institution for that year or in the previous year in which it is actually received by them, whichever is earlier. As per RBI guidelines, any recovery is required to be first appropriated towards interest and then to the principal portion.

1.17.4 It has been judicially held³ that where the assessee financial institution is following mercantile system of accounting, interest in respect of "sticky loans" debited to debtor and credited to suspense account is to be treated as the income of the assessee on accrual basis.

1.17.5 It has been judicially held⁴ that if an amount was received in the course of trading transactions, even though it was not taxable in the year of receipt as being of revenue character, when the amount became assessee's own money because of limitation or by any other statutory or contractual right, the character of the amount would change. In such an event, the amount should be treated as income of the assessee.

1.17.6 Audit noticed that the above provisions were not complied with in 15 cases involving tax effect of Rs. 79.05 crore. Four cases are shown in Table no. 1.10 below:

(Rs. in crore)

Table no. 1.10: Income not offered to tax				
Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Bank				
1.	M/s Indian Overseas Bank, Chennai I	2001-02 143(3)	As the liability towards unclaimed balances of Rs. 37.20 crore and gulf war claims payable of Rs. 51.94 crore ceased to exist after a period of three years, it was required to be treated as income.	35.26
2.	M/s Indian Overseas Bank, Chennai I	2002-03 143(3)	A deduction of Rs. 80.48 crore towards short claim under Foreign Currency Non Resident account (FCNR) was allowed for the assessment year 2002-03. As seen from the records relevant to the assessment year 2004-05, the bank had admitted settlement of the claims under FCNR account by the Government to an extent of Rs. 36.97 crore. Consequent on the cessation of liability to the extent of Rs. 36.97 crore, this amount was required to be treated as profits under section 41(1) of the Act.	13.26

³ Banaras State Bank vs Commissioner of Income Tax (210 ITR 129) SC

⁴ M/s TV Sundaram Iyengar & Sons (222 ITR 344) SC

Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
3.	M/s State Bank of Mysore, Bangalore III	2002-03 to 2004-05 143(3)	Recoveries of Rs. 10.44 crore, Rs. 9.10 crore and Rs. 12.63 crore received from bad debts written off in the earlier years were reduced from the net profit though the receipt from bad debts were required to be taxed under section 41(4) of the Act.	11.60
4.	M/s State Bank of Saurashtra, Ahmedabad VI	2004-05 143(3)	Interest of Rs. 13.99 crore on sticky advance was debited to the debtor's account as per mercantile system of accounting but the corresponding amount taken to suspense account was not treated as income. This is taxable based on apex court's judgment 210-ITR-129.	6.53

1.17.7 Seven cases are shown at serial numbers 45 to 51 of Appendix 2.

1.18 Incorrect allowance of depreciation and set off of losses

1.18.1 Section 32 of the Act provides that deduction on account of depreciation on block of 'plant and machinery' and other assets is admissible at the prescribed rates while computing the business income of the assessee, if these are owned by the assessee and used for the purpose of business during the relevant previous year.

1.18.2 Section 72 of the Act provides that where the net result of the computation under the head 'Profits and gains of the business or profession' is a loss to the assessee and such loss including depreciation cannot be wholly set off against income under any other head of the relevant year, so much of the loss as has not been set off shall be carried forward to the following assessment year/years to be set off against the 'Profits and gains of business or profession'.

1.18.3 Audit noticed that allowance of depreciation and set off of losses were allowed in excess in 13 cases involving tax effect of Rs. 81.15 crore. One case is illustrated below:

1.18.4 In Delhi V charge, the assessment of a public sector bank, **M/s Oriental Bank of Commerce**, for the assessment year 2005-06 was completed after scrutiny in March 2006 determining an income of Rs. 664.18 crore. Audit scrutiny revealed that the assessee claimed and was allowed set-off of losses of Rs. 228.52 crore of M/s. Global Trust Bank (amalgamated with M/s. Oriental Bank of Commerce) for the assessment year 2004-05. Further scrutiny of assessment records of M/s. Global Trust Bank for assessment year 2004-05 completed after scrutiny in November 2006 revealed that losses allowed to be carried forward were Rs. 35.95 crore only. The mistake resulted in underassessment of income of Rs. 192.57 crore involving potential tax effect of Rs. 69.08 crore.

1.18.4.1 The Department stated in September 2007 that remedial action has been taken.

1.18.5 One case is shown in Table no. 1.11 below:

Table no. 1.11: Incorrect allowance of depreciation and set off of losses			
Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
M/s Punjab National Bank, Delhi V	2003-04 143(3)	The assessee was allowed set off of losses of Rs. 18.90 crore pertaining to the assessment year 1996-97 against the assessment year 2003-04 completed after scrutiny in January 2006. Audit noticed that as per the assessment order of March 2001 pertaining to assessment year 1996-97, there was no loss which remained to be set off. The Department has taken remedial action (October 2007).	9.39

1.18.6 One case is shown at serial number 52 of Appendix -2.

1.19 Incorrect computation of tax on capital gains

1.19.1 As per section 112 of the Act, long term capital gain (LTCG) is taxable at the rate of twenty percent. However, as per proviso below sub section (1) to section 112, where tax payable in respect of any income arising from transfer of long term capital asset, being listed securities or unit, exceeds 10 percent of the amount of capital gains computed without taking indexation benefit, such excess shall be ignored for the purpose of computing tax payable by the assessee. In other words rate of 10 percent is applicable only if benefit of indexation is not availed.

1.19.2 In Maharashtra, Mumbai City 3 charge, assessment of a private bank, M/s ICICI Bank Ltd., for the assessment year 2003-04 was completed after scrutiny in February 2006. LTCG was determined at Rs. 519.75 crore and was taxed at the rate of 10 percent. Audit scrutiny revealed that the assessee had taken the benefit of indexation while computing the long term capital loss on investments and it was reduced from LTCG computed on sale of ICICI bank shares for which indexation was not done as the acquisition cost was stated to be nil. Since assessee had taken indexation benefit while computing long term capital loss on investments, the tax rate applicable should have been 20 percent and not 10 percent as applied which resulted in short levy of tax of Rs. 51.97 crore.

1.19.3 In its reply in March 2007, the Department did not accept the audit observation stating that since the capital gain arose on the sale of ICICI bank shares for which the benefit of indexation was not availed, the rate of tax applicable was only ten percent. Reply of the Department is not tenable as the proviso below subsection (1) of section 112(1) clearly states that tax payable in respect of any income arising from transfer of long term capital asset, being listed securities or units is ten percent only if benefit of indexation is not availed of under second proviso to section 48. In other words, the rate of tax applicable is 20 percent if benefit of indexation is availed. In the instant case, assessee had availed of the

benefit of indexation while setting off the loss arising out of sale of investment and sale of leased assets against income from sale of ICICI bank shares. Hence, the rate of tax applicable is 20 percent as per the provisions of section 112.

1.20 Incorrect allowance of provisions, capital expenditure and liabilities

1.20.1 Section 37 of the Act envisages that a provision made in the accounts for an accrued or ascertained liability is an admissible deduction, while other provisions do not qualify for deduction.

1.20.2 It has been judicially held by the Supreme Court⁵ that a contingent liability could not constitute expenditure for the purposes of income tax. It has been held that expenditure which is allowable for income tax purposes, is one which is towards a liability actually existing at that point of time but putting aside of money which may become expenditure on the happening of an event is not an expenditure.

1.20.3 It has also been judicially held⁶ that for a loss to be deductible, it must have actually arisen and incurred and not merely anticipated as certain to occur in future.

1.20.4 Audit noticed that the above provisions were not complied with in 19 cases involving tax effect of Rs. 51.64 crore. Two cases are shown in Table no. 1.12 below:

(Rs. in crore)

Table no. 1.12: Incorrect allowance of provisions, capital expenditure & liabilities

Sl no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Bank				
1.	M/s Indian Bank; Chennai I	2004-05 143(3)	The provision of Rs. 49.58 crore towards 'law charge' in respect of the earlier years, in addition to the current year's actual claim had been allowed. As the above amount represented provisions only and also related to prior period, it was required to be added back.	17.78
2.	M/s Indian Overseas Bank, Chennai I	2004-05 143(3)	Deduction of Rs. 28.40 crore was allowed towards 'loss arising out of unrecoverable investments' in respect of shares held in its wholly owned subsidiary company, which was merged with the bank during the previous year. As the investment in a subsidiary company was capital in nature, the loss allowed as revenue loss should also have been treated as capital loss only.	10.19

1.20.5 Ten cases are shown at serial numbers 53 to 62 of Appendix 2.

⁵ 248 ITR 4 – Indian Smelting and Refining Company Ltd., 245 ITR 428- Bharat Earth Movers Ltd.

⁶ CIT Vs Indian Overseas Bank (151 ITR 446) (Madras)

1.21 Incorrect allowance of expenditure on investments

1.21.1 It has been judicially held⁷ that where the assessee purchases securities at a price inclusive of accrued interest, the price paid for them is in the nature of capital outlay and no part of it can be set off as expenditure against the income accruing on those securities.

1.21.2 Audit noticed that the above provisions were not complied with while allowing deduction in respect of expenditure incurred in relation to investments in eight cases involving tax effect of Rs. 47.03 crore. Two cases are discussed in Table no. 1.13 below:

(Rs. in crore)

Table no. 1.13: Incorrect allowance of expenditure on investments				
Sl. no.	Assessee and CIT Charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Foreign Bank				
1.	M/s Deutsche Bank AG, DIT (IT) Mumbai	2004-05 143(3)	Assessing Officer disallowed Rs. 32.00 crore towards broken period interest ⁸ . However, while computing the taxable income, Rs. 0.32 crore only was added back resulting in under assessment of Rs. 31.68 crore. The assessing officer replied (March 2007) that rectification proceedings had been initiated and the order under section 154 would be passed shortly.	20.88
2.	M/s Deutsche Bank AG, DIT (IT) Mumbai	2002-03 143(3)	While allowing broken period interest of Rs. 37.05 crore on purchase of securities as per CIT (A)'s order, deduction of broken period interest already allowed on the sale of such securities was not withdrawn. The Department has accepted (May 2007) and rectified the mistake by passing an order under section 154.	19.85

1.21.3 Two cases are shown at serial numbers 63 and 64 of Appendix 2.

⁷ Vijaya Bank vs Commissioner of Income Tax (Additional) 187 ITR 541 (Supreme Court)

⁸ **Broken Period Interest (BPI)**

Interest on Government securities is payable on half-yearly basis. This interest is being paid to the holder of the security on due date. At the time of purchase of security, the buying bank pays the interest till the date of purchase (broken period) to the seller of security, debiting the same under "interest account". At the time of receipt from RBI at the end of the relevant half year, the entire half-year interest is credited to the same account.

1.22 Incorrect deduction of income from securities

1.22.1 Under the third proviso of section 36(1)(viia) of the Act, a scheduled bank or non-scheduled bank shall, at its option, be allowed a further deduction in excess of the limits specified in the preceding two provisos for an amount not exceeding the income derived from redemption of securities in accordance with a scheme framed by the Central Government. It is further provided that no deduction shall be allowed under the third proviso, unless such income has been disclosed in the return of income under the head "Profits and gains of business or profession".

1.22.2 Under section 145 of the Act, income under the heads 'profits and gains of business or profession' or 'income from other sources' shall be computed in accordance with either cash or mercantile system of accounting, regularly employed by the assessee. Under the RBI guidelines and the Indian Companies Act, 1956, banks follow the mercantile system of accounting and prepare accounts on accrual basis.

1.22.3 Audit noticed that the above provisions were not complied with in four cases involving tax effect of Rs. 38.25 crore while allowing deduction of income from redemption of securities and interest on securities. Two cases are discussed in Table no. 1.14 below:

(Rs. in crore)

Table no. 1.14: Incorrect deduction of income from securities

Sl. no.	Assessee and CIT Charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Banks				
1.	M/s Indian Bank, Chennai I	2001-02 to 2003-04 143(3)	Interest on securities credited to P&L account was deducted while computing the taxable income on the ground that the interest income accrued had not become due. Incorrect method of accounting followed in this case resulted in under assessment of income of Rs. 81.42 crore.	30.15
2.	M/s State Bank of Indore, Indore	2004-05 143(3)	A deduction of Rs. 11.75 crore on income on redemption of securities was allowed even though it was not credited to the P&L account. The Department did not accept (May 2007) the audit observation on the ground that the assessee had credited Rs. 226.22 crore being the net surplus on profit on sale of investments, where every transaction under this head had been duly accounted for. The reply is not tenable as profit of Rs. 226.22 crore was only the profit that was earned on investments other than redemption of securities and the profit of Rs. 11.75 crore earned on "redemption of securities under buy back scheme", had not been credited to the P&L account.	5.37

1.22.4 One case is shown at serial number 65 of Appendix 2.

1.23 Incorrect computation of income under special provisions

1.23.1 With effect from the assessment year 2001-02, when income tax payable on total income of a company as computed under the normal provisions of the Act in respect of the relevant previous year, is less than 7.5 percent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable on such total income shall be the amount of income tax calculated at the rate of 7.5 percent of the book profit or total income. Book profit means the net profit as shown in the profit and loss account, prepared as per the provisions of Part II and III of Schedule VI to the Companies Act, 1956 after making certain adjustments as prescribed in the Act. As per the provisions contained in the sub section (2) of section 115JAA of the Act, no interest shall be payable on the tax credit allowed under subsection (1) of section 115JAA.

1.23.2 Audit noticed mistakes due to incorrect computation of book profits and non-adherence to the above provisions of the Act in 12 cases involving tax effect of Rs. 37.54 crore. Two cases are shown in Table no. 1.15 below:

(Rs. in crore)

Table no. 1.15: Incorrect computation of income under special provisions				
Sl. no.	Assessee and CIT Charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Bank				
1	M/s Punjab National Bank, Delhi-V	2003-04 143(3)	The income for the assessment year 2003-04 should have been assessed as (-) Rs. 54.60 crore under normal provisions instead of (-) Rs. 70.43 crore under special provisions which resulted in over assessment of loss by Rs. 15.82 crore.	5.54 (P) ⁹
Foreign Bank				
2	M/s Standard Chartered Bank, DIT(IT), Mumbai	2002-03 143(3)	Interest of Rs. 22.42 crore was incorrectly allowed under section 244A on MAT credit though the provisions of section 115JAA specifically prohibit allowance of interest on MAT credit. Further, as refund excluding MAT credit works out to less than 10 percent of the tax determined, the assessee was not eligible for any interest. The Department has accepted (April 2006) the audit observation.	22.42

1.23.3 Four cases are shown at serial numbers 66 to 69 of Appendix 2

⁹ Potential

1.24 Incorrect allowance of deduction towards head office expenses/interest relating to foreign banks

1.24.1 Section 44C of the Act provides that in the case of a non resident, head office expenditure is allowable at the rate of five percent of the adjusted total income or the amount of so much of expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business of the assessee in India, whichever is less. As per explanation below sub section (1) of section 92, the allowances for any expense or interest arising from an international transaction shall be determined having regard to the arm's length price.

1.24.2 Board vide its circular no. 740 dated 17 July 1996 clarified that a branch of a foreign company /concern in India is a separate entity for the purpose of taxation. Interest paid/ payable by such branch to its head office or any branch located abroad would be liable to tax in India and would be governed by the provisions of section 115A of the Act. It has also been judicially held¹⁰ that the interest payment made by a permanent establishment in India to its own branch outside India is not an allowable expenditure as the payment is made to self. The tribunal held that the deductibility has to be in accordance with the provisions of local law and subject to the limitations provided therein, as provided in section 44C, etc.

1.24.3 Audit noticed that the above provisions were not complied with in 6 cases involving tax effect of Rs. 27.46 crore. Three cases are shown in Table no. 1.16 below:

(Rs. in crore)

Table no. 1.16: Incorrect allowance of deduction towards head office expenses/interest relating to foreign banks

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Foreign Banks				
1.	M/s Bank of America, DIT(IT), Mumbai	2002-03 to 2004-05 143(3)	Interest paid to head office/overseas branches of Rs. 8.06 crore, Rs. 4.96 crore and Rs. 12.35 crore in assessment years 2002-03 to 2004-05 were allowed as deduction.	11.01
2	M/s Standard Chartered Grindlays Bank, DIT (IT) Delhi	2003-04 143(3)	Deduction of Rs. 11.61 crore on account of head office expenses was incorrectly allowed on long term capital gain.	6.71

¹⁰ Income Tax Appellate Tribunal, Kolkata Branch, in a judgment delivered on 22-8-2005, in the case of ABN Amro Bank NV Vs Asst. Director of Income Tax, International Taxation, Calcutta

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
3.	M/s ABN Amro Bank, DIT (IT) Kolkata	2002-03 to 2004-05 143(3)	Deductions of Rs. 13.22 crore, Rs. 15.58 crore and Rs. 19.16 crore in respect of head office expenses were calculated directly on the taxable income without adjusting the allowances under section 36(1)(vii)(b) though section 44C defines that the deduction is to be calculated on the adjusted total income.	6.23

1.24.4 Two cases are shown at **serial numbers 70 and 71 of Appendix 2.**

1.25 Incorrect computation of income and other mistakes

1.25.1 As per the provisions contained in sub section (2) of section 36, no deduction towards bad debts shall be allowed unless such debts or part thereof have been taken into account in computing the income of the assessee or such debt represents money lent in the ordinary course of the business of banking or money lending which is carried on by the assessee.

1.25.2 Section 37(1) of the Act provides that any expenditure not being in the nature of capital expenditure, laid down and expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the income chargeable under the 'Profit and gains of business or profession'.

1.25.3 Section 143 of the Act provides that the assessing officer is required to determine and assess the income correctly after scrutiny assessments. The Board have issued instructions to the assessing officers and their supervising officers to ensure that the mistakes in assessments do not occur.

1.25.4 Audit noticed mistakes in computation of income and tax in 74 cases involving tax effect of Rs. 220.77 crore. One case is discussed below:

1.25.5 In Delhi, DIT (IT) charge, assessment of a foreign bank, **M/s Standard Chartered Grindlays Bank**, for the assessment year 2001-02 was completed after scrutiny in March 2004 determining an income of Rs. 433.08 crore. A rectification order under section 154 was passed in March 2005 allowing the assessee a TDS credit of Rs. 11.77 crore. Thereafter, the tax was re-calculated. Audit scrutiny revealed that tax was calculated on the returned income of Rs. 337.49 crore instead of calculating it on the total assessed income after scrutiny assessment of Rs. 433.08 crore which resulted in a refund of Rs. 10.89 crore instead of creating a demand of Rs. 52.97 crore. The mistake resulted in tax effect of Rs. 63.86 crore including interest.

1.25.6 Six cases are shown in Table no. 1.17 below:

(Rs. in crore)

Table no. 1.17: Incorrect computation of income and other mistakes				
Sl. no.	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Public Sector Bank				
1	M/s Oriental Bank of Commerce, Delhi V	2003-04 143(3)	Rs. 54.01 crore being interest accrued but not due was disallowed in the assessment order of 2002-03 but an order passed under section 250 revealed that the relief was given to the assessee by the CIT(A). However, the assessing officer had again allowed deduction of Rs. 54.01 crore in the assessment year 2003-04 resulting in a double deduction of Rs. 54.01 crore. During verification, audit noticed that the Department has taken remedial action under section 154 of the Act.	24.46
2.	M/s Allahabad Bank, Kolkata II	2003-04 143(3) 115JB	The assessee had paid a contribution of Rs. 61.01 crore to pension fund over and above the 'Provision for pension (new)' debited in the profit & loss account under the head 'payment to and provisions for employees'. The assessing officer started the computation of total income from the net profit as per the profit & loss account and allowed a deduction of Rs. 61.01 crore as "Contribution to Employees' Pension Fund". Since "Contribution to Employees' Pension Fund" amounting to Rs. 61.01 crore was not routed through the profit & loss account it was not allowable as deduction.	22.42
Private Bank				
3	M/s Karnataka Bank Ltd, Mangalore	2004-05 143(3)	Refund of Rs. 19.89 crore allowed in March 2005 at the time of processing the return in summary manner was not adjusted at the time of scrutiny assessment which resulted in excess refund and interest under section 234D. The Department accepted (July 2007) the audit observation and taken remedial action.	20.97
4	M/s Federal Bank Ltd, Kochi	1996-97 143(3)	Consequent to an appellate order by the ITAT, Rs. 19.54 crore disallowed in the assessment was allowed as deduction in the revised assessment in March 2005. However, Rs. 11.84 crore already allowed as deduction while giving effect to the order by CIT (A) in February 2004 was not considered at the time of giving effect to the ITAT order. The Department accepted (February 2007) the audit observation and taken remedial action.	5.43
Foreign Bank				
5	M/s American Express Bank, DIT(IT) Mumbai	2003-04 143(3)	Refund already issued to the assessee after summary assessment was not taken into account while computing tax demand as per order passed under section 154. The Department has accepted (March 2007) the audit observation.	15.64

Sl. no.	Assessee and CIT Charge	Assessment year and type of assessment	Nature of mistake	Tax effect
6	M/s Standard Chartered Bank, DIT(IT) Mumbai	2004-05 143(3)	<p>The assessee was allowed a deduction of Rs. 22.69 crore towards base cost of securities acquired in a slump sale from Standard Chartered Grindlays Bank (SCGB) in August 2002. It was observed from the notes to accounts that these securities were shown as acquired at book value of SCGB and additional compensation of Rs. 22.69 crore paid on its acquisition had not been included in its cost. Since the additional compensation paid on acquisition of securities had not been included in its cost, it could not be claimed as business expenditure.</p> <p>The Department did not accept (March 2007) the audit observation on the ground that since the securities were held as stock in trade, the deduction claimed by assessee was on revenue account and not capital outlay. Reply of the Department is not tenable as the additional compensation paid on acquisition of SCGB had not been included in the cost of acquisition of securities.</p>	10.79

1.25.7 Thirty one cases are shown at **serial numbers 72 to 102 of Appendix -2.**

1.26 Non adoption of Arm's Length Price

1.26.1 Section 92(1) of the Act provides that, any income, allowances for any expense or interest arising from an international transaction shall be determined with reference to the arm's length price (ALP). The computation of ALP has to be done as per section 92C. Section 92CA empowers the assessing officer to refer all cases of international transaction with the associated enterprises to the Transfer Pricing Officer (TPO) for determining ALP of each transaction. The TPO shall determine the ALP after considering all relevant material gathered by him for the said purpose. On the basis of TPO's order and subsequent scrutiny, the assessing officer shall proceed with the determination of taxable income.

1.26.2 In Maharashtra, Mumbai DIT (IT) charge, assessment of a foreign bank, **M/s Standard Chartered Bank**, for the assessment year 2004-05 was completed after scrutiny in November 2006. Assessee had filed form 3CEB pertaining to international transactions which was referred to the TPO for determination of ALP. The assessee had entered into a number of international transactions involving large amounts listed in the Annexures 1 to 8C of form 3CEB. The TPO in his order of October 2006 discussed only one issue relating to head office expenses. The assessee contended that expenditure incurred by it on behalf of its associated enterprises and reimbursements towards expenses incurred by its associated enterprises would not be covered under section 92 of the Act. As per explanation below section 92(1), all allowances or expenses with regard to international

transaction is to be determined based on ALP. However, in the instant case neither the TPO nor the Assessing Officer made any comment or adjustment in this regard.

1.26.3 The assessee had sold property worth Rs. 147.71 crore to its associate enterprise SCOPE (being wholly owned subsidiary of Standard Chartered Bank UK) during the previous year but did not offer the income to tax on the ground that no transfer was involved as per section 47 (iv) of the Act. Since the assessee was a separate entity for the purpose of taxation in India, income arising from transfer of assets of Indian PE to SCOPE should have been offered to tax, based on the ALP. However, neither the TPO nor the Assessing Officer made any comment or adjustment in this regard.

1.26.4 The assessee had also provided many administrative, marketing, supervising, banking and technical services to its head office and other associated enterprises. However, no significant charges were received for providing such services. Neither the TPO nor the Assessing Officer made any comments regarding ALP of these services in their respective orders.

1.26.5 In the case of the same assessee, assessment for the assessment year 2003-04 was completed after scrutiny in December 2005. The assessee had received service charges amounting to Rs. 5.54 crore from six associated enterprises. As per the TPO's report, the Arm's length price of the transaction under Comparable Uncontrolled Price (CUP) method was the same as received by assessee. However, in the note below Annexure-11 of Form 3CEB, the property service cost received by assessee was based on the allocation made of the estimated maintenance cost for the property given/taken on lease. The TPO did not make any change in respect of the above transactions in his report. In this case, the assessee had taken the estimated maintenance cost as fair market value for the purpose of determining ALP. Since the fair market value of any property was much higher than the maintenance cost, the price declared by the assessee should have been rejected and TPO should have determined the price based on fair market value. In its reply dated May 2006, the Department stated that the matter would be referred to the TPO for his examination.

1.26.6 In the exit conference, Board agreed to examine the case.

1.27 Non recognition of income

1.27.1 Under section 145 of the Act, income under the heads 'profits and gains of business or profession' or 'income from other sources' shall be computed in accordance with either cash or mercantile system of accounting, regularly employed by the assessee.

1.27.2 In the cases of **M/s Indian Bank, M/s Indian Overseas Bank, M/s Tamil Nad Mercantile Bank Ltd. and M/s City Union Bank Ltd.**, audit observed that during the assessment years 2001-02 to 2004-05, income from locker rent, credit

card membership fees, dividend income, insurance claims and commission was accounted on realisation basis instead of on accrual basis. This was in violation of section 145 of the Act. The difference between the accrued income and income offered on cash basis in respect of the above items could not be quantified by audit.

1.27.3 In the exit conference, Board agreed to examine the case.

1.28 Conclusion

1.28.1 Banks are an important driver of growth in the national economy and are among the highest tax payers in the country. Audit noticed several mistakes with significant tax effect in the assessments of banks. A very high proportion of error was noticed in the determination of deductions available to banks for bad and doubtful debts as per the provisions of the Act. Audit findings also indicate weaknesses with potential revenue impact relating to figures of bad and doubtful debts and advances made to rural branches. Audit also observed mistakes in valuation of investments. Several cases of non compliance with specific provisions of the Act have also been included in this review. It is recommended that the Ministry should examine these issues and evolve a suitable corrective mechanism, so as to safeguard the interest of revenue.

1.29 Summary of recommendations

1.29.1 *Audit recommends that the Ministry may strengthen its internal controls such as ensuring regular review of assessments of banks at an appropriate level, that all such cases are checked by internal audit etc.*

1.29.1.1 In the exit conference, Board accepted the recommendation and stated that administrative review of assessments of banks at the level of Commissioners of Income tax is provided for and that internal audit will check all cases of banks in the new system.

1.29.2 *Audit recommends that the Ministry may prescribe a checklist for the assessing officers requiring them to check that the bad debts to be written off have been debited to the provision for bad and doubtful debt account and that the credit balance of provision for bad and doubtful debt account of earlier years have been considered before allowing the same.*

1.29.2.1 In the exit conference, Board accepted the recommendation and stated that the concern of the checklist will be taken care of while preparing the Manual of Internal Audit.

1.29.3 *Audit recommends that the Ministry may also consider devising a system where the assessing officer can take cognizance of the credit balance available in the provision for bad and doubtful debt account pertaining to earlier years in respect of banks.*

1.29.3.1 In the exit conference, Board agreed to examine the issue.

1.29.4 *In view of the quantum of revenue involved in the deductions for bad and doubtful debts written off, audit recommends that the Ministry may examine the issue of the wide variations in the figures reported in NPA returns to RBI and the income tax returns.*

1.29.4.1 In the exit conference, Board stated that the issue would be examined.

1.29.5 *Audit recommends that the Ministry may strengthen its internal controls so that deductions to rural branches of banks are allowed only after suitable verification by the assessing officer so as to safeguard the interests of revenue.*

1.29.5.1 In the exit conference, Board stated that the issue would be examined.

1.29.6 *Audit recommends that the Ministry may consider introducing a suitable provision in the statute relating to valuation of investments by banks.*

1.29.6.1 In the exit conference, Board agreed to examine the issue.

Chapter II

Review on Appreciation of Third Party Reporting/ Certification in Assessment Proceedings

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CHAPTER II

THE HISTORY OF THE UNITED STATES

FROM 1776 TO 1861

BY

JOHN B. HENNING

OF THE UNIVERSITY OF MICHIGAN

ANN ARBOR, MICHIGAN

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Highlights

Audit reviewed the assessment records of corporate and non corporate assesseees (excluding who are salaried) with a view to i) ensure that the tax audit reports were complete in themselves to provide sufficient and requisite information to the assessing officer, thereby aiding him in completing the assessment as required under the Act, ii) determine the extent to which the assessing officers have evaluated and utilised information provided in prescribed reports while completing assessments, and iii) determine the effectiveness of the department's internal control mechanism in ensuring that the objective of obtaining a report from a third party (the accountant) is fulfilled.

(Paragraph 2.2)

In the review, 168 units were covered. Audit of these units revealed 2874 cases of irregularities with a value of Rs. 849.16 crore and revenue impact of Rs. 665.67 crore (including penalty of Rs. 41.52 crore).

(Paragraph 2.6.1)

System issues

Audit noticed 237 cases where the assessing officer did not rely on the particulars given in the tax audit reports, and made additions in income having revenue impact of Rs. 183.49 crore. However, no action was taken to report such cases in terms of CBDT instruction no. 1959 and section 288 of the Act.

(Paragraph 2.7.2)

Audit noticed 665 cases where the assessing officers did not take action to make additions or disallowances although there were omissions in the tax audit reports. This resulted in underassessment of income with a revenue impact of Rs. 425.44 crore.

(Paragraph 2.8.1)

Audit noticed that in 233 cases, the assessing officers did not utilise the information available in the tax audit reports/certificates while finalising assessments, involving revenue impact of Rs. 228 crore.

(Paragraph 2.9.1)

The internal control mechanism in the Department to ensure that (i) the audit reports/certificates were complete and provided sufficient and requisite information to the assessing officer, (ii) information which is provided in the audit reports is being effectively utilised by the assessing officers and (iii) cases are selected for scrutiny assessment on the basis of the tax audit reports, is not effective.

(Paragraph 2.11.18)

Compliance issues

Audit noticed non submission of accountant's reports/certificates by the assessee in 102 cases involving revenue impact of Rs. 11.42 crore.

(Paragraph 2.13.1)

Audit recommends that

- The Ministry may ensure taking of action in terms of instruction no. 1959 and section 288 of the Act, in cases where inadequate/inaccurate information have been furnished in the tax audit reports.
- The Ministry may issue instructions to ensure that assessing officers critically examine the tax audit reports along with the connected records and other available evidence so as to make an independent assessment in each case.
- The Ministry may ensure that information as available from the tax audit reports/certificates is effectively utilised in finalising the assessments.
- The Ministry needs to strengthen its internal control and monitoring mechanism to ensure compliance with the instructions, rules, circulars and provisions of the Income Tax Act, 1961.
- The Ministry may ensure that necessary tax audit reports/certificates have been furnished by the assessee before allowing deductions and determination of tax.

(Paragraph 2.15)

**Review on Appreciation of Third Party Reporting/Certification
in Assessment Proceedings**

2.1 Introduction

2.1.1 With a view to discourage tax avoidance and tax evasion and to ensure that the books of accounts of the assessee faithfully reflect the income of the tax payer and that claims for deduction are correctly made, the Income Tax Act, 1961 (Act), under its various provisions, provides for reporting/certification through the audit of accounts and audit reports from an accountant. Central Board of Direct Taxes (Board) circular no. 387 dated 6 July 1984 explains the rationale for such compulsory audit of accounts as under:

2.1.2 “Accounts maintained by companies are required to be audited under the Companies Act, 1956. Accounts maintained by co-operative societies are also required to be audited under the Co-operative Societies Act, 1912. There is, however, no obligation on other categories of taxpayers to get their accounts audited. A proper audit for tax purposes would ensure that the books of accounts and other records are properly maintained, that they faithfully reflect the income of the taxpayer and claims for deduction are correctly made by him. Such audit would also help in checking fraudulent practices. It can also facilitate the administration of tax laws by a proper presentation of the accounts before the tax authorities and considerably save the time of the assessing officer in carrying out routine verification like checking correctness of totals and verifying whether purchases and sales are properly vouched. The time of the assessing officer thus saved, could be utilised for attending to more important investigational aspects of a case.”

2.1.3 Thus, accountants have been mandated to be facilitators for the Income tax Department in administering the provisions of the Act correctly. The tax audit report/certificates issued by them serve as a valuable reference guide for the assessing officers while making assessments. The criticality of the information provided by the accountant in the form of tax audit reports can be gauged from the fact that 98 percent¹ of the assessments are completed in a summary manner, relying on the information given in the return of income and accompanying documents.

2.1.4 However, the tax audit report issued by an accountant, is only a tool in the hands of the Department while deciding the correctness of the income and deductions claimed by the assessee. The assessing officer is expected to make an independent judgment while finalising the assessment and can require the assessee to justify his claims with reference to records and evidence. In *Goodyear India Ltd. vs CIT* [2000] {112 Taxman 419}, while deciding on whether the ITO should insist upon production of records or details in spite of a tax audit report under section 44AB, Delhi High Court held, “such a broad proposition cannot be laid down. No

¹ Chapter II of the Audit Report of the C&AG of India on Direct Taxes of 2007

doubt, sanctity is to be attached to the audit report given by a qualified chartered accountant. Merely because an audit report is available there is no fetter on the power of the ITO to require the assessee to justify its claim with reference to records, materials and evidence. Such a power is inherent in an assessing officer in the scheme of the Act.”

2.2 Objective of the review

The review seeks to examine the scheme of third party reporting/certification with a view to:

2.2.1 ensure that the tax audit reports were complete in themselves to provide sufficient and requisite information to the assessing officer, thereby aiding him in completing the assessment as required under the Act

2.2.2 determine the extent to which the assessing officers have evaluated and utilised information provided in prescribed reports while completing assessments

2.2.3 determine the adequacy and relevance of the formats of the tax audit reports as provided in the Act

2.2.4 determine the effectiveness of the Department’s internal control mechanism in ensuring that the objective of obtaining a report from a third party (the accountant) is fulfilled

2.3 Law and procedure

2.3.1 The Income Tax Act as well as the Income Tax Rules provide for audit of accounts and audit reports by an accountant in specific cases as listed in **Appendix 3**. These tax audit reports entitle the assessee to a number of exemptions, deductions etc. under the various provisions of the Act. The forms in which such tax audit reports are to be prepared, have been prescribed under the respective Income Tax Rules. Some of the important sections of the Act requiring such reports/certificates have been elaborated below.

2.3.2 Section 44AB of the Income Tax Act, 1961, requires the audit of accounts of any person carrying out any business or profession, by an accountant if the total sales, turnover or gross receipts of the business for the previous year exceed Rs. 40 lakh, or if the gross receipts in profession for the previous year(s) exceed Rs. 10 lakh. The obligation of the assessee to get his accounts audited by an accountant and to furnish the tax audit report in the prescribed form is to be met before the specified date i.e. October 31 of the relevant assessment year. However, assessees covered under section 44AB who are expected to file annexure-less returns² are required to furnish the tax audit reports under section 44AB or any other documents only on demand by the authorities.

² Income-tax (7th Amendment) Rules, 2006 vide notification no. S.O.1163 (E) w.e.f. 24 July 2006

2.3.3 For the purpose of this section “accountant” means a chartered accountant within the meaning of the Chartered Accountant Act, 1949.

2.3.4 The report of audit of the accounts of a person required to be furnished under section 44AB shall be in Form no. 3CA in the case of a person who carries on a business or profession and who is required to get his accounts audited by or under any other law³. In the case of any other person carrying on a business or profession, it shall be in Form no. 3CB. The particulars which are required to be furnished under section 44AB shall, in the case of a person carrying on a business or profession, be in Form no. 3CD.

2.3.5 Under section 44AB, the accountant is required to report whether the balance sheet and the profit and loss account/income and expenditure account are in agreement with the books of accounts maintained by the assessee, and whether in his opinion, the said accounts provide a true and fair view of the state of affairs and profit/loss of the assessee. Comments/discrepancies/inconsistencies, if any, are also required to be reported.

2.3.6 Important particulars which are required to be furnished under section 44AB in Form no. 3CD are as follows:

- Amounts not credited to the profit and loss account.
- Particulars of depreciation allowable as per the Income Tax Act, 1961.
- Any sum received from employees towards contributions to any provident fund or superannuation fund; and the due and actual dates of payment to the concerned authorities.
- Amounts debited to the profit and loss account, being:-
 - Expenditure of capital nature
 - Expenditure of personal nature
 - Expenditure by way of penalty or fine for violation of any law for the time being in force
 - Particulars of any liability of a contingent nature
- In respect of any sum referred to in section 43B dealing with certain deductions admissible on actual payment basis only, particulars of the crystallisation of the liability and actual payment/non payment.
- Particulars of income or expenditure of prior period credited or debited to the profit and loss account.
- Particulars of loan or deposit taken or accepted/repaid in an amount exceeding the limit specified in section 269SS/269T otherwise than by an account payee cheque or bank draft.

³ Companies Act, 1956, Co-operative Societies Act, legislation governing various statutory organisations, etc.

- Details of brought forward loss or depreciation allowance to the extent available.
- Whether the assessee has complied with the provisions of Chapter XVII-B regarding deduction of tax at source and regarding the payment thereof to the credit of the Central Government. If the said provisions have not been complied with, full details thereof are to be given.

2.3.7 Penalty provision

Section 271B provides that if any person fails to get his accounts audited in respect of any previous year(s) or furnish a report of such audit as required under section 44AB, the assessing officer may levy a penalty equal to one-half percent of the total sales/turnover or of the gross receipt in case of a profession, in such previous year(s) or a sum of Rs. one lakh, whichever is less.

2.3.8 Audit reports/certificates required to claim deductions/pay tax under minimum alternate tax (MAT)

2.3.8.1 Sections 10A and 10B provide for deduction of profits derived by a newly established undertaking in a free trade zone or a newly established hundred percent export oriented undertaking from the export of articles or things or computer software. The deduction is admissible only where the assessee furnishes in the prescribed form⁴, along with the return of income, the report of an accountant certifying that the deduction has been correctly claimed in accordance with the provisions of the section.

2.3.8.2 Section 80IB provides deduction where the gross total income of an assessee includes any profit and gains derived from certain industrial undertakings⁵ other than infrastructure development undertakings. The deduction is admissible only where the accounts of the undertaking for the previous year have been audited by an accountant, and the assessee furnishes along with his return of income, the report of such audit in the prescribed form⁶ duly signed and verified by such accountant.

2.3.8.3 Section 115JB of the Act provides that in the case of a company if the income-tax, payable on the total income is less than seven and one-half⁷ percent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the

⁴ Form nos. 56F and 56G

⁵ An industrial undertaking including cold storage, a ship, a hotel, multiplex theatre, convention centres, scientific and industrial research and development, commercial production and refining of mineral oil, developing and building housing projects, handling, storage and transportation of food grains

⁶ Form no. 10CCB

⁷ 10 percent with effect from the assessment year 2007-08

amount of income-tax at the rate of seven and one-half⁸ percent. Every company, to which this section applies, is to furnish a report in the prescribed form⁹ from an accountant certifying that the book profit has been computed in accordance with the provisions of this section along with the return of income.

2.3.9 Penal provision

2.3.9.1 Board's instruction no. 1959 issued in January 1999 provides that cases where the information given in the tax audit report is incomplete or non committal, should be taken up by the CIT to see if these reflected any professional negligence on the part of the accountant signing the tax audit report whereupon action is to be taken as per section 288 of the Act.

2.3.9.2 Section 288 provides that if any person who is a legal practitioner or an accountant is found guilty of misconduct in his professional capacity by an authority entitled to institute disciplinary proceedings against him, an order passed by that authority shall have effect in relation to his right to attend before an income tax authority as it has in relation to his right to practice as a legal practitioner or accountant, as the case may be.

2.4 Scope and audit methodology of the review

2.4.1 Assessment records of both corporate and non corporate assesseees (excluding those who were salaried) along with the supporting audit reports/certificates as required under section 44AB and other sections of the Act were selected for examination. The review was conducted on both summary and scrutiny assessments completed during the financial years from 2004-05 to 2006-07 and till the date of audit. A total of 168 units were covered during the period of review. The basis of selection of the units and records for audit is given in **Appendix 4**.

2.4.2 Copies of the draft review reports containing audit observations were issued to the respective Chief Commissioners of Income Tax/Commissioners of Income Tax by the Director General/Pr. Directors of Audit/Pr. Accountants General/Accountants General during the period from June 2007 to August 2007.

2.5 Acknowledgement

2.5.1 Indian Audit and Accounts Department acknowledges the cooperation of the Income tax Department in providing the necessary records and information for audit. The draft review report was issued to the Ministry in October 2007. An exit conference was held in December 2007 with the Board to discuss the results of this review. The views expressed by them in the exit conference have been appropriately incorporated in this report.

⁸ 10 percent with effect from the assessment year 2007-08

⁹ Form no. 29B

2.6 Audit findings

2.6.1 Audit of the selected 168 units during the period of review revealed 2874 cases of irregularities with a value of Rs. 849.16 crore and revenue impact of Rs. 665.67 crore (including penalty of Rs. 41.52 crore) in the states of Andhra Pradesh, Assam, Bihar, Chandigarh (UT), Delhi, Goa, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

2.6.2 Audit observations¹⁰ with money value exceeding Rs. one crore have been discussed either in the paragraphs of this report or highlighted in the appendices. Those below Rs. one crore have not been highlighted individually although their revenue impact has been included in the report.

System issues

2.7 Action not taken for furnishing of inadequate information in tax audit reports

2.7.1 Under section 44AB, the tax auditor has to certify the correctness of the accounts of the assessee with reference to the requirements indicated in various clauses of Form no. 3CD. These clauses contain particulars of certain pertinent information which would enable/facilitate proper determination of the assessee's income. Further, an assessee is required to obtain audit reports/certificates in the prescribed form from the accountant in order to avail of exemptions/deductions under various other sections of the Act. Since the auditor is required to furnish true and correct information, such information should aid the assessing officer in finalising the assessment.

2.7.2 Audit noticed that, in 237 cases in Andhra Pradesh, Bihar, Delhi, Himachal Pradesh, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal, the assessing officer did not rely on the particulars given in tax audit reports, and made additions in income having revenue impact of Rs. 183.49 crore. Of these, eight cases are given in **Table no. 2.1** below and four other cases are given in **Appendix 5**.

¹⁰ Other than penalty cases for non filing of the tax audit report as discussed in paragraph no. 2.11.15

(Rs. in lakh)

Table no. 2.1: Inadequate information in tax audit reports resulting in additions made by assessing officers

Sl. no.	Name of the Assessee/CIT Charge	Assessment year	Type/date of assessment	Details of the additions made by the department due to non acceptance of particulars as given in the audit reports.	Revenue impact
1	Hindustan Lever Ltd. CIT 1, Mumbai	2002-03 2003-04 2004-05	Scrutiny December 2006 March 2006 December 2006	Deduction under section 80IB recomputed ¹¹ by the department and reduced from Rs. 2491.45 crore to Rs. 2350.37 crore.	5086.00
2	Oracle India Pvt. Ltd. CIT V, Delhi	2002-03	Scrutiny March 2005	Expenditure of capital nature not reported in audit report, and irregular deduction under section 80IA ¹² and 10A ¹³ report disallowed by the department.	2740.00
3	Tata Motors Ltd. CIT 2, Mumbai	2004-05	Scrutiny December 2006	Provision for warranty of Rs. 64.40 crore was not disclosed in the tax audit report. It was but brought to tax by the department during scrutiny.	2310.00
4	Cuttack Gramya Bank (Co-operative society) CIT, Cuttack	2005-06	Scrutiny January 2006	Brought forward loss of Rs. 39.79 crore was reported in the tax audit report. However, actual brought forward business loss was worked out to Rs. 25.50 crore by the assessing officer.	448.15
5	M/s MP State Textile Corporation CIT, Bhopal	2003-04 2004-05	Scrutiny March 2006 December 2006	Deduction in respect of prior period expenditure and excise penalty of Rs. 5.36 crore were not reported in the tax audit report. It was disallowed by the assessing officer.	323.40
6	M/s Indore Dugdha Sangh Sahakari Maryadit CIT, Indore	2004-05	Scrutiny December 2006	Provision for interest, interest not actually paid and prior period expenses of Rs. six crore were not reported in the tax audit report. The expenditure was disallowed by the department.	198.00
7	The Catholic Syrian Bank Ltd. CIT, Thrissur	2000-01 2001-02	Scrutiny December 2006	The assessing officer added back Rs. 1.99 crore for the assessment year 2001-02 and Rs. 1.19 crore for the assessment year 2000-01 respectively, towards provision for contribution to approved pension fund, which was not paid by the assessee by the due date. The amount which was inadmissible under section 43B (b) was not reported in Form no. 3CD.	191.76

¹¹ Owing to re-allocation of expenses by the department on account of head office, interest, research and development, advertisement etc.

¹² assessee company was merely duplicating the products manufactured by M/s Oracle Corporation USA which does not amount to manufacturing/ production of article/things as per provisions of section 80 IA

¹³ assessee was not eligible for the deduction as one unit was formed by splitting/reconstruction of other unit

Sl. no.	Name of the Assessee/CIT Charge	Assessment year	Type/date of assessment	Details of the additions made by the department due to non acceptance of particulars as given in the audit reports.	Revenue impact
8	M/s IIT Capital Services P Ltd. CIT 8, Mumbai	2004-05	Scrutiny November 2005	Interest of Rs. 3.74 crore not actually paid by the assessee was not reported in the tax audit report. The amount was disallowed, and brought to tax by the Department during scrutiny.	134.00

2.7.3 Thus, the intention of the Act in providing for audit of accounts of the assessee to ensure that deductions claimed by the latter are correct was not fulfilled in these cases. Although the necessary additions/disallowances were made by the assessing officers without relying on incorrect information in the tax audit reports, records produced to audit did not indicate whether any further action has been taken to report these cases in terms of Board's instruction no. 1959 and section 288 of the Act.

2.7.4 *Audit recommends that the Ministry may ensure that action is taken in terms of instruction no. 1959 and section 288 of the Act, in cases where inadequate/inaccurate information have been furnished in the tax audit reports.*

2.7.5 In the exit conference, the Board accepted the audit recommendation.

2.8 Inadequate disclosure in tax audit reports not acted upon by assessing officers

2.8.1 Audit observed in 665 cases that the assessing officers did not take action to make additions or disallowances although there were omissions in the tax audit reports. This resulted in underassessment of income having revenue impact of Rs. 425.44 crore in Andhra Pradesh, Assam, Bihar, Chandigarh, Delhi, Goa, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Out of these, 17 cases are discussed below and 16 other cases are given in **Appendix 6**.

2.8.2 Where the gross total income of an assessee includes any profit and gains derived from a specified industrial undertaking other than infrastructure development undertakings, there shall be allowed in computing the total income of the assessee, a deduction from such profits and gains of an amount equal to such percentage and for such number of assessment years as specified in this section. The deduction shall, however, not be admissible unless the accounts of the undertaking for the previous year relevant to the assessment year for which the deduction is claimed have been audited by an accountant.

2.8.2.1 In Maharashtra, CIT 1, Mumbai charge, the assessment of a company, **M/s Hindustan Petroleum Corporation Ltd.**, for the assessment year 2004-05 was completed after scrutiny in November 2006. Audit examination revealed that

the assessee had claimed a deduction of Rs. 793.88 crore in respect of Vishakh Refinery – VREP II Project. During audit examination, it was observed that while working out the deduction in the tax audit report¹⁴, an amount of Rs. 279.55 crore on account of marketing margin was also considered, which was not attributable to the activities of the industrial undertaking (Vishakh Refinery VREP II Project). Market margin is the profit derived by the marketing division of the assessee on the products manufactured by the refinery unit viz. Vishakh Refinery, and transferred to the marketing division of the assessee at a fixed price. As the marketing division is i) not an industrial undertaking under the definition of section 80IB and ii) is involved in trading activities (converting the bulk produced by the refinery into retailable lots and selling it in retail markets), the profit earned by the marketing division is only a trading profit and not a profit derived out of manufacturing activities.¹⁵ Thus consideration of marketing margin for claiming deduction under section 80IB was irregular. However, this amount was not disallowed, resulting in excess deduction of Rs. 279.55 crore under section 80IB, involving short levy of tax of Rs. 110.82 crore.

2.8.3 Under clause 13 of Form no. 3CD, amounts not credited to the profit and loss account, but which fall within the scope of profits and gains of business or profession, or any other item of income, are required to be disclosed. Such amounts of income, which have not been credited to profit and loss account, are required to be added back to the income and brought to tax.

2.8.3.1 In Delhi, CIT V charge, the assessment of a company, **M/s National Fertilizers Ltd.**, for the assessment year 2002-03 was completed after scrutiny in March 2005. Audit examination revealed that while computing the income, the assessee had not taken into consideration the interest income of Rs. 120.95 crore which had accrued as a result of an arbitration award in its favour. The tax audit report did not mention this fact, nor was the amount added back by the assessing officer during scrutiny assessment. This resulted in underassessment of income of Rs. 120.95 crore and consequent short levy of tax of Rs. 60.66 crore including interest.

2.8.3.2 On the matter being pointed out by audit, the Department added back (February 2006) the interest accrued at the rate of five percent per annum for the assessment year 2003-04. However, it did not take corrective measures to add back the interest income of Rs. 120.95 crore which had accrued up to assessment year 2002-03.

2.8.3.3 In Delhi, CIT VI charge, the assessment of a company, **M/s The State Trading Corporation of India Ltd.**, for the assessment year 2004-05 was completed after scrutiny in October 2006. Audit examination revealed that the interest income accruing to the assessee on term deposits worked out to Rs. 35.26

¹⁴ In Form no. 10CCB, under section 80IB of the Act

¹⁵ Profit derived by the refinery out of its refining activities was Rs. 514.33 crore i.e. 14 percent of its cost of operations

crore as per the balance sheet, yet only Rs. 7.25 crore was credited in the profit and loss account. The fact was also not reported in the tax audit report. The omission on the part of the assessing officer to bring the balance interest income to tax resulted in underassessment of income of Rs. 28.01 crore with potential revenue impact of Rs. 10.05 crore. The Department stated (June 2007) that necessary statutory notice had been issued to the assessee.

2.8.4 Capital expenditure is not allowable in computing business income. Particulars of amounts debited to the profit and loss account being expenditure of capital nature, are required to be disclosed in Form no. 3CD [clause 17(a)].

2.8.4.1 In Assam, CIT, Dibrugarh, Assam charge, the assessment of a company, **M/s Kitply Ind. Ltd.**, for the assessment year 2005-06 was processed in summary manner in November 2005. Audit examination revealed that the assessee had debited 'extra ordinary loss' of Rs. 170.43 crore in the profit and loss account on account of non recoverable loans and advances. The 'Notes to Account' indicated that the amount was treated as extraordinary loss considering the loans and advances as non current asset (capital nature). Audit observed that the deduction on account of loss was not allowable as loans and advances were borne on the capital account. This was, however, not reported in the tax audit report. Thus, allowance of incorrect deduction of Rs. 170.43 crore by the Department resulted in excess carry forward of loss by like amount involving potential revenue impact of Rs. 59.65 crore.

2.8.4.2 The Department has accepted (March 2007) the audit observation.

2.8.5 Where in the case of an assessee, being a company, the income-tax payable on the total income as computed under this Act is less than seven and one-half¹⁶ percent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of seven and one-half¹⁷ percent. Book profit means the net profit as shown in the profit and loss account, as increased by the amount set aside as provisions for meeting liabilities other than ascertained liabilities. Every company, to which this section applies, shall furnish a report in the prescribed form¹⁸ from an accountant certifying that the book profit has been computed in accordance with the provisions of this section along with the return of income.

2.8.5.1 In Maharashtra, CIT 1, Mumbai charge, the assessments of a company, **M/s Reliance Infocomm Ltd.**, for the assessment year 2005-06 was processed in summary manner in February 2007. Audit examination revealed that while working out the book profit and minimum alternate tax in Form no. 29B, provision for bad and doubtful debts of Rs. 235.75 crore was not added back to the net profit

¹⁶ 10 percent with effect from the assessment year 2007-08

¹⁷ 10 percent with effect from the assessment year 2007-08

¹⁸ Form no. 29B

resulting in short computation of book profit by Rs. 235.75 crore with consequent short levy of tax by Rs. 18.49 crore.

2.8.6 Any amount payable to a contractor or sub-contractor, being resident, for carrying out any work, on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid during the previous year, shall not be deducted in computing the income. Such inadmissible expenditure is required to be disclosed under clause 17(f) of Form no. 3CD.

2.8.6.1 In Andhra Pradesh, CIT, Tirupati charge, the assessment of a firm, **M/s Ramakrishna Reddy**, for the assessment year 2006-07 was processed in summary manner in January 2007. Audit examination revealed that the assessee paid Rs. 34.38 crore towards a sub-contract on which tax at source was not deducted and remitted under section 194C of the Act. This was not reported in the tax audit report. As the assessee failed to deduct tax at source, the assessing officer should have disallowed the expenditure of Rs. 34.38 crore. The omission to do so resulted in underassessment of income of Rs. 34.38 crore with consequential revenue impact of Rs. 13.19 crore including interest. The observation was not accepted by the Department on the ground that it was processed under summary assessment. The Department's reply is not tenable as mistakes arising from summary assessments conferring otherwise un-entitled benefits to the assesseees and prejudicial to the interest of revenue could be rectified under the powers separately available to the assessing officers under the Act.

2.8.7 Payment of any tax, duty, interest from loan or advance from bank is to be allowed as deduction, only if such amounts have actually been paid in the previous year. Particulars of the liability of such expenses and actual payment/non payment thereof are required to be reported in Form no. 3CD [Clause 21].

2.8.7.1 In Tamil Nadu, CIT I, Chennai charge, assessment of a company, **M/s Tamilnadu Cement Corporation Ltd.**, for the assessment year 2002-03 was completed after scrutiny in March 2005. During the previous year, the assessee had claimed a deduction of Rs. 27.61 crore on account of sales tax payment. Audit examination, however, revealed that the amount had not actually been paid, but was shown as a liability as on 31 March 2002 under the head 'Sales Tax Deferred & Interest Loan'. In the 'Notes to Accounts', it had been stated that the company had deferred the payment of sales tax for the financial year 2001-02. A proposal for converting this amount into a subsidy/long term loan had been submitted to the Government of Tamil Nadu for consideration. As such, the expenditure of Rs. 27.61 crore was not admissible under the Act. This was, however, not reported in the tax audit report. The omission on the part of the assessing officer to disallow this amount resulted in underassessment of income by Rs. 27.61 crore with consequent revenue impact of Rs. 9.12 crore and potential revenue impact of Rs. 3.55 crore.

2.8.7.2 On the matter being pointed out, the Department replied (May 2007) that if the sales tax was routed through the profit and loss account, then disallowance would not arise. Reply of the Department is not tenable in view of the fact that expenditure on account of sales tax, even if it is routed through profit and loss account, is allowable on actual payment basis only.

2.8.8 In order to avail of depreciation, it has to be ensured that i) the asset is owned by the assessee, ii) the asset is used for the purpose of business or profession and iii) the asset is used during the relevant previous year. Particulars of depreciation allowable as per the Income-tax Act, description of asset/block of assets, rate of depreciation etc. are required to be disclosed in Form no. 3CD [Clause 14].

2.8.8.1 In Rajasthan, CIT Ajmer charge, the assessment of a company, **M/s Ajmer Vidyut Vitran Nigam Ltd.**, for the assessment year 2002-03 was completed after scrutiny in January 2005. Audit examination revealed that fixed assets valuing Rs. 122.40 crore were non-existent as reported in the statutory auditor's report for the year 2001-02, but this was not reported in the tax audit report. However, depreciation of Rs. 30.60 crore on these assets was allowed by the department in contravention of the provisions of section 32 of the Act, involving revenue impact of Rs. 10.92 crore. It was further observed that the assessing officer in the scrutiny assessment in March 2006 for the assessment year 2003-04 had disallowed the depreciation on account of such non-existing assets.

2.8.9 A deduction of such profits and gains as are derived by a hundred percent export oriented undertaking from the export of articles or things or computer software for a period of 10 years, shall be allowed from the total income of the assessee. The deduction, however, shall not be admissible unless the assessee furnishes in the prescribed form¹⁹, along with the return of income, the report of an accountant certifying that the deduction has been correctly claimed in accordance with the provisions of this section. However, in computing the total income of the assessee, no loss shall be carried forward or set-off where such loss relates to any of the relevant assessment years ending before the 1 April 2001.

2.8.9.1 In Maharashtra, CIT 6, Mumbai charge, assessment of a company, **M/s Century Textile Industries Ltd.**, for the assessment year 2004-05 was completed after scrutiny in November 2006. Audit examination revealed that unabsorbed depreciation of export oriented units of Rs. 22.85 crore pertaining to assessment year 1999-2000 was allowed to be carried forward by the Department in contravention of section 10B (6)(ii) of the Act. This fact was also not reported in the tax audit report. The omission resulted in irregular carry forward of unabsorbed depreciation of Rs. 22.85 crore having potential revenue impact of Rs. 8.20 crore.

¹⁹ Form no. 56F and 56G

2.8.10 Expenditure on account of liability of a contingent nature is not allowable. Particulars of any liability of a contingent nature are required to be disclosed in Form no. 3CD [Clause 17(K)].

2.8.10.1 In Tamil Nadu, CIT I, Chennai charge, assessment of a company, M/s HTL Ltd., for the assessment year 2005-06 was processed in summary manner in November 2006. Audit examination revealed that Rs. 17.43 crore was debited towards provision for liquidated damages and provision for non-moving inventory, which being an expenditure of contingent nature was required to be disallowed. This was not reported in the tax audit report. Failure on the part of the Department to disallow the contingent expenditure resulted in underassessment of income of Rs. 17.43 crore with consequent potential revenue impact of Rs. 6.38 crore.

2.8.11 Seven other cases are given in Table no. 2.2 below:

(Rs. in lakh)

Table no. 2.2: Inadequate disclosure in tax audit reports not acted upon by assessing officers

Sl. no.	Name of the assessee/ CIT charge	Assessment year(s)	Type/date of assessment	Details of non/inadequate disclosure in tax audit report and omission on the part of the department in making additions to taxable income	Revenue impact	Department's reply
1	M/s Invensys India Pvt. Ltd. CIT IV, Delhi	2002-03	Scrutiny March 2005	Information in respect of prior period expenditure of Rs. 14.76 crore, although available in the 'Notes to Accounts', was not reported in the tax audit report. The department also did not disallow such expenditure.	526.98	The department accepted (February 2007) the audit observation.
2	M/s Kalahandi Anchalik Gramya Bank CIT, Sambalpur	2006-07	Summary November 2006	Business loss beyond eight years, of Rs. 12.62 crore, has been reported in tax audit report but the department failed to disallow such excess loss.	416.00	Reply has not been received (November 2007).
3	M/s Tata Infotech Ltd. CIT 7, Mumbai	2004-05	Scrutiny December 2006	While working out the deduction under section 10A in Form no. 56F, the expenditure incurred on the delivery of software outside India was reduced from export turnover as well as the total turnover. There is, however, no provision in the Act for reducing this expenditure from the total turnover.	397.00	Reply has not been received (November 2007).

Sl. no.	Name of the assessee/ CIT charge	Assessment year(s)	Type/date of assessment	Details of non/inadequate disclosure in tax audit report and omission on the part of the department in making additions to taxable income	Revenue impact	Department's reply
4	M/s Lionbridge Technologies P. Ltd. CIT 8, Mumbai	2003-04 2004-05	Scrutiny June 2006 December 2006	While working out the deduction under section 10A in Form no. 56F, the expenditure incurred in foreign currency for providing technical services outside India, foreign travel expenses and communication expenses of Rs. 5.50 crore and Rs. 21.28 crore was irregularly considered.	388.21	The Department stated (May 2007) that the definition of total turnover as per section 80HHE was considered. Reply of the Department is not tenable since there is no enabling provision under the Act to make such an adjustment to the total turnover.
5	M/s National Hydroelectric Power Corporation Limited CIT, Faridabad	2004-05	Scrutiny December 2006	Assessee while computing the taxable income under section 115JB, claimed irregular deduction on account of exempt interest income of Rs. 48.49 crore on long term loans though the said exemption was effective from November 2004 relevant to the assessment year 2005-06.	373.00	Reply has not been received (November 2007).
6	M/s Bannari Amman Sugars Ltd. CIT I, Coimbatore	2004-05	Scrutiny December 2006	Purchase tax on cane, and cane cess pertaining to 2002-03 had been converted into loan. This amount was, however, claimed as deduction under section 43B. As the actual payment of the said statutory obligations had not been made, allowance of the deduction under section 43B of the Act was irregular.	294.00	The Department replied (April 2007) that since the purchase tax and cane cess were collected by the Commercial Taxes Department, it could be allowed under section 43B. Reply is not tenable as Board had issued a

						notification permitting this specifically in respect of sales tax only and not other taxes/cess levied by the Commercial Taxes Department.
7	M/s. Eonour Technologies CIT I, Chennai	2002-03	Scrutiny March 2005	Out of the total export turnover of Rs. 66.58 crore, the assessee had received only Rs. 22.81 crore towards export proceeds, and had obtained permission from the RBI for Rs. 7.30 crore to be realised later. Thus, the claim under section 10A should have been restricted to Rs. 30.11 crore only. However, the claim was incorrectly made based on the total export turnover of Rs. 66.58 crore. This resulted in excess deduction under section 10A of Rs. 5.85 crore.	293.00	Reply has not been received (November 2007).

2.8.12 Thus, the intention of the Act in introducing compulsory audit so that the income tax returns faithfully reflect the income of the taxpayer and claims for deduction are correctly made was not achieved in these cases. The departmental officers also failed to notice these errors and omissions and take corrective action while finalising the assessments.

2.8.13 *Audit recommends that the Ministry may issue instructions to ensure that assessing officers critically examine the tax audit reports along with the connected records and other available evidence so as to make an independent assessment in each case.*

2.8.14 In the exit conference, the Board accepted the audit recommendation.

2.9 Information not utilised by the assessing officers

2.9.1 Audit noticed 233 cases in which the assessing officers failed to utilise the information available in the tax audit reports/certificates while finalising assessments, involving revenue impact of Rs. 228.01 crore, in Andhra Pradesh, Assam, Bihar, Chandigarh, Delhi, Goa, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Thirteen cases are discussed below and six other cases are given in **Appendix 7**.

2.9.2 Income chargeable under the head “Profits and gains of business or profession” shall be computed in accordance with either cash or mercantile system of accounting regularly employed by the assessee. In cases where the mercantile system of accounting has been employed by the assessee, deduction in respect of prior period expenditure is not to be allowed. Particulars of such income or expenditure of prior period credited or debited to the profit and loss account are required to be disclosed in Form no. 3CD [Clause 22].

2.9.2.1 In Delhi, CIT I charge, the assessment of a company, **M/s Bharat Sanchar Nigam Ltd.**, for the assessment year 2002-03 was completed after scrutiny in February 2005. Audit examination revealed that as per the tax audit report, assessee had made adjustments of prior period expenses of Rs. 332.19 crore which included prior period depreciation of Rs. 192.88 crore. However, the Department, while taking cognizance of the prior period adjustments, failed to consider the prior period depreciation of Rs. 192.88 crore as reported in the tax audit report, and the same was not added back in computation, with a potential revenue impact of Rs. 68.86 crore.

2.9.3 No loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed. Details of brought forward loss or depreciation allowance, to the extent available, are to be disclosed in Form no. 3CD [Clause 25].

2.9.3.1 In Delhi, CIT IV charge, the assessment of a company, **M/s Hotline CPT Ltd.**, for the assessment year 2003-04 was completed after scrutiny in February 2006 determining a loss of Rs. 122.67 crore. In the tax audit report, the accountant had reported year wise details of unabsorbed depreciation and brought forward loss totaling Rs. 151.32 crore. Audit examination revealed that in the previous year, assessee had a business profit of Rs. 0.84 crore, and the assessing officer instead of adjusting the unabsorbed business loss to the extent of business profit for the assessment year 2003-04 i.e. Rs. 0.84 crore and determining the income as ‘nil’, allowed the assessee to incorrectly adjust the entire brought forward loss and unabsorbed depreciation of Rs. 151.32 crore, and completed the assessment at a loss of Rs. 122.67 crore²⁰. The mistake resulted in irregular set off of unabsorbed business loss and consequent over assessment of loss involving potential revenue impact of Rs. 42.93 crore.

2.9.3.2 The Department has accepted (July 2007) the audit observation.

2.9.4 No person shall take or accept/repay from/to any other person, any loan or deposit otherwise than by an account payee cheque or bank draft if the amount of such loan or deposit is twenty thousand rupees or more. Non-compliance of these provisions attracts penalty, a sum equal to the amount of the loan/deposit taken or

²⁰ Rs. 151.32 crore (unabsorbed losses and depreciation) less Rs. 0.84 crore (business profit during the previous year) less Rs. 27.81 crore (expenditure disallowed by the assessing officer).

repaid. Particulars to this effect are required to be disclosed in Form no. 3CD [Clause 24].

2.9.4.1 In Tamil Nadu, CIT I, Chennai charge, assessment of a company, **M/s DSQ Software Ltd.**, for the assessment year 2003-04 was completed after scrutiny in March 2006. Audit examination revealed that in Form no. 3CD, the accountant had reported that Rs. 31.85 crore was paid otherwise than by account payee cheque/demand draft to another party. Though the case was completed after scrutiny, yet no details were called for to establish reasonable grounds for payment other than through account payee cheque/demand draft. The assessee was thus liable for penalty of Rs. 31.85 crore under section 271E, equal to the amount of deposit repaid.

2.9.4.2 When this was pointed out, the Department in its reply stated (April 2007) that the case had been referred for initiating penal proceedings under section 271E to the Additional Commissioner of Income Tax.

2.9.4.3 In Maharashtra, CIT 8, Mumbai charge, assessment of a company, **M/s World Wide Commodities Trade P. Ltd.**, for the assessment year 2004-05 was completed after scrutiny in December 2006. Audit examination revealed that loans of Rs. 4.77 crore were repaid otherwise than by account payee cheque or draft as per the tax audit report. The assessee was thus liable for penalty of Rs. 4.77 crore under section 271E, equal to the amount of deposit repaid.

2.9.5 Any sum, received by the assessee from any of his employees towards contributions to any provident fund or superannuation fund, shall be allowed as deduction if such sum is credited by the assessee to the employee's account in the relevant fund on or before the due date. Particulars to this effect are required to be disclosed in the Form no. 3CD [Clause 16].

2.9.5.1 In Gujarat, CIT II, Ahmedabad charge, assessment of a company, **M/s Gujarat State Road Transport Corporation**, for the assessment year 2004-05 was completed after scrutiny in March 2006. Audit examination revealed that as per the tax audit report, assessee had deposited employees' contribution of Rs. 23.04 crore beyond the due date of deposit. However, the same was not disallowed at the time of scrutiny assessment resulting in underassessment of income by Rs. 23.04 crore, involving revenue impact of Rs. 8.27 crore.

2.9.5.2 In West Bengal, CIT I, Kolkata charge, assessment of a company, **M/s Indian Iron and Steel Company**, for the assessment year 2004-05 was completed after scrutiny in November 2006. Audit examination revealed that as per the tax audit report, the assessee had deposited employees' contribution of Rs. 19.03 crore beyond the due date of deposit which was not allowable. However, this was not added back at the time of scrutiny assessment resulting in underassessment of income by Rs. 19.03 crore involving revenue impact of Rs. 6.83 crore.

2.9.6 Capital expenditure is not allowable in computing business income. Particulars of amounts debited to the profit and loss account being expenditure of capital nature are required to be disclosed in Form no. 3CD [clause 17(a)].

2.9.6.1 In Tamil Nadu, CIT I, Chennai charge, assessment of a company, **M/s Ford India Ltd.**, for the assessment year 1999-2000 was completed after scrutiny in November 2006. Audit examination revealed that while disallowing capital expenditure as reported in tax audit report, the figures were adopted incorrectly by the assessing officer. As against the actual amount of Rs. 28.42 crore to be disallowed, only Rs. 2.84 crore was disallowed resulting in underassessment of income by Rs. 25.58 crore with a potential revenue impact of Rs. 9.72 crore.

2.9.7 Any amount payable to a contractor or sub-contractor, being resident, for carrying out any work, on which tax is deductible at source and such tax has not been deducted or, after deduction, has not been paid during the previous year, shall not be deducted in computing the income. Such inadmissible expenditure is required to be disclosed under clause 17(f) of Form no. 3CD.

2.9.7.1 In Andhra Pradesh, CIT II, Hyderabad charge, the assessment of a company, **M/s Cesma-Hua Kok-Tiong Seng-Neo Construction (India) P. Ltd.**, for the assessment year 2005-06 was processed in summary manner in March 2006. Audit scrutiny revealed that the assessee had claimed an expenditure of Rs. 84.54 crore towards sub-contracts and consultancy services. However, it was observed from the tax audit report that TDS was deducted on Rs. 70.75 crore only. Thus, tax was not deducted at source on the payments of Rs. 13.79 crore made to sub-contractor/consultant. Therefore, the total payment of Rs. 13.79 crore was required to be disallowed. The omission to do so resulted in underassessment of income of Rs. 13.79 crore with consequential short demand of tax of Rs. 5.93 crore including interest. The observation was not accepted by the Department on the ground that the assessment had been processed in a summary manner. The Department's reply is not tenable as mistakes arising from summary assessments conferring otherwise un-entitled benefits to the assesseees and prejudicial to interest of revenue could be rectified under the powers separately available to the assessing officers under the Act.

2.9.8 Five other cases are given in **Table no. 2.3** below:

(Rs. in lakh)

Table no. 2.3: Information not utilised by the assessing officers						
Sl. no.	Name of the assessee/CIT charge	Assessment year(s)	Type/date of assessment	Nature of mistake	Revenue impact	Department's reply
1	Pfizer Pharmaceuticals Ltd. CIT 8, Mumbai	2004-05	Scrutiny December 2006	The Department allowed set off of losses of Rs. 28.05 crore and carry forward of loss of Rs. 12 crore. However, as per the tax audit report, the assessee had brought forward loss of Rs. 26.78 crore only for assessment years 2000-01 and 2001-02 resulting in excess allowance of carry forward of loss.	430.57	Reply has not been received (November 2007).
2	North Delhi Power Ltd. CIT V, Delhi	2003-04	Scrutiny February 2006	Energy tax of Rs. 8.45 crore was not paid by the assessee till the date of filing of the return. Despite this being reported in the tax audit report, the Department did not add back this amount to the income of the assessee.	310.65	Reply has not been received (November 2007).
3	Metropolitan Transport Corporation Ltd. CIT III, Chennai	2003-04	Summary November 2003	As per the tax audit report, remittances of Rs. 8.40 crore into the provident fund were made beyond the due dates. Failure on the part of the Department to add back the said remittances resulted in underassessment of income.	308.88	Reply has not been received (November 2007).
4	Star Agro Marine Exports (P) Ltd. CIT III, Chennai	2005-06	Summary October 2005	Contingent liabilities though reported in the tax audit report but not disallowed by the assessing officer.	307.28	Returns were processed in summary manner. The reply is not tenable as mistakes arising from summary assessments conferring otherwise unentitled benefits to the assessee and prejudicial to interest of revenue could be rectified under the powers separately available to the assessing officers under the Act.

Sl. no.	Name of the assessee/CIT charge	Assessment year(s)	Type/date of assessment	Nature of mistake	Revenue impact	Department's reply
5	Sailee Developers P. Ltd. CIT 9, Mumbai	2005-06	Summary March 2007	Loan of Rs. 1.80 crore was repaid otherwise than by account payee cheque or draft as per the Tax Audit Report in contravention of the provisions of section 269T attracting penalty under section 271E. However, penalty was not levied.	180.24	Reply has not been received (November 2007).

2.9.9 Thus, the objective behind audit of accounts under various provisions of the Act was not achieved as the information emerging out of the tax audit reports was not utilised by the assessing officers while finalising assessments in these cases.

2.9.10 *Audit recommends that the Ministry may ensure that information as available from the tax audit reports is effectively utilised in finalising the assessments.*

2.9.11 In the exit conference, the Board accepted the audit recommendation.

2.10 Incomplete/non-committal comments in the tax audit reports

2.10.1 The tax audit reports are to be signed by a chartered accountant within the meaning of the Chartered Accountants Act, 1949. The chartered accountant while signing the report has to indicate his membership number/certificate of practice number. Audit observed in 1029 (**Appendix 8**) cases that either the tax audit reports had not been signed or the membership number had not been given.

2.10.2 Where the assessee incurs any expenditure in respect of which payment is made in a sum exceeding Rs. 20,000 otherwise than by an account payee cheque/bank draft, 20 percent of such expenditure shall not be allowed as deduction except in certain cases and circumstances. Further, no person shall take or accept/repay from/to any other person, any loan or deposit otherwise than by an account payee cheque or bank draft if the amount of such loan or deposit is Rs. 20000 or more. Non-compliance of these provisions attracts a penalty equal to the amount of the loan/deposit taken or repaid. Particulars of such cases are required to be disclosed in Form no. 3CD [Clause 17(h), Clause 24].

2.10.2.1 Audit examination revealed that in 431 cases (**Appendix 9**), accountants had stated that they were not able to verify if expenditure in excess of Rs. 20000 was incurred or whether loans or deposits were taken or accepted otherwise than by an account payee cheque/bank draft as the necessary evidence was not available with the assessee.

2.10.3 It would be seen from the above that in a large number of cases, accountants have been commenting that they are not in a position to verify the mode (account payee cheque/bank draft or otherwise) of payments made in the absence of necessary evidence with the assessee. However, with effect from 10 August 2006²¹, the accountant is required to indicate in Form no. 3CD whether a certificate has been obtained from the assessee regarding payments relating to any expenditure/taking or accepting loan or deposit, or repayment of the same through account payee cheque/bank draft.

2.10.4 *Audit recommends that the Ministry may consider evolving a mechanism to ensure that assessing officers test check such receipts/payments by the assessees and utilise penal provisions where required.*

2.11 Internal Control

2.11.1 In order to ensure that the assessee, accountant and assessing officer comply with the various provisions of the Act, Board had issued instruction no. 1959 and 1976 in January 1999 and November 1999. These instructions contain detailed procedures for effective utilisation of information available in the tax audit reports while finalising assessments. Compliance with these instructions are discussed below:

2.11.2 At the time of completion of assessment after detailed scrutiny under section 143(3), the assessing officer may again examine the tax audit report thoroughly to ascertain whether any addition to the income is possible on the basis of the same or whether any further investigation is required pursuant to the information submitted therein.

2.11.3 Audit observed in 233 cases (paragraph 2.9) though relevant information was available in the audit reports, yet it was not utilised while finalising the scrutiny assessment by the assessing officers.

2.11.4 Audit also observed 665 cases of inadequacies/omissions in the tax audit reports which were not detected by the assessing officers. Failure of the assessing officers in detecting such omissions/inadequacies in the tax audit reports (paragraph 2.8.1) and consequently not disallowing inadmissible deductions is indicative of the fact that tax audit reports are not being evaluated effectively.

2.11.5 All cases where the information provided in the tax audit report is incomplete or such non-committal replies are furnished so as to render the remarks or the report meaningless should be reported by the assessing officer to the CIT. The matter thereafter be taken up by the CIT to see if the case reflects any professional negligence on the part of the accountants signing the audit report. Action for initiation of disciplinary proceedings in terms of section 288 of the Act

²¹ Income tax (Ninth Amdt.) Rules, 2006,

should be immediately taken by the CIT with the approval of CCIT as the case may be.

2.11.6 Audit observed that in 237 cases, errors and omissions in the audit reports were noticed by the department (paragraph 2.7.2). Further, as discussed in paragraph 2.10, 1460 cases of incomplete/non-committal comments in the tax audit reports have been noticed. However, as per records available to audit, no action had been taken by the Department in terms of instruction no. 1959, 1976 and section 288 of the Act in respect of mistakes/inadequacies noticed in the audit reports.

2.11.7 A "Control Register of tax audit cases under section 44AB" should be maintained by assessing officers as per format prescribed in Annexure 'A' (**Appendix 10**) to the instruction no. 1976 dated 3.11.99. The maintenance of this register would enable assessing officers to keep effective check on (i) all cases where tax audit report is mandatory, (ii) cases of non-filing or late filing of tax audit report, (iii) penalty proceedings under section 271B for failure to get accounts audited or furnishing report of such audit and (iv) irregularities in tax audit report.

2.11.8 Based on the information furnished/records produced it was observed that the "Control register of tax audit cases under section 44AB" was not being maintained in 19 states²² (**Appendix 11**). The control register was being maintained in some circles in states of Kerala, Madhya Pradesh and West Bengal. In Andhra Pradesh, Punjab and Uttar Pradesh, the Department has replied that henceforth the register would be maintained.

2.11.9 Audit reports are required to be examined to see if it contained any credible information on the basis of which cases can be picked up for assessment under section 143(3).

2.11.10 Audit observed that five cases²³ were processed in summary manner (paragraph 2.9) which should have been picked for scrutiny after examining the tax audit reports. Not considering the information disclosed in the tax audit reports resulted in underassessment of income involving revenue impact of Rs. 15.68 crore.

2.11.11 Further with the introduction of e-filing of returns and the new annexure-less forms, an assessee is not required to attach tax audit report/certificate by accountant along with the return, which are now to be furnished only on demand by the authorities. This would impact the use of information available in the tax audit report for selecting cases for scrutiny.

²² The Department has furnished information in respect of 19 states only till date

²³ Paragraph no. 2.9.7.1 (Rs. 5.93 crore), 2.9.8: Table no. 2.3: Sl. no. 3 (Rs. 3.09 crore), Sl. no. 4 (3.07 crore), Sl. no. 5 (Rs. 1.80 crore), Appendix 7: Sl. no. 1 (Rs. 1.79 crore)

2.11.12 *Audit recommends that the Ministry may consider a suitable mechanism for linking the information available in the tax audit reports with the new annexure-less forms.*

2.11.13 In the exit conference, the Board stated that the issue would be examined.

2.11.14 Where the tax audit reports are not filed or filed late; penalty is to be levied promptly.

2.11.15 Audit observed that in 109 cases (**Appendix 12**), tax audit reports were either not filed or were filed late. Penalty of Rs. 80.05 lakh has not been levied.

2.11.16 The assessing officer is required to submit a quarterly progress report in the prescribed format as per Annexure 'B' (**Appendix 13**) to the instruction no. 1976 to report on progress on tax audit cases under section 44AB.

2.11.17 Audit observed that such "quarterly progress reports" were not being submitted by a majority of the assessing officers. Information given/records produced to audit indicated that the return was being submitted only in certain circles in the states of Gujarat and Karnataka.

2.11.18 Thus, the internal control mechanism in the Department to ensure that (i) the audit reports/certificates were complete and provided sufficient and requisite information to the assessing officer, (ii) information which is provided in the audit reports is being effectively utilised by the assessing officers and (iii) cases are selected for scrutiny assessment on the basis of tax audit reports, is not effective.

2.11.19 *Audit recommends that the Ministry strengthens its internal control and monitoring mechanism to ensure compliance with the instructions, rules, circulars and provisions of the Income Tax Act, 1961.*

2.11.20 In the exit conference, the Board accepted the audit recommendation.

Compliance issues

2.12 Variation between inadmissible expenditure as per assessee and as per audit report

2.12.1 In Kerala, CIT, Trichur charge, assessment of a company, **M/s The Kerala State Financial Enterprises Ltd.**, for assessment year 2004-05 was completed after scrutiny in December 2006. Audit examination revealed that Rs. 18.70 crore debited to the profit and loss account on account of provision for doubtful debts was taken as inadmissible expenditure by the assessee himself in computation of his taxable income but such disallowance was not indicated in the tax audit report.

2.12.2 In Kerala, CIT, Trichur, charge, the assessment of company, **M/s Catholic Syrian Bank Ltd.**, for the assessment year 2000-01 and 2001-02 was completed after scrutiny in December 2006. Audit examination revealed that though Rs. 10.56 crore debited to the profit and loss account on account of provision for tax was taken as inadmissible expenditure by the assessee himself in computation of his taxable income, it was not reported as inadmissible in the tax audit report.

2.12.3 In Kerala, CIT, Cochin charge, in the assessment of a local authority, **Cochin Port Trust**, for the assessment year 2003-04, it was noticed that the assessee had filed a revised return, offering for assessment interest income of Rs. 9.32 crore which was initially incorrectly credited to the balance sheet instead of the profit and loss account. Similarly, by another revised return, the assessee had reduced its claim for depreciation by Rs. 26.73 lakh. Audit examination revealed that the mistakes in the accounts, though rectified by the assessee, were not highlighted in the tax audit report.

2.13 Non submission of tax audit reports/certificates by the assessee

2.13.1 Audit noticed non submission of accountant's reports/certificates by the assessee in 102 cases involving short levy of tax of Rs. 11.42 crore in Andhra Pradesh, Assam, Goa, Gujarat, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Two cases are illustrated below:

2.13.2 Where in the case of an assessee, being a company, the income-tax, payable on the total income as computed under this Act is less than seven and one-half²⁴ percent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of seven and one-half²⁵ percent. Every company, to which this section applies, shall furnish a report²⁶ in the prescribed form from an accountant certifying that the book profit has been computed in accordance with the provisions of this section along with the return of income.

2.13.3 In Maharashtra, CIT 1, Mumbai charge, the assessments of a company, **M/s Reliance Infocomm Ltd.**, for the assessment years 2004-05 was completed in scrutiny manner in December 2006. While computing income for the assessment year 2004-05, the assessee stated that since book profit was negative, minimum alternate tax (MAT) was not applicable. The assessee had not furnished the certificate of the accountant in Form no. 29B along with the return.

2.13.3.1 Audit examination, however, revealed that provisions for bad and doubtful debts of Rs. 436.26 crore was not added to the net loss (Rs. 390.31 crore) to arrive at a book profit. Thus, omission to add back the said provisions resulted

²⁴ 10 percent with effect from the assessment year 2007-08

²⁵ 10 percent with effect from the assessment year 2007-08

²⁶ Form no. 29B

in understatement of book profit by Rs. 45.95 crore with consequent short levy of tax by Rs. 3.53 crore. It was further observed that while computing the income of the assessee in the normal course, this provision had been added by the assessing officer to calculate the income.

2.13.4 In Maharashtra, CIT 1, Pune charge, assessment of a company, **M/s Brahma Bazaz Hotel Ltd.**, for the assessment year 2004-05 was processed in summary manner in August 2006. Audit examination revealed that the assessee had book profits of Rs. 12.15 crore, and was liable to pay tax under section 115 JB of the Act. However, neither was the certificate in Form no. 29B taken from the accountant and submitted as required, nor was the tax paid, resulting in revenue loss of Rs. 1.11 crore including interest.

2.13.4.1 The Department stated (April 2007) in respect of M/s Brahma Bazaz Hotel Ltd. that the assessment was processed in summary manner. However, remedial action would be initiated.

2.13.5 *Audit recommends that the Ministry may ensure that necessary tax audit reports/certificates have been furnished by the assessee before allowing deductions and determination of tax.*

2.13.6 In the exit conference, the Board accepted the audit recommendation.

2.14 Conclusion

2.14.1 Audit has noticed several cases of (i) tax audit reports with inadequate/inaccurate information which was not verified at the time of assessment and (ii) where information available in the tax audit reports were not effectively utilised while finalising assessments. Thus, in these cases, the intention of the Act in introducing compulsory audit/certification by third parties so that books of accounts faithfully reflect the income of the taxpayer and that the claims for deductions are correctly made, has not been fulfilled. Ministry may consider ways to improve the quality of tax audit reports/certificates to ensure greater compliance with the provisions of the Act, as also reiterate its instructions to assessing officers to appropriately evaluate and utilise the information in tax audit reports while finalising assessments. Further, the internal control mechanism in the Department to monitor compliance with provisions of the Act and its instructions on compulsory audit of accounts and audit reports/certificates, as also evaluation and utilisation of the information in these reports, is ineffective. The internal control mechanism as well as the monitoring mechanism in the Department may be made more effective for ensuring compliance with the instructions of the Department.

2.15 Summary of recommendations

2.15.1 *The Ministry may ensure taking of action in terms of instruction no.1959 and section 288 of the Act, in cases where inadequate/inaccurate information have been furnished in the tax audit reports.*

2.15.1.1 In the exit conference, the Board accepted the audit recommendation.

2.15.2 *The Ministry may issue instructions to ensure that assessing officers critically examine the tax audit reports along with the connected records and other available evidence so as to make an independent assessment in each case.*

2.15.2.1 In the exit conference, the Board accepted the audit recommendation.

2.15.3 *The Ministry may ensure that information as available from the tax audit reports/certificates is effectively utilised in finalising the assessments.*

2.15.3.1 In the exit conference, the Board accepted the audit recommendation.

2.15.4 *The Ministry may consider evolving a mechanism to ensure that assessing officers test check transactions of Rs. 20000 or more and utilise penal provisions where required.*

2.15.5 *The Ministry may consider a suitable mechanism for linking the information available in the tax audit reports with the new annexure-less forms.*

2.15.5.1 In the exit conference, the Board stated that the issue would be examined.

2.15.6 *The Ministry needs to strengthen its internal control and monitoring mechanism to ensure compliance with the instructions, rules, circulars and provisions of the Income Tax Act, 1961.*

2.15.6.1 In the exit conference, the Board accepted the audit recommendation.

2.15.7 *The Ministry may ensure that necessary tax audit reports/certificates have been furnished by the assessee before allowing deductions and determination of tax.*

2.15.7.1 In the exit conference, the Board accepted the audit recommendation.

Chapter III

Review on assessments relating to infrastructure development (Deductions under section 80IA of the Income Tax Act)

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Highlights

Audit reviewed the assessment records of the assessee engaged in infrastructure development and claiming deduction under section 80IA of the Income Tax Act completed during the financial years 2003-04 to 2006-07 (upto the date of audit) with a view to (i) determine the extent of underassessment/loss of revenue due to mistakes in assessment, (ii) determine the degree of compliance by the specified undertakings or enterprises with the provisions of the Act, and (iii) derive an assurance that the systems and procedures are sufficient and promote compliance with the provisions of the Act/rules.

During the review audit test checked 685 assessments in company and non company circles involved in the specified infrastructure activity for verifying the claims of deduction under section 80IA of the Act. Audit observed mistakes in 91 cases having a value of Rs. 2037.22 crore and revenue impact of Rs. 932.29 crore.

(Paragraph 3.6.1)

Deduction under section 80IA was allowed without taking into account all losses and depreciation relating to the eligible units involving revenue impact of Rs. 581.89 crore. In the case of **M/s Bharat Sanchar Nigam Limited**, unabsorbed depreciation had not been taken into account while allowing deduction under section 80IA involving a revenue impact of Rs. 318.17 crore.

(Paragraphs 3.6.3.4 and 3.6.3.5)

Benefit of deduction under section 80IA was allowed in respect of incomes not relatable to the eligible undertaking with a revenue impact of Rs. 96.92 crore. In the case of **M/s Gujarat Powergen Energy Corporation** interest income was not disallowed while computing deduction under section 80IA with a revenue impact of Rs. 81.50 crore.

(Paragraphs 3.6.9.1 to 3.6.9.8)

Incorrect apportionment of expenses relating to eligible undertakings resulted in inflation of eligible profits and consequent deduction involving a revenue impact of Rs. 101.38 crore. In the case of **M/s Nuclear Power Corporation of India Ltd**, this resulted in excess deduction involving a revenue impact of Rs. 67.87 crore.

(Paragraphs 3.6.4.2 and 3.6.4.3)

Benefit of deduction under section 80IA had been availed of by ineligible assessee involving a revenue impact of Rs. 40.20 crore. In the case of **M/s Kirloskar Brothers Limited** the deduction under section 80IA was allowed though the assessee was ineligible for the same, with a revenue impact of Rs. 12.35 crore.

(Paragraphs 3.6.2.3 to 3.6.2.13)

There were no clear directions for the determination of reasonable profits to be allowed as deduction for captive power plants under section 80IA.

(Paragraphs 3.6.6.1 to 3.6.6.13)

Major companies providing telecommunication services had either not claimed or could not avail of the deduction under section 80IA provided in the Act as they were either operating under loss or were being assessed under the special provisions of the Act which does not take into account deductions under section 80IA.

(Paragraph 3.6.11.7)

Audit recommends that:

- The Ministry may strengthen its internal control mechanism to ensure that the assessing officers correctly apply the provisions of the Act in respect of deductions extended to works contractors.

(Paragraph 3.7.1.1)

- The Ministry may consider making it mandatory for the assessee availing of 80IA deduction to furnish details of carry forward of loss/depreciation from the first year of operation in order to compute profits relating to eligible units as a distinct entity. It is recommended that assessment orders clearly specify the details of losses to be carried forward for set off in future years for eligible and ineligible units separately.

(Paragraph 3.7.3.1)

- The Ministry may consider incorporating a provision in the rules so that the tax audit report in Form no. 10CCB specifies the basis of apportionment/ allocation of common expenses especially with regard to composite business where assessee have both eligible and ineligible units.

(Paragraph 3.7.4.1)

- The Ministry may institute a mechanism for compulsory checking of the statutory reports before allowing deductions.

(Paragraph 3.7.5.1)

- The Ministry may like to devise a monitoring mechanism which ensures that its scrutiny guidelines are scrupulously followed and no high risk case is omitted from scrutiny. The Ministry should also ensure that the CASS identifies all cases which fulfil the criteria for the selection of cases for scrutiny.

(Paragraph 3.7.7.1)

- The Ministry may like to examine the availment of deduction under section 80IA by the specified sectors and also carry out an impact analysis in order to ensure that the policy objectives of the government are achieved.

(Paragraph 3.7.8.1)

**Review on assessments relating to infrastructure development
(Deductions under section 80IA of the Income Tax Act)**

3.1 Introduction

3.1.1 The provision of efficient infrastructure services is essential to realise the full potential of growth in the economy. The infrastructure sector includes power, telecommunication, roads, and industrial parks as well as power generation, distribution and transmission. It has been recognised that government alone cannot fulfill all the requirements of providing infrastructure and that the private sector also needs to be actively engaged in the process by providing an appropriate policy framework which gives them adequate confidence and incentives to invest on a large scale, while simultaneously preserving adequate checks and balances through transparency, competition and regulation¹.

3.1.2 Tax incentives can be defined as any incentive that reduces the tax burden of enterprises in order to induce them to invest in particular projects or sectors or geographical areas. Tax incentives or tax preferences include reduced rates of taxes on profits, tax holiday, accelerated depreciation, deferrals, credits, etc. In developing an incentive system, the government needs to clearly list and analyse the deficiencies in the system that the incentives are designed to reduce. The costs of granting incentives can then be compared to the benefits of removing or reducing such deficiencies. Periodic review of the incentive system would help to plug revenue leakage as also appropriately modify the incentive scheme.

3.2 Objective of the review

The review seeks to examine the benefit of deduction under section 80IA of the Act in respect of industrial undertakings or enterprises with a view to:

- i) determine the extent of underassessment/loss of revenue and other irregularities due to mistakes in assessment
- ii) determine the degree of compliance by the specified undertakings or enterprises with the provisions of the Act
- iii) derive an assurance that the systems and procedures are sufficient and promote compliance with the provisions of the Act/Rules.

3.3 Law and procedure

3.3.1 Background of section 80IA

Section 80IA of the Income Tax Act (Act) provides the extent and scope of deductions available to undertakings involved in the business of infrastructure development. The Finance Act, 1999 substituted section 80IA with a new section

¹ Chapter 9 of the Economic Survey 2006-07

80IA and section 80IB. Section 80IA as it originally stood in the Act provided for deductions in respect of profits and gains of industrial undertaking in certain cases. With effect from 1 April 2000, deduction under section 80IA is available to the following business carried on by an undertaking:

- Provision of infrastructure facility which includes roads, highway projects, water supply, water treatment projects, sanitation and sewerage systems, solid waste management systems and ports including airport, inland waterway or inland port
- Telecommunication services
- Industrial parks
- Power generation, transmission and distribution.

3.3.2 The eligible profits have to be taken as if they are the only source of income and computed accordingly. The deduction is admissible only if the accounts of the undertaking have been audited by a chartered accountant and the tax audit report in Form no. 10CCB duly signed and verified by such accountant is furnished along with the return of income.

3.4 Scope of review

3.4.1 The review was conducted on both summary and scrutiny assessments completed during the financial years 2003-04 to 2006-07 (upto the date of audit). Audit test checked assessment records of 685 assesseees in company and non company circles involved in the specified infrastructure activity for verifying claims of deduction under section 80IA of the Act.

3.4.2 Audit methodology

A list of undertakings engaged in the eligible business were collected from various sources including State Government authorities, Electricity Boards, the Ministry of Telecommunications and the Department of Industrial Policy and Promotion Council (DIPP) to identify assesseees who were likely to claim deduction under section 80IA. In addition, the assessment records and also the list of assesseees furnished by the Director General of Income Tax (Systems), New Delhi and Regional Computer Centres of the respective states were scrutinised to identify assesseees who had availed of deduction under section 80IA.

3.4.3 Copies of the draft review reports containing audit observations were issued to the respective Chief Commissioners of Income Tax/ Commissioners of Income Tax by the Director General of Audit/Pr. Director of Audit/Pr. Accountants General/ Accountants General during the period from June 2007 to July 2007.

3.5 Acknowledgement

Indian Audit and Accounts Department acknowledges the cooperation of the Income tax Department in providing the necessary records and information for audit. The draft review was issued to the Ministry in November 2007. An exit conference was held in December 2007 with the Board to discuss the results of this review. The views expressed by them in the exit conference have been appropriately incorporated in this report.

3.6 Audit findings

3.6.1 Audit of assessment records of 685 assesseees in company and non company circles in the review revealed mistakes in 91 cases with a revenue impact of Rs. 2,037.22 crore, of which Rs. 932.29 crore relates to short levy of tax and Rs. 1,104.93 crore relates to other issues which have potential impact on levy of tax such as non restriction of deduction to reasonable profits, non preparation of separate accounts etc., in the states of Andhra Pradesh, Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

System issues

3.6.2 Benefit of deduction availed by ineligible assesseees

Audit noticed in 16 cases that the benefit of deduction under section 80IA had been allowed to ineligible assesseees as detailed in paragraphs below:

Infrastructure sector

3.6.2.1 The benefit of deduction under section 80IA is available to an Indian company or a consortium of such companies which develops infrastructure. For being considered a developer of an infrastructure project, an assessee needs to execute the project on a build-operate-transfer (BOT), build-operate-own-transfer (BOOT) or build-operate-lease-transfer (BOLT) basis and the assessee has to invest his own funds in the infrastructure project. The enterprise has to enter into an agreement with a government entity (viz. Central Government, State Government or local authority or any other statutory body). In cases where the assessee is operating and maintaining an infrastructure facility, the assessee needs to secure an operation as well as maintenance contract and the concerned asset has to be transferred to the assessee for such purpose. It has been judicially² held that the intention behind this provision was to give a "fillip of deduction against the total income of the assessee derived from the infrastructure project as the entire cost of the infrastructure was being borne by the assessee".

² Ayush Ajay Construction Ltd vs Income-Tax Officer {79 ITD 213}

3.6.2.2 This implies that deduction under section 80IA is not available to a company which does not develop the infrastructure but merely constructs them on contract basis. The Finance Act, 2007 inserted an explanation retrospectively that nothing contained in section 80IA would apply to a person who executes a work on contract basis. It has been judicially³ held that the explanation must be read into the main provision with effect from the time that the main provision came into force.

3.6.2.3 In Maharashtra, CIT 1, Pune charge, the assessments of a company, **M/s Kirloskar Brothers Limited**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in March 2006 and December 2006 respectively. The assessee had claimed deduction of Rs. 5.49 crore and Rs. 28.24 crore in the assessment years 2003-04 and 2004-05 respectively on profits derived from the work carried out by the assessee for M/s Sardar Sarovar Narmada Nigam Ltd. which consisted of design and supply of equipment and a second contract for erection, commissioning, operating and maintaining the equipment for a limited period. The assessee was not entitled for deduction as it was merely carrying out the work on works contract basis and it had not developed any infrastructure facility. Since the assessee was not a developer of the project as specified under section 80IA, the allowance of deduction was irregular. The omission to do so resulted in loss of revenue of Rs. 1.97 crore and Rs. 10.38 crore in assessment years 2003-04 and 2004-05 respectively.

3.6.2.4 In Maharashtra, CIT 2, Mumbai charge, the assessments of a company, **M/s Larsen and Toubro Limited**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in January 2006 and December 2006 respectively after allowing a deduction of Rs. 13.12 crore and Rs. 9.60 crore under section 80IA. Audit examination revealed that the income on which deduction has been allowed related to contract works executed by the assessee. Neither was the work carried out on BOT, BOOT or BOLT basis nor was any agreement with the government entity filed with the Department. Hence deduction under section 80IA should have been disallowed, which was not done. This resulted in incorrect allowance of deduction aggregating to Rs. 22.72 crore involving revenue impact of Rs. 8.26 crore.

3.6.2.5 In Maharashtra, CIT Central 3, Mumbai charge, assessment of a company, **M/s ABG Heavy Industries**, for the assessment year 2003-04 was completed after scrutiny in December 2005. The assessee had supplied cargo handling equipments to the Jawaharlal Nehru Port (JNPT) for which JNPT was paying lease rentals to the assessee. The assessee had supplied only cranes as per the JNPT's requirements, which could not be construed as having developed, maintained or operated an infrastructure facility namely, 'port'. Though the Department had disallowed the deduction in assessment years 1998-99 and 1999-2000, it was allowed in the assessment year 2003-04. The omission to disallow it resulted in

³ Supreme Court Judgment in case no. Appeal (Civil) 351-355 of 2005 Sedco Forex International Drill. Inc. & Others vs CIT, Dehradun & Anr dated 17 November 2005

underassessment of income of Rs. 18.06 crore involving revenue impact of Rs. 6.64 crore.

3.6.2.6 The Department has accepted (March 2007) the observation.

3.6.2.7 In Maharashtra, CIT 24, Mumbai charge, assessment of a company, **M/s Patel KNR JV**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in December 2005 and December 2006 respectively after allowing a deduction of Rs. 0.79 crore and Rs. 9.89 crore under section 80IA. Audit examination revealed that the assessee was executing widening and rehabilitation of carriageway (Krishna Vaniyambadi section) as a contractor engaged by the National Highway Authority of India (NHAI), which was the developer in this project. Since the assessee was not a developer of the project as specified under section 80IA, the allowance of deduction aggregating to Rs. 10.68 crore was irregular involving revenue impact of Rs. 3.84 crore.

3.6.2.8 In Maharashtra, CIT 24, Mumbai charge, the assessments of a company, **M/s KNR Patel JV**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in December 2005 and December 2006 respectively, after allowing a deduction of Rs. 4.84 crore and Rs. 4.76 crore under section 80IA. Audit examination revealed that the assessee was executing widening and rehabilitation of carriageway (Nellore Kavali section) as a contractor engaged by the NHAI, which was the developer in this project. Since the assessee was not a developer of the project as specified under section 80IA, the allowance of deduction aggregating to Rs. 9.60 crore was irregular involving revenue impact of Rs. 3.49 crore.

3.6.2.9 In Maharashtra, CIT 10, Mumbai charge, assessment of a company, **M/s Petron Civil Engineering Pvt. Ltd.**, for the assessment year 2003-04 was completed after scrutiny in January 2006, after allowing a deduction of Rs. 4.45 crore under section 80IA. Audit examination revealed that the assessee was executing various works in the capacity of a contractor engaged by government bodies such as Maharashtra Sewerage Board, Bangalore Water Supply and Sewerage Board, Gujarat Water Supply and Sewerage Board, etc. Since the assessee was not a developer of the project as specified under section 80IA the allowance of deduction of Rs. 4.45 crore was irregular involving revenue impact of Rs. 1.64 crore.

3.6.2.10 In Maharashtra, CIT 2, Pune charge, the assessments of a firm, which was a partnership between **M/s Shree Satav Construction Pvt. Ltd.** and **M/s Dena Rahsaz JV**, for the assessment years 2002-03 and 2003-04, were completed in summary (February 2003) and scrutiny (March 2006) manner respectively. As seen from the balance sheet, the assessee was a partnership firm consisting of a company and another partner Dena Rahsaz JV, which was not a company as defined under section 2(17) of the Act. As the firm was not a consortium of companies, it was not entitled to deduction under section 80IA. Further, the

assessee's profits were derived from providing services as a works contractor, which was not eligible for deduction. Incorrect allowance of deduction of Rs. 1.61 crore and Rs. 2.57 crore in the assessment years 2002-03 and 2003-04 respectively, resulted in revenue impact aggregating to Rs. 1.52 crore.

3.6.2.11 Similarly, in Maharashtra, CIT 2, Pune charge, the assessment of a firm which was a partnership between **M/s Shree Satav Construction Pvt. Ltd. JV** and another partner **M/s Shree Kumar & Co.**, for the assessment year 2004-05 was completed after scrutiny in November 2006. A perusal of the balance sheet revealed that M/s Shree Kumar & Co. was not a company as defined in section 2(17) of the Act. As the firm was not a consortium of companies, it was not entitled to deduction under section 80IA. Further, the assessee's profits were derived from providing services as a works contractor, which was not eligible for deduction. Incorrect allowance of deduction of Rs. 2.46 crore resulted in revenue impact of Rs. 0.88 crore.

3.6.2.12 In Rajasthan, CIT I, Jaipur charge, assessments of a company, **M/s Om Metal Ltd.**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in March 2006 and May 2006 respectively after allowing a deduction of Rs. 94.39 lakh and Rs. 138.27 lakh under section 80IA. Audit examination revealed that assessee was executing works on behalf of a government undertaking in Maharashtra and the scope of work included manufacture and installation of dam gates. As the assessee was not involved in any infrastructure activity specified under section 80IA, the deduction allowed was irregular. This resulted in irregular allowance of deduction of Rs. 2.32 crore involving revenue impact of Rs. 1.09 crore including interest.

3.6.2.13 In Madhya Pradesh, CIT, Ujjain charge, the assessment of a company, **M/s Indermal Samarathmal Infrastructure (P) Ltd.**, for assessment year 2002-03 was completed under section 143 (3) read with section 147 in March 2006 determining 'nil' income after allowing deduction under section 80IA of Rs. 1.76 crore and at Rs. 1.84 crore under special provisions of the Act. Audit examination revealed that since all the rights of the assessee under the BOT agreement on which deduction under section 80IA had been allowed had been cancelled by the Government, the assessee was not entitled for deduction under section 80IA. The omission to disallow it resulted in incorrect allowance of deduction of Rs. 1.76 crore involving a revenue impact of Rs. 48.72 lakh.

3.6.2.14 Six other cases, where deduction had been allowed to works contractors are given in **Table no. 3.1** below:

(Rs. in lakh)

Table no. 3.1: Irregular allowance of deduction to works contract

Sl. no.	Name of the assessee/CIT charge	Nature of business	Assessment Year(s)	Type/date of assessment	Deduction allowed	Revenue impact
1	M/s VA Tech Wabag Ltd. CIT I, Chennai	Execution of water/waste water treatment plant projects	2002-03	Summary February 2003	276.47	98.70
2	M/s Supreme Infrastructure (India) Pvt. Ltd. CIT 1, Pune	Civil contractor for local bodies	2003-04	Scrutiny November 2005	22.00	58.00
			2004-05	Scrutiny December 2006	140.00	
3	M/s SJR Infrastructure (P) Ltd. CIT III, Bangalore	Civil contractor for local bodies	2003-04	Scrutiny March 2006	13.60	29.22
			2004-05	Scrutiny March 2006	34.45	
			2005-06	Summary November 2006	19.11	
4	M/s Ajwani Infrastructure P Ltd. CIT 10, Mumbai	Civil contractor for local bodies	2003-04	Scrutiny January 2006	41.00	29.00
			2003-04	Scrutiny December 2006	39.00	
5	M/s CES ONYX P Ltd. CIT I, Chennai	Sweeping, collection and transportation of the municipal solid waste	2004-05	Scrutiny November 2006	28.06	9.00
6	M/s Anthony Motors Ltd. CIT 10, Mumbai	Contract from the solid waste management division of Municipal Corporation of Greater Mumbai for cleaning	2004-05	Scrutiny March 2005	23.00	8.25

Note: In respect of Sl. no. 1, the Department revised the assessment in December 2006. In respect of Sl no. 3 the Department has accepted the audit objection and initiated remedial action (July 2007). In respect of Sl. no. 5 Department has initiated remedial action (August 2007).

3.6.2.15 Audit examination thus revealed that, the benefit of deduction under section 80IA had been irregularly extended to works contractors although they could not be deemed to be engaged in developing or maintaining an infrastructure facility within the meaning of section 80IA.

3.6.2.16 Audit recommends that the Ministry may strengthen its internal control mechanism to ensure that the assessing officers correctly apply the provisions of the Act in respect of deductions extended to works contractors.

3.6.2.17 In the exit conference, the Board agreed to examine the issue.

Telecommunication services

3.6.2.18 In order to attract huge investments and encourage a large number of commercial enterprises to engage in these services, the benefit of deduction under section 80IA was extended to the telecommunication sector⁴. Any undertaking which starts providing telecommunication services as provided in the Act on or after 1 April 1995 shall be eligible for deduction under section 80IA. The deduction is provided in the Act to basic service providers to encourage more providers to come into the field. Such deductions may not be found necessary to be extended for secondary players in the sector, as the tariff rates enjoyed by them (through increased competition) would by itself take care of the need of incentives⁵.

3.6.2.19 In Maharashtra, CIT 5, Mumbai charge, the assessments of a company, **M/s Millenium Telecom Ltd.**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in October 2005 and September 2006. The assessee had claimed deduction under section 80IA as a provider of internet services of Rs. 1.10 crore and Rs. 78.53 lakh. Audit examination of the records revealed that the profits for which the deduction was claimed were derived mainly from providing e-tendering services to M/s MTNL and not from providing internet services. The assessee had not made any investment in infrastructure and was, in fact, using the internet infrastructure of MTNL by paying rent and ISP management charges. Incorrect allowance of deduction resulted in short levy of tax of Rs. 40.55 lakh and Rs. 28.17 lakh for the assessment years 2002-03 and 2004-05 respectively.

3.6.2.20 Three other cases, where franchisees were being allowed deduction are given in **Table no. 3.2** below:

(Rs. in lakh)

Table no. 3.2: Deduction allowed to ineligible assesseees						
Sl. no.	Name of the assessee/CIT charge	Assessment Year	Type of assessment(s)	Nature of business	Incorrect allowance of deduction	Revenue impact
1	M/s EKNOCOM CIT X, Chennai	2001-02 to 2006-07	Summary (except 2003-04 which was under scrutiny)	Franchisee for operating EPABX system	75.88	27.43
2	M/s United Telelinks Pvt. Ltd. CIT III, Bangalore	2003-04 2004-05	Scrutiny Summary	Franchisee for operating EPABX system	47.95	21.57
3	A. Jayalakshmi CIT I, Trichy	1999-2000 to 2006-07	Summary (except 2003-04 which was under scrutiny)	Franchisee for operating EPABX system	44.02	12.35

Note: In respect of Sl. no. 2, the Department has initiated remedial action (July 2007).

⁴ The Finance Act, 1997

⁵ ITAT, Special Bench, Mumbai in ITA no. 840/Mum/2003 in the case of VSNL, Mumbai vs CIT

3.6.2.21 The legal instruments granting tax incentives are required to be carefully drafted so that they achieve the policy objectives with minimum leakage of tax revenue. They are to be expressed as precisely as possible to avoid ambiguity in implementation.

3.6.2.22 *Audit recommends that the Ministry may consider suitably clarifying the provisions of section 80IA so as to prevent misuse of the incentive by ineligible assesseees.*

3.6.3 Incorrect allowance of deduction without adjustment of losses and depreciation relating to eligible units

3.6.3.1 To safeguard against the possibility of suppression of expenditure and inflation of profits of eligible units by diverting the same to existing (taxable) units, the Act provides that the profits and gains from the eligible business shall be computed as if such eligible business was the only source of income of the assessee during the previous year. A separate report is to be furnished by each undertaking claiming deduction and shall be accompanied by the profit and loss account and balance sheet as if the undertaking were a distinct entity. The deduction under section 80IA is available for any ten consecutive assessment years out of fifteen years beginning from the year in which the assessee commences the eligible activity.

3.6.3.2 For computing the deduction under chapter VIA, the Act provides that the amount of income derived by the assessee and included in his total income has to be computed under the provisions of the Act, *inter alia*, taking into account the carried forward losses and unabsorbed depreciation of the earlier years. Further, it has been judicially held⁶ that for the purposes of determining the quantum of deduction under chapter VIA (and thus section 80IA), depreciation and other expenditure falling within sections 28 to 44D will have to be taken into consideration whether it is claimed by the assessee or not.

3.6.3.3 Audit examination revealed that the assesseees were not preparing separate accounts from the date of commencement of business but were preparing separate accounts only from the year from which they were claiming exemption. However, in respect of assesseees' engaged in both eligible and non eligible activities the unabsorbed losses, unabsorbed depreciation, etc. relating to the eligible undertaking are to be notionally taken into account in determining the quantum of deduction even though these may actually have been set off against the profit of the assessee

⁶ Pandian Chemicals Ltd. vs CIT (2003) {262 ITR 278} (SC)
Nahar Exports Ltd. vs CIT 156 Taxman 305 (2006) (P & H)
Cambay Electric Supply Industrial Co. Ltd. vs CIT (1978) {113 ITR 84} (SC)
Power Finance Corporation. Ltd. vs CIT (2006) {100 TTJ 114}
Varindra Agro Chem Ltd. vs DCIT (2006) {100 TTJ 114} (CHD)

from other sources⁷. The omission to do so resulted not only in reduction of taxable income of the non eligible units but also inflated profits to the eligible units.

3.6.3.4 Audit noticed that in 29 cases the benefit of deduction under section 80IA had been allowed without taking into consideration the losses and depreciation relating to the eligible undertakings which resulted in excess allowance of deduction as detailed in the paragraphs below:

3.6.3.5 In Delhi CIT I charge, assessment of a company, **M/s Bharat Sanchar Nigam Limited**, audit examination of the assessment concluded after scrutiny in December 2006 for the assessment year 2004-05 revealed that 80IA deduction had been allowed incorrectly. The assessee had an unabsorbed depreciation of Rs. 1176.09 crore relating to the earlier assessment year viz. 2003-04. It was seen that deduction under section 80IA for assessment year 2004-05 had been allowed without setting off this unabsorbed depreciation of Rs. 1176.09 crore, which resulted in excess allowance of deduction to the extent of Rs. 887 crore involving revenue impact of Rs. 318.17 crore.

3.6.3.6 The Department has accepted the audit observation and rectified the assessment (April 2007).

3.6.3.7 In Gujarat, CIT II, Ahmedabad charge, audit examination of the assessment records of a company, **M/s Gujarat Powergen Energy Corporation Ltd.**, for the assessment year 2002-03 revealed that as per the notes forming parts of the accounts, assessee had not claimed depreciation of Rs. 490.17 crore for the assessment years 1997-98 to 2001-02 and deduction under section 80IA was allowed without reducing the amount of depreciation which resulted in revenue impact of Rs. 171.56 crore.

3.6.3.8 The Department has agreed to examine the issue (April 2007).

3.6.3.9 In Karnataka, CIT I Bangalore charge, the assessment of a company, **M/s KPC Ltd.**, for the assessment year 2004-05 was completed under scrutiny during December 2006 determining an income of Rs. 97.10 crore after allowing deduction of Rs. 173.67 crore under section 80IA. Audit examination revealed that three out of six eligible power generating units had earned profit of Rs. 173.67 crore during the year. The other three units had accumulated and brought forward loss of Rs. 99.80 crore, which was not set off while computing the profit of eligible business for claiming deduction. The omission resulted in excess deduction of Rs. 99.80 crore with revenue impact of Rs. 46.39 crore including interest.

3.6.3.10 The Department has accepted the audit observation (July 2007).

3.6.3.11 In Karnataka, CIT I, Bangalore charge, assessment of a company **M/s KPC Ltd.**, for the assessment year 2002-03 was completed under scrutiny

⁷ CIT vs Kotagiri Industrial Cooperative Tea Factory Ltd., 1997 {224 ITR 604} (SC)

during February 2005 determining 'nil' income after allowing deduction of Rs. 80.56 crore under section 80IA and setting off Rs. 247.24 crore being unabsorbed depreciation relating to earlier years. The balance of unabsorbed depreciation of Rs. 205.09 crore was allowed to be carried forward. Audit examination of the assessment records revealed that deduction under section 80IA had been allowed before setting off unabsorbed depreciation. After setting off of unabsorbed depreciation of earlier years no income was available for claiming deduction. This resulted in incorrect allowance of deduction and excess carry forward of unabsorbed depreciation of Rs. 80.56 crore with potential revenue impact of Rs. 28.76 crore.

3.6.3.12 The Department has accepted the audit observation (July 2007).

3.6.3.13 In Tamil Nadu, CIT I, Chennai charge, a company **M/s Tamil Nadu Newsprints & Paper Ltd.**, engaged in the business of manufacture and sale of paper also derived income from generation of power through wind mills that commenced operation in the financial year 1993-94 (assessment year 1994-95).

3.6.3.14 The assessee claimed deduction under section 80IA from the assessment year 2003-04 being the initial year and maintained separate profit and loss account for the eligible business from 2003-04 onwards. The profit of the eligible business was computed and deduction of Rs. 9.24 crore and Rs. 2.65 crore was allowed for the assessment year 2003-04 and 2004-05 respectively. However, it was noticed that the assessee had claimed depreciation on assets used for generation of power of Rs. 72.97 crore from assessment year 1994-95 to the assessment year 2002-03 which was not reduced from profits of eligible business for the assessment year 2003-04 and 2004-05 before working out the deduction allowable under section 80IA. This has resulted in incorrect allowance of deduction of Rs. 9.24 crore and Rs. 2.65 crore with consequential revenue impact of Rs. 4.67 crore and Rs. 1.27 crore for the assessment years 2003-04 and 2004-05 respectively.

3.6.3.15 The Department initiated remedial action (April 2007).

3.6.3.16 In Tamil Nadu, CIT I, Chennai charge, an assessee company **M/s EID Parry (I) Ltd.**, had adjusted the loss relating to power generation business as per section 80IA(5) and the accumulated loss of Rs. 19.17 crore was carried forward to the assessment year 2004-05. In the assessment year 2004-05 the assessee company had claimed deduction under section 80IA of Rs. 16.40 crore after adjusting a carry forward loss of Rs. 6.93 crore instead of the actual accumulated loss of Rs. 19.17 crore. This resulted in excess claim of deduction of Rs. 12.24 crore involving revenue impact of Rs. 5.27 crore.

3.6.3.17 The Department has initiated remedial action (August 2007).

3.6.3.18 In Karnataka, CIT I, Bangalore charge, the assessment of a company, **M/s Jindal Aluminium (P) Limited**, for assessment years 2003-04 and 2004-05

were completed after scrutiny during March 2006 and December 2006 respectively determining 'nil' income under normal provisions after allowing deductions under section 80IA and at Rs. 4.17 crore under special provisions of the Act and tax levied thereon. Audit examination revealed that the assessee had incurred a net loss of Rs. 17.98 crore and Rs. 2.15 crore during the relevant previous years in three units engaged in power generation. However, while allowing deduction, only profit earned by Unit I was reckoned without setting off the loss sustained by Unit II and III. This omission resulted in short computation of income by Rs. 1.48 crore and Rs. 8.89 crore during assessment years 2003-04 and 2004-05 respectively, involving revenue impact aggregating to Rs. 2.60 crore including interest.

3.6.3.19 The Department has accepted the audit observation (July 2007).

3.6.3.20 In Gujarat, CIT IV, Ahmedabad charge, the assessment of **M/s Sadbhav Engineering Ltd.**, was completed after scrutiny for the assessment year 2004-05. Audit examination revealed that while working out the deduction under section 80IA, losses of Rs. 6.75 crore determined in the earlier assessment year were not adjusted against positive income determined for assessment year 2004-05 in respect of three eligible units. This irregular deduction resulted in underassessment of Rs. 4.49 crore with consequent short levy of tax of Rs. 1.81 crore including interest.

3.6.3.21 The Department has agreed to review the case (March 2007).

3.6.3.22 In Madhya Pradesh, CIT, Bhopal charge, the assessment of **M/s HEG Ltd.**, for the assessment year 2002-03 was completed after scrutiny in March 2005 wherein the assessing officer had restricted the deduction claimed by the assessee. On appeal by the assessee, deduction was allowed by CIT (A) and assessee was allowed a deduction under section 80IA aggregating to Rs. 20.24 crore on power generation division located at Durg, Tawa and Rishabdev. Audit examination, however, revealed that the assessee had sustained a loss in Tawa Division which was not considered while computing the deduction under section 80IA. This resulted in excess deduction of Rs. 3.03 crore involving potential revenue impact of Rs. 1.08 crore.

3.6.3.23 Similarly, in the assessment year 2003-04, in the scrutiny assessment concluded in March 2007, a deduction under section 80IA of Rs. 7.23 crore was allowed to the power division at Tawa. As the assessee had unabsorbed loss of Rs. 66.50 lakh in power division at Tawa, it had to be set off before working out the deduction under section 80IA, which was not done. The omission resulted in excess allowance of deduction to the extent of Rs. 66.50 lakh involving revenue impact of Rs. 32.27 lakh including interest.

3.6.3.24 The Department accepted the audit observation (June 2007).

3.6.3.25 Six other cases, where brought forward loss or unabsorbed depreciation were not adjusted before computing deduction under section 80IA, are given in the

Table no. 3.3 below and 15 cases involving a revenue impact of Rs. 3.15 crore are brought out at **Appendix 14**.

(Rs. in lakh)

Sl. no.	Name of the assessee/CIT charge	Assessment year(s)	Type of assessment	Incorrect allowance of deduction	Revenue impact
1	M/s. Servalakshmi Paper Boards (P) Ltd. CIT I, Coimbatore	2004-05	Scrutiny	193.14	92.32
2	M/s. Rain Calcining Ltd. CIT III, Hyderabad	2004-05	Scrutiny	238	85.27
3	M/s. Easun Reyrolle Ltd. CIT-I, Chennai	2000-01 and 2005-06 2001-02 and 2004-05	Summary Scrutiny	196.09	73.27
4	Sagar Power Ltd. CIT III, Hyderabad	2003-04	Scrutiny	126	61.00
5	M/s Ketan Construction Ltd., CIT I, Rajkot	2004-05	Scrutiny	127.78	56.84
6	GVG Paper Mills Ltd. CIT-III, Coimbatore	2004-05 2005-06	Scrutiny Summary	84.47	56.36

Note: In respect of Sl. no. 1 and 4, the Department accepted (April 2007) the audit observation. In respect of Sl. no. 3 the Department has initiated remedial action (August 2007)

3.6.3.26 Audit examination thus revealed that in cases where the assessees had both eligible and non eligible units, separate accounts were not being prepared from the date of commencement of business, but were being prepared only from the year from which they were claiming exemption. As a result of this, deduction under section 80IA was being allowed without taking into account all losses and depreciation relating to the eligible units treating them as distinct entity.

3.6.3.27 *Audit recommends that the Ministry may consider making it mandatory for the assessees availing of 80IA deduction to furnish details of carry forward of loss/depreciation from the first year of operation in order to compute profits relating to eligible units as a distinct entity. It is recommended that assessment orders clearly specify the details of losses to be carried forward for set off in future years for eligible and ineligible units separately.*

3.6.3.28 In the exit conference, the Board agreed to examine the issue.

3.6.4 Incorrect apportioning of expenses resulting in excess deduction

3.6.4.1 Subsection (10) of section 80IA provides that where it appears to the assessing officer that owing to the close connection between the assessee carrying on the eligible business and any other person, or for any other reason, the course of business between them is so arranged that the business transacted between them produces to the assessee more than the ordinary profits which might be expected to arise in such eligible business, the assessing officer shall in computing the profits

and gains of such eligible business for the purposes of this section, take the amount of profit as may be reasonably deemed to have been derived from the business.

3.6.4.2 In Maharashtra, CIT 3, Mumbai charge, the assessments of a company, **M/s Nuclear Power Corporation of India Ltd.**, for the assessment years 2002-03 and 2005-06 were completed after scrutiny in December 2004 and January 2007 respectively. The assessee had not debited the proportionate expenses i.e. administrative and other expenses shown in the consolidated profit and loss account to the units claiming deduction under section 80IA. This resulted in inflating the profit of the units claiming 80IA deduction resulting in excess deduction of Rs. 43.53 crore and Rs. 185.47 crore involving revenue impact of Rs. 15.54 crore and Rs. 67.87 crore for the assessment years 2002-03 and 2005-06 respectively.

3.6.4.3 In Tamil Nadu, CIT I Central charge, an assessee company, **M/s TCP Ltd.**, for the assessment years 2001-02 to 2004-05 while allocating the common indirect expenses such as administrative expenses, selling overheads, etc., out of total indirect expenditure of Rs. 137.19 crore, expenditure of Rs. 47.19 crore only was allocated to the power division. The basis of allocation was not available on record. However, the proportionate expenditure as calculated by audit based on the turnover of the eligible undertaking worked out to Rs. 92.19 crore. The incorrect allocation of indirect expenditure reduced the profits of ineligible business resulting in excess allowance of deduction of Rs. 45 crore under section 80IA involving revenue impact of Rs. 17.97 crore.

3.6.4.4 In Tamil Nadu, CIT I, Central Chennai charge, a company, **M/s A.S. Shipping Agencies (P) Ltd.**, engaged in the business of Steamer Agents and Container Freight Station (CFS) operators for assessment years 2002-03 and 2003-04 had been allowed deduction of Rs. 49.26 lakh and Rs. 145.90 lakh respectively. Audit examination revealed that the assessee had income from bonded warehousing, leasing out of canteen and miscellaneous income of Rs. 42.54 lakh and Rs. 43.45 lakh for the assessment years 2002-03 and 2003-04 respectively which was not eligible for computing the deduction. Further, the expenditure of Rs. 22.64 lakh and Rs. 6.93 lakh for the assessment years 2002-03 and 2003-04 of maintenance of the plot relating to eligible 80IA unit were omitted to be included in that business. This incorrect apportionment of income and expenditure between eligible business and ineligible business resulted in excess allowance of deduction of Rs 49.26 lakh and Rs.73.92 lakh for the above assessment years involving an aggregate revenue impact of Rs. 52.63 lakh.

3.6.4.5 Though the Department replied (March 2007) that the assessing officer was aware of the mistake, no rectificatory proceedings had been initiated to rectify it.

3.6.4.6 Four other cases, where incorrect deduction was allowed due to non apportionment of pro-rata expenditure are given in the **Table no. 3.4** below:

(Rs. in crore)

Table no. 3.4: Incorrect deduction due to non apportionment of pro-rata expenditure

Sl. no.	Name of assessee/ CIT charge	Assessment year	Type of assessment	Nature of mistake	Incorrect deduction	Revenue impact
1	Tata Chemicals CIT 2, Mumbai	2002-03	Scrutiny	Did not apportion depreciation correctly to the unit eligible for deduction	9.72	3.47
		2003-04	Scrutiny		7.44	2.73
		2004-05	Scrutiny		5.63	2.02
2	M/s Larsen and Tubro Ltd. CIT 2, Mumbai	2003-04	Scrutiny	Did not apportion interest and the administrative expenses to the eligible business	12.00	2.74
		2004-05	Scrutiny		7.45	4.30
3	M/s Servalakshmi Paper Boards (P) Ltd. CIT I, Coimbatore	2004-05	Scrutiny	Did not apportion managerial remuneration	0.53	0.25
4	M/s Rajshree Sugars and Chemicals Ltd. CIT II, Coimbatore.	2004-05	Scrutiny	Did not apportion interest payments	Not quantified	
		2005-06	Summary			

3.6.4.7 Audit examination thus revealed that the assessing officers were not apportioning the expenses relating to eligible undertakings correctly, which resulted in inflation of eligible profits and, thereby, the deduction.

3.6.4.8 *Audit recommends that the Ministry may consider incorporating a provision in the rules so that the tax audit report in Form no. 10 CCB specifies the basis of apportionment/allocation of common expenses especially with regard to composite business where assessees have both eligible and ineligible units.*

3.6.4.9 In the exit conference, the Board agreed to examine the issue.

3.6.5 Allowance of deduction without proper auditor's report/certificate

3.6.5.1 Subsection (7) of section 80IA provides that deduction under this section shall not be admissible unless the accounts of the undertaking relevant to the assessment year for which the deduction claimed have been audited by an accountant. Rule 18 BBB further ordains that the assessee shall furnish along with his return of income, the report of such audit in the prescribed Form no. 10 CCB duly signed and verified by a chartered accountant which shall be accompanied by the profit and loss account and balance sheet of the eligible undertaking as if the undertaking were a distinct entity. In the case of CIT vs Shivanand Electronics [1994] {209 ITR 63} (Bombay), it was held that no duty is cast on the assessing officer to ask an assessee who has failed to file the audit report, to do so before rejecting his claim for relief.

3.6.5.2 In Haryana, Hisar charge, the assessment of a company, **M/s Jindal Steel and Power Limited**, for the assessment year 2003-04 was completed after scrutiny in March 2006. Deduction of Rs. 65.94 crore was allowed on power generation units under section 80IA under normal provisions and by charging tax of Rs. 14.09 crore on book profits under special provisions of the Act. Audit examination revealed that deduction under section 80IA was allowed without obtaining the separate accounts for eligible undertakings as required under Rule 18 BBB of the Income Tax Rules. In the absence of separate accounts, audit was unable to verify correctness of the allowed deduction of Rs. 65.94 crore involving revenue impact of Rs. 24.23 crore.

3.6.5.3 The Department stated (September 2006) that the requisite information was already available on record in the shape of prescribed audit report in Form no. 10 CCB. Reply of the Department is not tenable as separate account was to be compulsorily filed failing which deduction was not admissible.

3.6.5.4 In Tamil Nadu, CIT I, Chennai charge, a company, **M/s TIDEL Park Ltd.**, which was allowed deduction under section 80IA of Rs. 3.09 crore, did not file the mandatory audit certificate in Form no. 10CCB as prescribed under Rule 18BBB of the Income Tax Rules along with the return of income for the assessment year 2003-04. Besides, as per column 26 of Form no. 3CD, the section wise details of deduction admissible under chapter VIA was reported as 'nil' by the company tax auditor. In the absence of the requisite audit certificate in Form no. 10CCB, the assessee was not eligible for deduction under section 80IA of Rs. 3.09 crore. The omission to disallow it resulted in revenue impact of Rs. 1.13 crore.

3.6.5.5 The Department has initiated remedial action (April 2007).

3.6.5.6 In West Bengal, CIT IV, Kolkata charge, assessments of a company **M/s APM Industries Ltd.**, for the assessment years 2002-03 and 2003-04 were completed in scrutiny manner in March 2005 and January 2006 after allowing deduction under section 80IA of Rs. 75.32 lakh and Rs. 1.83 crore respectively. Audit examination revealed that the assessee had not submitted the audit certificate in Form no. 10CCB and hence no deduction was allowable under section 80IA of the Act. The omission to disallow it resulted in irregular allowance of deduction involving revenue impact of Rs. 26.89 lakh and Rs. 90.89 lakh respectively.

3.6.5.7 In its reply the Department stated (May 2007) that for a procedural defect, admissible statutory deduction should not be disallowed. The Department referred to a Board circular which states that refund or deductions omitted to be claimed by the assessee are allowable in assessments. The reply is not tenable as submission of Form no. 10CCB is mandatory for allowance of deduction under section 80IA. Further, the Board circular cited is also not relevant to the instant case.

3.6.5.8 In Andhra Pradesh, CIT Central, Hyderabad charge, assessment of a company **M/s Sree Rayalaseema Green Energy Ltd.**, for the assessment year

2004-05 was completed after scrutiny. Audit examination revealed that no audit certificate had been enclosed with the return of income. Further, it was also seen that the assessee had been wrongly allowed deduction under section 80IA in respect of the receipts from the sale of sugarcane and sugar which were not part of the eligible unit. The omission to disallow the deduction without auditor's certificate and properly examine the computation of eligible profits resulted in short computation of income of Rs. 1.87 crore with consequential revenue impact of Rs. 81.99 lakh including interest.

3.6.5.9 In Andhra Pradesh, CIT, Rajahmundry charge, assessment of a company **M/s Gowthami Bio-Energies Ltd.**, for the assessment year 2003-04 was completed after scrutiny in December 2005. Audit examination revealed that the audit certificate in Form no. 10CCB enclosed with the return of income issued by the chartered accountant was incomplete and defective in as much as that the deduction admissible was not certified therein. In the absence of correct and complete statutory certificate, the deduction under section 80IA of Rs. 1.07 crore was not allowable. The omission to do so resulted in short computation of income of Rs. 1.07 crore with consequential revenue impact of Rs. 53.10 lakh including interest. On this being pointed out the Department initiated remedial measures.

3.6.5.10 In Maharashtra, CIT 10, Mumbai charge, the assessments of a company **M/s E. A. Infrastructure Pvt. Ltd.**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in August 2005 and December 2006 respectively. The assessee had not furnished the audit report in Form no. 10 CCB along with the return. Hence, the deduction under section 80IA was not admissible. The omission to disallow it resulted in incorrect allowance of deduction of Rs. 95.37 lakh and Rs. 38.89 lakh involving revenue impact aggregating to Rs. 49 lakh for both the assessment years.

3.6.5.11 Audit examination thus revealed that deduction under section 80IA was being allowed even though the assessee were not filing the required audit report/certificates along with the profit and loss account and balance sheet relating to the eligible undertaking treating it as a distinct entity.

3.6.5.12 *Audit recommends that the Ministry may institute a mechanism for compulsory checking of the statutory reports before allowing deductions.*

3.6.5.13 In the exit conference, the Board accepted the audit recommendation.

3.6.6 Incorrect computation of deduction

Power generation and distribution

3.6.6.1 In order to meet the growing need of power, investments are encouraged in power generation and distribution including captive power plants by providing them with incentives, one of them being deduction under section 80IA.

3.6.6.2 Though it has been judicially held⁸ that one cannot do business with oneself, the benefits of deduction under section 80IA were extended to captive power plants (CPP) on the reasoning that CPP operators would draw less electricity from the electricity boards, thereby lessening the load on the grid. The Board, while clarifying⁹ the availability of benefits to CPPs stated that the deduction would be subject to the following:

- The CPP set up by an undertaking is distinct and separate and there is an element of commercial profits or gains by the power generating undertaking from the industrial user
- The assessing officer through examination shall ensure that the transactions between CPP and its undertaking is at arms length
- The grant of deduction shall not be taken to legitimise something not permissible under the provisions of Electricity Supply Act and related laws
- The user undertaking shall not debit the expenses incurred by the CPP in its own profit and loss account.

3.6.6.3 The Indian Electricity Act 2003 provides the basic framework for the regulation of the electricity industry in India. The Central Government has set up independent and autonomous regulatory bodies viz. Central Electricity Regulatory Commission (CERC) and the State Electricity Regulatory Commissions (SERCs). CERC is empowered to regulate and frame guidelines on matters relating to electricity tariff covering generation, transmission and distribution of electricity.

3.6.6.4 Tariff structures, both for the 'public sector' and 'independent power producers' (IPPs), was determined on 'cost plus profit basis'. For IPPs the 'return on equity' is computed on the capital¹⁰ relatable to the generating unit at the rate of 16 percent as has been laid down in a notification¹¹ issued by the Ministry of Power. The notification also states that while fixing the tariff, an element of income tax (corporate tax) paid by the power producer is also to be taken into account.

3.6.6.5 This notification read in consonance with the condition that profits and gains of eligible undertakings would be on a reasonable basis (subsection 10 under section 80IA) implies that profits arising to undertakings in the power sector entitled for deduction shall not exceed 16 percent on their equity relatable to the power project. Given the imperative of allowing the deduction on a reasonable basis, audit sought to examine the procedures and practice in the Department for computing profits of captive power plants on a reasonable basis which would

⁸ [1979] {119 ITR 303} (Gujarat High Court) CIT vs Rasiklal Balabhai B.J. Divan, CJ. and B.K. Mehta

⁹ Letter issued to the Secretary General, Indian Merchants Chamber, Mumbai in File no. 178/28/2001-ITA I dated 3 October 2001

¹⁰ Capital for the purpose of computing the return on equity includes paid up capital, premium raised by the generating company while issuing share capital and investment or internal resources created out of free reserve of the existing company, if any, for the funding of the project, for the purpose of computing the return on equity

¹¹ Notification no. SO 251(E) dated 30 March 1992

safeguard against any artificial inflation of profits arising to the eligible unit, thereby increasing the amount of deduction available as detailed below:

Excess allowance of benefit due to non-restriction of deduction to reasonable profit derived from electricity

3.6.6.6 Under section 80IA of the Act, where it appears to the assessing officer that, owing to the close connection between the assessee carrying on the eligible business and any other person, or the course of business of an assessee is so arranged that the business transacted produces more than ordinary profits which might be expected to arise, the assessing officer can recompute the profits arising from such arrangements and the deduction available to the assessee.

3.6.6.7 Audit examination revealed that there were inconsistencies in the methodology adopted for computing reasonable profits allowable as deduction under section 80IA. A perusal of the assessment records of M/s Tata Power Co Ltd., Mumbai for the assessment year 2004-05 completed after scrutiny revealed that revenue attributable to the power plants for the purposes of deduction under section 80IA had been arrived at based on the 'clear profit and reasonable return on capital base as per the Electricity Supply Act¹²'. In the case of Hindustan Petroleum Corporation Ltd, Mumbai for the assessment year 2004-05 completed after scrutiny, lower deduction under section 80IA had been allowed based on the market rate of electricity minus fifteen percent.

3.6.6.8 No such exercise was done to restrict the claims of assessee who had claimed deduction in excess of profits allowable under Electricity Act or to apply a consistent and acceptable standard as highlighted in the following paragraphs.

3.6.6.9 In Maharashtra, CIT I, Mumbai charge, assessments of **M/s Reliance Energy Ltd. (REL)**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed after scrutiny in January 2005, March 2005 and March 2006 respectively. The assessee was engaged in the business of generation and distribution of electricity and was allowed deduction under section 80IA for the eligible business of generation of electricity at Rs. 385.97 crore, Rs. 261.96 crore and Rs. 474.95 crore for the assessment years 2002-03, 2003-04 and 2004-05 respectively.

3.6.6.10 The Maharashtra Electricity Regulatory Commission (MERC) had quantified the profits at the rate of 16 percent arising to the composite business of generation and distribution of REL¹³ for the financial years relevant to the assessment years 2002-03, 2003-04 and 2004-05 at Rs. 235 crore, Rs. 249 crore and Rs. 290 crore. Audit examination revealed that the assessing officer had not worked out the pro rata deduction for computing the profits attributable to the eligible unit of generation of electricity while allowing deduction under section

¹² Taken from the balance sheet

¹³ vide tariff order issued in case no. 18 of 2003 dated 1 July 2004

80IA. This resulted in excess allowance of deduction aggregating to Rs. 636.89 crore involving a revenue impact of Rs. 229.04 crore as detailed in **Table no. 3.5** below:

(Rs. in crore)

Table no. 3.5: Excess allowance of benefit due to non-restriction of deduction to reasonable profit derived from electricity

Sl. no.	Details	Assessment year		
		2002-03	2003-04	2004-05
1	Profit determined by MERC for both generation and distribution	235	249.00	290.00
2	Power sale from eligible generating station (million Kwh)	3442	3546.00	4084.00
3	Total power sales (million Kwh)	5676	5880.00	6126.00
4	Pro rata profits eligible for deduction under section 80IA computed as (1) * (2) / (3)	142.50	150.16	193.33
5	80IA deduction allowed	385.97	261.96	474.95
6	Excess 80IA deduction allowed (5)-(4)	243.47	111.80	281.62
Revenue impact		86.92	41.09	101.03

3.6.6.11 In Maharashtra, CIT 6, Mumbai charge, the assessments of a company, **M/s Hindalco Industries Ltd.**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed after scrutiny in February 2004, January 2005 and March 2006 respectively. It was seen that the assessee had computed the profit derived from supply of electricity for captive consumption, which worked out to an average of 92.75 percent return on investment per annum as against 16 percent prescribed in the notification of March 1992. Further, it was seen that assessee did not apportion all the expenses to its captive power plant and hence was able to show more than normal profits. The omission to recompute profits of the assessee from captive power plant as provided under section 80IA and limit it to a reasonable quantum as prescribed in notification of the Ministry of Power resulted in inflation of profits eligible for deduction under section 80IA. This resulted in excess deduction of Rs. 492.13 crore, Rs. 372.41 crore and Rs. 262.27 crore in the three assessment years resulting in revenue impact of Rs. 175.69 crore, Rs. 136.86 crore and Rs. 94.09 crore respectively.

3.6.6.12 Six other cases, where the claim of deduction under section 80IA was not restricted as per guidelines of the Ministry of Power are given in **Table no. 3.6** below:

(Rs. in crore)

Table no. 3.6: Excess computation of profit on captive power plants

Sl. no.	Name of the assessee/CIT charge	Assessment Year(s)	Type of assessment	Excess deduction*	Revenue impact
1	M/s Reliance Industries Ltd. CIT 3, Mumbai	2002-03	Scrutiny	223.00	79.61
		2003-04	Scrutiny	320.02	117.60
		2004-05	Scrutiny	266.59	95.64
2	M/s Gujarat Ambuja Cement Ltd. CIT 3, Mumbai	2002-03	Scrutiny	97.90	34.95
		2003-04	Scrutiny	90.62	33.30
		2004-05	Scrutiny	91.18	32.71

Sl. no.	Name of the assessee/CIT charge	Assessment Year(s)	Type of assessment	Excess deduction*	Revenue impact
3	M/s Larsen and Tubro Ltd. CIT 2, Mumbai	2002-03	Scrutiny	36.52	13.04
		2003-04	Scrutiny	24.94	9.17
4	M/s Atul Limited CIT I, Ahmedabad	2002-03	Scrutiny	13.65	6.84
		2003-04	Scrutiny	14.49	7.32
5	M/s Sterlite Industries (I) Ltd. CIT III, Chennai	2004-05	Scrutiny	6.00	2.86
6	M/s Thiagarajar Mills Ltd. CIT I, Madurai	2000-01 to	Scrutiny	5.76	2.14
		2004-05			
		2005-06	Summary		

**Excess deduction has been computed as deduction allowed minus deduction allowable [@ 16%]
In respect of Sl. no. 5, the Department has accepted (September 2007) the audit observation and agreed to initiate remedial action.*

3.6.6.13 Audit examination thus revealed that there were no clear directions for the determination of reasonable profits to be allowed as deduction for captive power plants under section 80IA.

3.6.6.14 *Audit recommends that the Ministry should take appropriate measures to ensure that the interest of revenue is protected while allowing deduction to captive power plants.*

3.6.6.15 In the exit conference, the Board agreed to examine the issue in view of the wide variations noticed.

3.6.7 Non selection of 80IA cases for scrutiny

3.6.7.1 As per the scrutiny guidelines issued by the Board annually, the cases where chapter VIA- deduction exceeds Rs. 25 lakh, are to be compulsorily selected for scrutiny for the financial years 2003-04, 2004-05 and 2005-06. Non compliance of the above instructions were noticed in the following cases:

3.6.7.2 In Uttar Pradesh, CIT II, Kanpur charge, an assessee **M/s UP State Industrial Development Corporation**, filed its return of income for the assessment year 2003-04 declaring 'nil' income in May 2005 as against the due date of October 2003 (extended up to November 2003).

3.6.7.3 No notice had been issued to regularise the belated filing of return or to examine the veracity of the deductions/exemptions claimed by the assessee. The audit examination revealed that assessee had derived income from three units, out of which only one was entitled to avail of deduction under section 80IA. During the earlier assessment year (viz. assessment year 2002-03), expenditure of Rs. 5.52 crore (relating to group gratuity schemes, prior period expenses, diminution in value of shares, etc) had been made in respect of the ineligible units. Since the assessee had claimed deduction exceeding Rs. 25 lakh under section 80IA in his return of income, the return ought to have been selected for scrutiny as per scrutiny guidelines issued by the Board. Audit noticed that disallowances of similar nature

were to be carried out during the assessment year 2003-04 also, which could not be done as no action was taken on the return filed by the assessee. The omission to select the case for scrutiny resulted in underassessment of income of Rs. 12.89 crore involving revenue impact of Rs. 4.74 crore.

3.6.7.4 The Department agreed (May 2007) to take remedial action.

3.6.7.5 In Maharashtra, CIT 6, Mumbai charge, the assessment of a company **M/s IRB Infrastructure Limited**, for the assessment year 2002-03 was done in summary manner wherein profits arising from income on toll fees were claimed as deduction under section 80IA. Though the deduction claimed was in excess of limits prescribed by the Board, the case was not selected for scrutiny. The audit examination revealed that the deduction under section 80IA on toll fees had been disallowed during the assessment year 2001-02. The omission to select the case for scrutiny resulted in incorrect allowance of deduction of Rs. 1.52 crore involving revenue impact of Rs. 54 lakh.

3.6.7.6 In Delhi, CIT I charge, the assessment of a company, **M/s Jagson International Ltd.**, for the assessment years 2004-05 was processed in summary manner in March 2005 after allowing the deduction under section 80IA of Rs. 48.48 lakh. Audit examination revealed that for the assessment year 2004-05, as the assessee had claimed a deduction of Rs. 48.48 lakh, which was more than Rs. 25 lakh, this case fell under compulsory scrutiny. However, it was not selected for scrutiny.

3.6.7.7 On this being pointed out, the Department initiated action to select the case for scrutiny (August 2007).

3.6.7.8 Four other instances, where cases were not selected for scrutiny are given in **Table no. 3.7** below:

(Rs. in crore)

Table no. 3.7: Non selection of 80IA cases for scrutiny

Sl. no.	Name of the assessee/ CIT charge	Assessment year/type of assessment	Deduction claimed under section 80IA	Reasons furnished by the Department for non-selection for scrutiny
1	M/s Gayathri Agro Industrial Power Ltd. CIT VI, Hyderabad	2003-04 Summary	1.17	The assessing officer replied (June 2007) that as this case was processed in summary manner during March 2004, the return was not selected for scrutiny. The reply is not tenable as the instructions of the Board were not complied with.
2	MSK Infrastructure & Toll Bridge Pvt Ltd. CIT II, Vadodara	2005-06 Summary	1.17	The assessing officer replied (May 2007) that the above case had not been selected for scrutiny through CASS ¹⁴ . Manual selection was prohibited and hence, no action could be taken in this case.

¹⁴ Computer assisted scrutiny system

Sl. no.	Name of the assessee/ CIT charge	Assessment year/type of assessment	Deduction claimed under section 80IA	Reasons furnished by the Department for non-selection for scrutiny
3	M/s Trident Power Systems Ltd. CIT II, Hyderabad	2005-06 Summary	1.02	The assessing officer replied (May 2007) that scrutiny guidelines are not applicable as the resultant income would be nil after setoff of losses. However, the reply is not correct as the case should have been selected for scrutiny to disallow the claim under section 80IA.
4	M/s City Online Services Ltd. CIT I, Hyderabad	2004-05 Summary	0.47	The assessing officer replied (November 2006) that the above case had not been picked up for scrutiny through CASS. Manual selection was prohibited and hence, no action could be taken.

3.6.7.9 Audit examination thus revealed that cases were not being selected for scrutiny even though they fulfilled the criteria. The CASS was also not aiding in the identification of assessees for compulsory scrutiny as per the criteria prescribed by the Board.

3.6.7.10 *Audit recommends that the Ministry may like to devise a monitoring mechanism which ensures that its scrutiny guidelines are scrupulously followed and no high risk case is omitted from scrutiny. The Ministry should also ensure that the CASS identifies all cases which fulfill the criteria for the selection of cases for scrutiny.*

3.6.7.11 In the exit conference, the Board accepted the recommendation and stated that this aspect is being taken care of in the new CASS for selection of cases for scrutiny during 2007-08.

Compliance issues

3.6.8 Incorrect allowance of deduction on notional value of steam

3.6.8.1 Sub section (8) of section 80IA provides that where any goods or services held for the purposes of the eligible business are transferred to any other business carried on by the assessee, the consideration, if any, for such transfer as recorded in the accounts of the eligible business does not correspond to the market value of such goods or services as on the date of the transfer, then, for the purposes of the deduction, the profits and gains of such eligible business shall be computed as if the transfer had been made at the market value of such goods or services. In exceptional circumstances, the assessing officer may compute such profits and gains on a reasonable basis.

3.6.8.2 Section 80IA of the Act, provides for deduction of hundred percent of the profits from the generation or generation and distribution of power. It has been

judicially held¹⁵ that non-mention of the word 'electricity' in section 80IA was only because the Legislature wanted to give the term 'power' a wider meaning. The word 'power' has to be given a meaning which in common parlance means 'energy' and can be of any form-mechanical, electrical, wind or thermal. Thus, steam produced by the assessee would be termed as power and qualify for the deductions under section 80IA. Steam is a transient product without shelf life. Under the circumstances notional computation of value of steam on the basis of cost of production could inflate the amount of deduction allowable.

3.6.8.3 In Maharashtra, CIT 2, Mumbai charge, the assessments of a company **M/s Tata Chemicals Ltd.**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed in scrutiny manner in January 2005, February 2006 and December 2006 respectively. The company had been allowed deduction under section 80IA for captive power plants. Audit examination revealed that the deduction was computed after taking into account sale of electricity and steam generated by the eligible units. While working out the sale value for computing the profit the assessee had adopted the value for electricity based on the rates of Gujarat Electricity Board treating it as fair market value. The 'Notes to Accounts' appended to return of income stated that steam is not a marketable product and, therefore, the sale could not be recorded at fair market value. Profits on sale of steam had been taken as the cost of production. As the cost of production of steam equals the sale value no profit can be attributed to this transaction.

3.6.8.4 Thus, as the determination of profit on production of steam was on a notional basis, the deduction allowed was incorrect. This resulted in incorrect allowance of deduction of Rs. 53.04 crore, Rs. 51.28 crore and Rs. 39.74 crore and short levy of tax of Rs. 18.94 crore, Rs. 18.84 crore and Rs. 14.26 crore for assessment years 2002-03, 2003-04 and 2004-05 respectively.

3.6.8.5 Three other cases, where the deduction under section 80IA was allowed on the basis of notional value of steam are given in the **Table no. 3.8** below:

(Rs. in crore)

Sl. no.	Name of the assessee/CIT charge	Assessment year(s)	Type/date of assessment	Value of steam included for 80IA deduction	Revenue impact
1	M/s. Hindalco Industries Ltd. CIT 6, Mumbai	2002-03	Scrutiny / February 2004	8.54	3.05
		2003-04	Scrutiny / January 2005	13.03	4.79
		2004-05	Scrutiny / March 2006	24.34	8.73
2	M/s Hindustan Petroleum Corporation Ltd. CIT 1, Mumbai	2002-03	Scrutiny / March 2005	29.95	0.31
		2003-04	Scrutiny / December 2005	35.05	3.57
		2004-05	Scrutiny / November 2006	40.19	1.38
3	M/s. Shri Krishna Khandsari Sugar Mills, CIT 1, Nashik	2003-04	Scrutiny / December 2005	0.35	0.13

¹⁵ Sial SBEC Bioenergy Ltd vs CIT [2004] {83 TTJ (Delhi) 866}

3.6.8.6 In its reply, the Department stated (July 2007) in the case of M/s Hindalco Industries Ltd. that, merely because steam was not marketable the value could not be considered as 'nil'. The Department drew an analogy to the valuation of 'work in progress' in the processing industry.

3.6.8.7 In case of M/s Shri Krishna Khandasari Sugar Mills Ltd., the Department stated (February 2007) that the eligible units derive income from two elements viz. from sale of electricity and from sale of steam.

3.6.8.8 Reply of the Department is not tenable in both the cases as no profit can be attributed to a transaction where the sale value has been equated with the cost of production.

3.6.8.9 In the exit conference the Board accepted the audit observation and stated that benefit of deduction under section 80IA to sale of steam as an intermediate product is not admissible.

3.6.9 Incorrect allowance of deduction on other income

3.6.9.1 It has been judicially held that the word 'derived from' cannot have a wide import so as to include any income which can in some manner be attributed to the business. The derivation of the income must be directly connected with the business and generated there from. Interest income is not considered to be directly derived from eligible industrial undertaking and is also not to be considered for deduction as per various judicial pronouncements¹⁶.

3.6.9.2 In Gujarat, CIT II, Ahmedabad charge, assessment of a company, **M/s Gujarat Powergen Energy Corporation**, for the assessment year 2004-05 was completed after scrutiny. The assessee was allowed a deduction of Rs. 217.61 crore under section 80IA on interest income relying on a judicial pronouncement by the High Court of Gujarat¹⁷. Audit examination however revealed that the said judgment had not been accepted by the Department and a special leave petition against this decision had been filed and it had been admitted by the Supreme Court. Thus, the interest income was required to be excluded to keep the issue alive and ensure consistency. However, interest income was not disallowed while computing deduction under section 80IA which resulted in revenue impact of Rs. 81.50 crore including interest.

3.6.9.3 The Department agreed to take remedial action (April 2007).

¹⁶ CIT vs Cochin Refineries Ltd [1982] {135 ITR 278} (Ker.)
CIT vs Cement Distributors Ltd [1994] {208 ITR 355} (Delhi)
CIT vs Cambay Electric Supply Industrial Company Ltd (1978) {113 ITR 84} (SC)
CIT vs Sterling Foods(1999) {237 ITR 579} (SC)
CIT vs Pandian Chemicals Ltd. {262 ITR 278} (SC)

¹⁷ In the case of Nirma Ltd.

3.6.9.4 In Andhra Pradesh, CIT II, Hyderabad charge, assessment of a company, **M/s GMR Energy Ltd.**, for the assessment year 2004-05 was completed after scrutiny in October 2006 determining the tax of Rs. 6.29 crore (at the rate of seven and one-half percent of Rs. 81.85 crore) under special provisions of the Act viz. 115JB which was more than the tax of Rs. 58.88 lakh under normal provisions of the Act leviable at the rate of 35 percent. Audit examination revealed that a deduction of Rs. 37.26 crore was allowed under section 80IA while computing taxable income under normal provisions of the Act. However, other income of Rs. 25.80 crore (being interest on deposits, foreign fluctuation gain, etc.) had not been reduced while allowing the 80IA deduction. After disallowing 'other income', the tax leviable under normal provisions would be more than that under special provisions. The omission to disallow other income resulted in excess allowance of deduction of Rs. 25.80 crore with a consequential revenue impact of Rs. 4.05 crore.

3.6.9.5 In Gujarat, CIT I, Rajkot charge, assessment of a company, **M/s Ketan Construction**, for the assessment years 2002-03, 2003-04 and 2004-05 was completed after scrutiny. Audit examination revealed that deduction under section 80IA had been computed taking into account insurance claim, commission and other income aggregating to Rs. 8.48 crore (Rs. 73.26 lakh, Rs. 588.48 lakh and Rs. 186.42 lakh) which was not eligible for deduction. The omission to disallow this resulted in incorrect allowance of deduction of Rs. 8.48 crore involving revenue impact of Rs. 3.13 crore.

3.6.9.6 In Maharashtra, CIT 2, Mumbai charge, assessments of a company, **M/s Nhava Sheva International Container Terminals Pvt. Ltd.**, for the assessment years 2002-03 and 2003-04 were completed after scrutiny in January 2005 and March 2006 respectively. The assessee had included 'other income' of Rs. 1.45 crore and Rs. 2.84 crore in the assessment years 2002-03 and 2003-04 respectively while computing the deduction allowable under section 80IA. As this was not derived from eligible business activity, it had to be disallowed for the purposes of computing deduction. The omission to do so resulted in incorrect grant of deduction which resulted in revenue impact aggregating to Rs. 1.56 crore.

3.6.9.7 In Gujarat, CIT I, Rajkot charge, assessments of a company, **M/s Backbone Enterprise**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny. Audit examination revealed that the deduction under section 80IA had been computed taking into account other income aggregating to Rs. 326.45 lakh (Rs. 82.42 lakh and Rs. 244.03 lakh) from interest on deposits which was not eligible for deduction. The omission to disallow this resulted in incorrect allowance of deduction of Rs. 3.26 crore involving revenue impact of Rs. 1.35 crore.

3.6.9.8 Proviso to sub section 4 of section 92C provides that where an arm's length price is determined by the assessing officer for international transaction, the assessing officer may compute the total income of the assessee having regard to the

arm's length price so determined and no deduction under chapter VIA shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under this subsection.

3.6.9.9 In Maharashtra, CIT 2, Mumbai charge, the assessments of a company, **M/s Nhava Sheva International Container Terminals Pvt. Ltd.**, for the assessment year 2003-04 and 2004-05 were completed after scrutiny on March 2006 and December 2006 respectively. An addition of Rs. 3.29 crore and Rs. 3.30 crore was made under section 92C(3). Audit examination revealed that the assessing officer included the above addition for computing the profits for deduction under section 80IA which resulted in incorrect allowance of deduction aggregating to Rs. 6.59 crore involving an aggregate revenue impact of Rs. 2.39 crore (Rs. 1.21 crore and Rs. 1.18 crore for assessment years 2003-04 and 2004-05 respectively).

3.6.9.10 Five other cases, where income not derived from eligible activity had been considered for allowing deduction are given in **Table no. 3.9** below:

(Rs. in lakh)

Sl. no.	Name of the assessee/CIT charge	Assessment year(s) /Type of assessment	Other income on which deduction incorrectly allowed under section 80IA		Revenue impact
			Nature	Amount	
1	M/s Rajkamal Builders Infrastructure (P) Ltd. CIT IV, Ahmedabad	2002-03/ Scrutiny	Interest on deposits	58.66	93.94
		2003-04/ Scrutiny		77.58	
		2004-05/ Scrutiny		53.45	
2	M/s Gayathri Agro Industries Power Ltd., Suryapet CIT VI, Hyderabad	2002-03/ Summary	Interest on deposits	20.09	24.15
		2003-04/ Summary		40.26	
		2004-05/ Scrutiny		22.90	
		2005-06/ Scrutiny		12.75	
3	M/s Bharuch Enviro Infrastructure Ltd CIT III, Vadodara	2004-05/ Scrutiny	Interest on deposits	48.13	22.96
4	M/s TIDEL Park Ltd CIT I, Chennai	2003-04/ Scrutiny	Income from lease	34.54	17.92
5	M/s R.V.K. Energy (P) Limited CIT III, Hyderabad	2003-04/ Scrutiny	Interest on deposits	29.75	10.93

Note: In respect of Sl. no. 5, the Department has accepted the audit observation (October 2006).

3.6.10 Other issues

3.6.10.1 In Tamil Nadu, CIT I, Chennai charge, a company, **M/s Terra Energy Ltd.**, incorporated on March 1995 with the object of generation of power had neither transacted any business nor acquired any fixed assets till the transfer of two co-generation plants from M/s Thiru Arooran Sugars Ltd., as slump sale under a scheme of arrangement approved by the High Court of Madras in August 2000. As this was a transfer of a business already in existence, the new unit formed was not

eligible for deduction under section 80IA. The incorrect allowance of deduction under section 80IA resulted in revenue impact of Rs. 2.80 crore for the assessment year 2001-02.

3.6.10.2 The Department has initiated remedial action (April 2007).

3.6.10.3 In Maharashtra, CIT Central Circle IV charge, assessment of a company **M/s All Cargo Movers (India) Pvt. Ltd.**, for the assessment year 2004-05 was completed after scrutiny in December 2006 wherein deduction was allowed on profits derived from a 'container station'. A container station does not fall within the definition of eligible infrastructure. The port authorities also did not issue any certificate that the said structure formed part of the port. The omission to disallow the claim of deduction resulted in incorrect allowance of deduction of Rs. 1.22 crore involving a revenue impact of Rs. 44 lakh.

3.6.10.4 In Tamil Nadu, CIT III, Coimbatore charge, a company assessee **M/s Armstrong Knitting Mills (P) Ltd.**, after purchasing windmills during the assessment year 2002-03 had sold these to its sister concern and later leased back the same assets and claimed deduction on the income generated from windmills for the assessment year 2004-05. As no industrial undertaking was setup by the assessee claiming deduction (since the assets were only leased and not owned) and the machinery was also previously used in the business, the assessee was not eligible for deduction under section 80IA. This resulted in irregular allowance of deduction of Rs. 48.89 lakh involving revenue impact of Rs. 17.54 lakh.

3.6.10.5 The Department agreed to examine the issue (May 2007).

3.6.10.6 Proviso to sub section 4(c) of section 80IA provides that where an infrastructure facility is transferred after 1 April 1999 to another enterprise for the purpose of operating and maintaining the infrastructure facility on its behalf in accordance with the agreement with a government entity, the provisions of the section shall apply to the transferee for the unexpired period as if the transfer had not taken place.

3.6.10.7 In Maharashtra, CIT 8, Mumbai charge, the assessments of **M/s Ideal Toll Roads Investment & Operations Pvt. Ltd.**, for the assessment year 2002-03 was processed in summary manner (December 2002) and for the assessment years 2003-04 and 2004-05 after scrutiny (in January 2006 and December 2006 respectively). The assessee was allowed deduction under section 80IA on the profits generated on account of the toll collected for a road (Udaipur Bypass Project) located in the state of Rajasthan. The road was constructed by M/s Atlanta Construction (I) Limited (later known as Atlanta Infrastructure Ltd.) by a tripartite BOT agreement in July 1996 with the Government of India and the Government of Rajasthan. There was no provision in this agreement to transfer or assign the maintenance and operation of the road or to assign the rights to collect the toll to a third party. M/s Atlanta Infrastructure Ltd. assigned its rights to recover toll to the

assessee company for Rs. 10.10 crore. As the transfer was not in accordance with the agreement, the assessee was not entitled to deduction under section 80IA. Incorrect grant of deduction resulted in underassessment of income of Rs. 5.79 crore, Rs. 6.20 crore and Rs. 5.05 crore with consequent revenue impact of Rs. 2.07 crore, Rs. 2.28 crore and Rs. 1.81 crore for assessment years 2002-03, 2003-04 and 2004-05 respectively.

3.6.11 Tax expenditure

3.6.11.1 Tax expenditures are provisions in the Act, such as exclusions, deductions, credits, exemptions and other incentives that are designed to encourage certain kinds of activities or to aid taxpayers in special circumstances and reflect the policy choices of the government. They reduce the amount of tax revenues that may be collected and can be considered as direct government expenditure.

3.6.11.2 The steps involved in framing a tax incentive policy broadly include the design of tax incentives, implementation of the scheme and follow up in terms of compliance with the provisions of the Act and policy objectives. The benefit arising out of such tax incentives must also be periodically evaluated so as to derive an assurance that the policy and its implementation methods are indeed benefiting the beneficiaries. In order to do this effectively, it is necessary that the Department is in possession of real time and reasonable data relating to the major issues involved such as details of companies availing of deduction, nature of the activities for which the deductions are being allowed, sectors availing of the deduction, impact of the deduction on the various sectors, amount of revenue foregone, etc. Such data would assist in streamlining the Income Tax Act as well as in fine tuning the conditionality built into the section with actual developments in the sector.

3.6.11.3 Quantification of revenue foregone

A tax expenditure statement was laid before Parliament during Budget 2005-06 and 2006-07¹⁸ providing data on the revenue foregone¹⁹ on account various exemptions and deductions. The budget estimate of tax expenditure on account of each incentive has been broadly based on the probable revenue realisations by the exchequer in case the tax incentive was removed. In this exercise, the Ministry collected tax related information relating to 1689 companies from different sectors from the field formations of the Income tax Department in respect of the financial year 2003-04 (assessment year 2004-05). This exercise revealed that the highest tax expenditure was on account of deduction provided to profits of undertakings involved in development of infrastructure facilities, telecommunication services, power generation transmission and distribution as defined under section 80 IA.

¹⁸ Annex 12 to Receipts Budget 2005-06 and 2006-07

¹⁹ The tax forgone on each tax concession claimed by the companies has been estimated by applying corporate tax rate of 36.59 percent on the amount of deduction.

3.6.11.4 At the time of carrying out the audit review, no separate database of assessee availing of exemption under section 80IA was available with the Department. Audit identified 685 cases using collateral sources as specified in paragraph 3.4.1 above and test checked the assessments pertaining to the assessment year 2004-05 so as to be able to compare the estimates of revenue foregone with those stated in the tax expenditure statement of the Receipts Budget 2006-07, results of which are indicated in **Table no. 3.10** below:

(Rs. in crore)

	2004-2005
Deduction allowed as per the 166 assessment records seen by audit	16341.48
Tax expenditure @ 36.59 percent	5979
Tax expenditure @ 36.59 percent as quantified in the budget for 1689 companies	5832
Difference	147

3.6.11.5 In order to provide an impetus to undertakings to invest in the telecommunication sector, deduction under section 80IA was extended to undertakings providing telecommunication services. There has been an exponential growth in the telecom sector during the past decade. Audit examined the income tax assessments of major undertakings providing telecommunication services in order to examine the extent to which they had availed of the benefit of exemptions under section 80IA.

3.6.11.6 Status of deduction availed by telecommunication companies under section 80IA

The market share of various players in the telecom sector under GSM and CDMA along with the deduction allowed to them under section 80IA in the assessments is brought out in **Table no. 3.11** below:

(Rs. in crore)

Sl. no.	Name of operator	Market share in percent*	Details of deductions claimed/allowed under section 80IA for the assessment years			
			2002-03	2003-04	2004-05	2005-06
1	Bharti	22.00	Assessed under section 115JB#	Assessed under section 115JB#	Not claimed	Not claimed
2	BSNL	19.89	Not claimed	Not claimed	Assessed under section 115JB#	Assessed under section 115JB#
3	Reliance	19.51	Not claimed	Not claimed	Not claimed	Not claimed
4	Idea	8.31	Not claimed	Not claimed	Not claimed	Not claimed
5	Tata Teleservices	5.46	Not claimed	Not claimed	Not claimed	Not claimed
6	Spice Telecom (Now Spice Communication Pvt Ltd)	2.17	Not claimed	Not claimed	Not claimed	Not claimed

* Source: TRAI Annual Report 2005-06
Tax levied under special provisions, hence deduction under section 80IA has not been taken into account.

3.6.11.7 Audit examination thus revealed that major companies providing telecommunication services had either not claimed or could not avail of the deduction under section 80IA provided in the Act as they were either operating under losses or were being assessed under special provisions of the Act which does not take in to account deductions under section 80IA (details at **Appendix 15**).

3.6.11.8 *Audit recommends that the Ministry may like to examine the availment of deduction under section 80IA by the specified sectors and also carry out an impact analysis in order to ensure that the policy objectives of the government are achieved.*

3.6.11.9 In the exit conference, the Board agreed to examine the issue.

3.7 Conclusions and summary of recommendations

3.7.1 The benefit of deduction under section 80IA had been irregularly extended to works contractors although they could not be deemed to be engaged in developing or maintaining an infrastructure facility within the meaning of section 80IA.

3.7.1.1 *Audit recommends that the Ministry may strengthen its internal control mechanism to ensure that the assessing officers correctly apply the provisions of the Act in respect of deductions extended to works contractors.*

3.7.1.2 In the exit conference, the Board agreed to examine the issue.

3.7.2 The legal instruments granting tax incentives are required to be carefully drafted so that they achieve the policy objectives with minimum leakage of tax revenue. They are to be expressed as precisely as possible to avoid ambiguity in implementation.

3.7.2.1 *Audit recommends that the Ministry may consider suitably clarifying the provisions of section 80IA so as to prevent misuse of the incentive by ineligible assesseees.*

3.7.3 Assesseees deriving income from both eligible and non eligible units were not preparing separate accounts from the date of commencement of business, but were preparing it only from the year from which they were claiming exemption. As a result of this, deduction under section 80IA was being allowed without taking into account all losses and depreciation relating to eligible units treating them as a distinct entity.

3.7.3.1 *Audit recommends that the Ministry may consider making it mandatory for the assesseees availing of 80IA deduction to furnish details of carry forward of loss/depreciation from the first year of operation in order to compute profits relating to eligible units as a distinct entity. It is recommended that assessment*

orders clearly specify the details of losses to be carried forward for set off in future years for eligible and ineligible units separately.

3.7.3.2 In the exit conference, the Board agreed to examine the issue.

3.7.4 The assessing officers were not apportioning the expenses relating to the eligible undertakings correctly which resulted in inflation of eligible profits and, thereby, deduction.

3.7.4.1 *Audit recommends that the Ministry may consider incorporating a provision in the rules so that the tax audit report in Form no. 10CCB specifies the basis of apportionment/ allocation of common expenses especially with regard to composite business where assesseees have both eligible and ineligible units.*

3.7.4.2 In the exit conference, the Board agreed to examine the issue.

3.7.5 Deduction under section 80IA was being allowed even though the assesseees were not filing the required audit report/certificates along with the profit and loss account and balance sheet relating to the eligible undertaking treating it as a distinct entity.

3.7.5.1 *Audit recommends that the Ministry may institute a mechanism for compulsory checking of the statutory reports before allowing deductions.*

3.7.5.2 In the exit conference, the Board accepted the audit recommendation.

3.7.6 There were no clear directions for the determination of reasonable profits to be allowed as deduction for captive power plants under section 80IA.

3.7.6.1 *Audit recommends that the Ministry should take appropriate measures to ensure that the interest of revenue is protected while allowing deduction to captive power plants.*

3.7.6.2 In the exit conference, the Board agreed to examine the issue.

3.7.7 Cases were not being selected for scrutiny even though they fulfilled the criteria. The CASS was also not aiding in identification of assesseees for compulsory scrutiny as per the criteria prescribed by the Board.

3.7.7.1 *Audit recommends that the Ministry may like to devise a monitoring mechanism which ensures that its scrutiny guidelines are scrupulously followed and no high risk case is omitted from scrutiny. The Ministry should also ensure that the CASS identifies all cases which fulfill the criteria for the selection of cases for scrutiny.*

3.7.7.2 In the exit conference, the Board accepted the audit recommendation.

3.7.8 Major companies providing telecommunication services had either not claimed or could not avail of the deduction under section 80IA provided in the Act as they were either operating under losses or were being assessed under special provisions of the Act which does not take into account deductions under section 80IA.

3.7.8.1 *Audit recommends that the Ministry may like to examine the availment of deduction under section 80IA by the specified sectors and also carry out an impact analysis in order to ensure that the policy objectives of the government are achieved.*

3.7.8.2 In the exit conference, the Board agreed to examine the issue.



New Delhi
Dated: 1 January 2008

(SUDHA KRISHNAN)
Principal Director of Receipt Audit
(Direct Taxes)

Countersigned



New Delhi
Dated: 1 January 2008

(VIJAYENDRA N. KAUL)
Comptroller and Auditor General of India

Appendices

Appendix -1

Review on Assessments of Banks

(Referred to in paragraph 1.3.5)

- (i) “adjusted total income” means the total income computed in accordance with the provisions of this Act, without giving effect to the allowance referred to in this section or in sub-section (2) of section 32 or the deduction referred to in section 32A or section 33 or section 33A or the first proviso to clause (ix) of sub-section (1) of section 36 or any loss carried forward under sub-section (1) of section 72 or sub-section (2) of section 73 or sub section (1)28 (or sub-section (3)) of section 74 or sub-section (3) of section 74 A or the deductions under Chapter VI-A;
- (ii) “average adjusted total income” means:-
 - (a) in a case where the total income of the assessee is assessable for each of the three assessment years immediately preceding the relevant assessment year, one third of the aggregate amount of the adjusted total income in respect of the previous years relevant to the aforesaid three assessment years;
 - (b) in a case where the total income of the assessee is assessable only for two of the aforesaid three assessment years, one half of the aggregate amount of the adjusted total income in respect of the previous years relevant to the aforesaid two assessment years;
 - (c) in a case where the total income of the assessee is assessable only for one of the aforesaid three assessment years, the amount of the adjusted total income in respect of the previous year relevant to that assessment year;

Appendix 2

(Rs. in crore)

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Incorrect allowance of bad debts written off (Paragraph 1.9)				
Private Banks				
1	M/s IDBI Bank Ltd, City 3, Mumbai	2003-04 143(3)	The amount of Rs. 11.00 crore of bad debts written off was not debited to the provision for bad and doubtful debts account which had a credit balance of Rs. 11.40 crore.	4.04
2	M/s ICICI Bank Ltd, City 3, Mumbai	2003-04 143(3)	Bad debts of Rs. 8.11 crore were written off and allowed in respect of eight parties where interest income was claimed exempt under section 10(23G) in previous years. As the income was not offered for tax in the previous years, no deduction can be allowed under section 36(2) towards bad debts written off, when such exempt income and also the corresponding principal loan amount becomes non recoverable.	2.98
3	M/s J&K Bank Ltd, Jammu	2002-03 143(3)	Deduction for bad debts written off of Rs. 3.33 crore was allowed without debiting it to the provision for bad and doubtful debts account which had a credit balance of Rs. 77.78 crore.	1.99
4	M/s Lord Krishna Bank Ltd, Kochi,	2002-03 143(3)	While allowing bad debts written off amounting to Rs. 17.94 crore, credit balance of Rs. 3.11 crore available in the provision for bad and doubtful debts account was not reduced. The Department has taken remedial action (August 2007).	1.56
5	M/s Karur Vysya Bank Ltd, Trichy I	2004-05 143(3)	Deduction for bad debts written off amounting to Rs. 3.34 crore was allowed without debiting it to the provision for bad and doubtful debts account which had a credit balance of Rs. 35.66 crore.	1.19
6	M/s Kotak Mahindra Bank Ltd, City 3, Mumbai	2003-04 143(3)	While allowing bad debts of Rs. 2.85 crore, credit balance of Rs. 7.13 crore available in the provision for bad and doubtful debts account was not reduced.	1.05
Foreign Banks				
7	M/s American Express Bank, DIT(IT), Mumbai	2002-03 143(3)	The provision for bad and doubtful debt account had a credit balance of Rs. 13.09 crore. Bad debts written off by the assessee totalled was Rs. 21.49 crore. Against the allowable deduction of Rs. 8.40 crore as bad debts written off, deduction of Rs. 15.28 crore was allowed, resulting in excess deduction of Rs. 6.88 crore.	2.89
8	M/s Deutsche Bank, DIT(IT), Mumbai	2003-04 143(3)	Deduction for bad debts written off of Rs.5.55 crore was allowed without debiting it to the provision for bad and doubtful debts account which had a credit balance of Rs. 19.92 crore. The Department has accepted (October 2007) the audit observation.	2.33

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
9	M/s Bank of Bahrain and Kuwait, DIT(IT), Mumbai	2002-03 143(3)	While allowing bad debts written off amounting to Rs. 9.99 crore, credit balance of Rs. 3.04 crore available in the provision for bad and doubtful debts account was not reduced.	2.05
10	M/s Calyon Bank, DIT(IT), Mumbai	2002-03 143(3)	While allowing the bad debts written off, credit balance of Rs. 2.30 crore brought forward from the earlier year in the provision for bad and doubtful debts account was not considered.	1.11 (P) ¹
Incorrect allowance of provision for bad and doubtful debts (Paragraph 1.10)				
Private Banks				
11	M/s Lakshmi Vilas Bank Ltd, Trichy I,	2001-02 2002-03 143(3)	Deduction under section 36(1)(vii)(a) is allowable under one of the following options: (i) the prescribed percentage on the amount of total income, and the prescribed percentage on the advances made by the rural advances; (ii) the prescribed percentage of the bad and doubtful debts, classified in accordance with the RBI guidelines. Deduction of Rs. 18.23 crore was allowed under option (i) and deduction of Rs. 10.32 crore was allowed under option (ii) as well instead of allowing only one of these options.	3.85
12	M/s ICICI Bank Ltd, City 3, Mumbai	2003-04 143(3)	While allowing provision for bad and doubtful debts under section 36(1) (vii), total income was not reduced by the amount of deduction allowed under section 36(1) (viii) of Rs. 50 crore resulting in under assessment of income of Rs. 3.75 crore. The Department has accepted (March 2007) the audit observation in principle and taken remedial action under section 154/147 of the Act.	1.38
13	M/s Karur Vysya Bank Ltd, Trichy I	2002-03 2004-05 143(3)	Deduction was not restricted to the actual provisions of Rs. 11.30 crore and Rs. 16.27 crore made in respect of bad and doubtful assets in the books of accounts during the assessment years 2002-03 and 2004-05 respectively, resulting in excess deduction of Rs. 3.31 crore.	1.21
Foreign Bank				
14	M/s Bank of America, DIT(IT), Mumbai	2003-04 143(3)	While allowing provision for bad and doubtful debts of Rs. 6.43 crore under section 36(1) (vii), deduction towards bad debts written off was not restricted to the provision actually created in the books during the year.	2.70
Deduction towards advances given by rural branches of bank (Paragraph 1.13)				
Public Sector Bank				
15	M/s State Bank of Saurashtra, Ahmedabad-VI	2003-04 2004-05	Branches of bank where population exceeded 10000 were considered as rural branches and deductions were allowed accordingly. This was irregular and resulted in excess deduction aggregating Rs. 7.54 crore.	3.59

¹ Potential

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Incorrect allowance of depreciation on valuation of investments made by banks (Paragraph 1.14)				
Public sector Banks				
16	M/s Central Bank of India, City 2, Mumbai	2002-03 2003-04 143 (3)	The gain/loss on the sale of investment held for maturity was allowed as long term capital gain. In view of the judgment (251 ITR 522 SC), the said loss/gain should have been treated as business income and benefit of indexation was required to be disallowed. This resulted in under assessment of income of Rs. 10.05 crore and Rs. 1.91 crore in these assessment years. The Department has accepted (May 2005) the audit observation and taken remedial action.	4.29
17	M/s State Bank of Saurashtra, Ahmedabad-VI	2002-03 143 (3)	Rs. 2.57 crore being appreciation on investment in securities was disallowed by the assessing officer. However, while computing the taxable income, he first reduced this amount from income and then again added it back thus making the net effect nil.	0.92
Private Banks				
18	M/s Indusind Bank Ltd, City 2, Mumbai	2002-03 143(3)	Provision for depreciation in the value of investments held under the category Held To Maturity (HTM) of Rs. 2.83 crore was incorrectly allowed. Further depreciation of Rs. 4.25 crore on bond and debentures including deep discount bond and mutual funds were allowed, although these were not categorised under any of the three categories of investments prescribed by the RBI guidelines. The Department has accepted (March 2006) the audit observation.	3.47
19	M/s Federal Bank Ltd, Kochi,	2005-06 143(3)	While allowing depreciation of Rs. 5.47 crore on AFS category of investments, appreciation of Rs. 72.40 crore was ignored.	2.00
20	M/s Dhanalakshmi Bank Ltd, Thrissur,	2003-04 143(3)	Depreciation of Rs. 2.69 crore was allowed without netting the appreciation of Rs. 2.84 crore.	0.82
Foreign Bank				
21	M/s American Express Bank, DIT(IT), Mumbai	2004-05 143(3)	Although Rs. 5.90 crore being depreciation in the value of securities, was disallowed by the assessing officer at the time of scrutiny assessment, only Rs. 1.14 crore was added at the time of computation of income, resulting in under assessment of income by Rs. 4.76 crore.	2.60
Incorrect allowance of expense towards exempt income (Paragraph 1.15)				
Public Sector Banks				
22	M/s Central Bank of India, City 2, Mumbai	2003-04 143(3)	The assessment was completed determining taxable income of Rs. 786.39 crore after allowing deduction of Rs. 15 crore towards gross dividend income without deducting the expenses incurred to earn such income. The assessing officer while computing the expenditure relating to exempt income towards	4.83

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
			<p>interest earned on tax-free bonds, had adopted 70 percent of the income as expenditure based on the earlier year's assessment. On the same analogy, the assessing officer should have disallowed 70 percent of the dividend income as expenditure against exempt income and added it back. Omission to do so resulted in excess allowance of deduction of Rs. 10.50 crore.</p> <p>The Department has accepted (May 2005) the audit observation.</p>	
23	M/s State Bank of Saurashtra, Ahmedabad VI	2002-03 143(3)	Proportionate expenditure in respect of exempt interest income of Rs. 11.52 crore earned u/s 10 (23G) was not disallowed.	2.85
24	M/s Allahabad Bank, Kolkata II	2002-03 143(3)	<p>Assessee bank had earned dividend income for Rs. 14.89 crore and interest from tax free loan for Rs. 38.67 crore which were allowed as exempt income u/s 10(33) and u/s 10(15) respectively. But related expenses for earning such exempt income, which worked out to Rs. 4.99 crore, was not disallowed.</p> <p>The Department has taken remedial action (August 2007).</p>	2.00
25	M/s State Bank of Bikaner & Jaipur, Jaipur	2004-05 143(3)	The assessee has reduced the income by Rs. 4.89 crore earned as interest on tax free debentures and Rs. 11.61 crore from mutual funds calculated on due basis, whereas the assessee bank had accounted for Rs. 4.74 crore and Rs. 8.07 crore respectively in its accounts computed on accrual basis. The omission has involved excess reduction of exempt income by Rs. 3.7 crore.	1.77
26	M/s State Bank of Mysore, Bangalore III	2003-04 2004-05 143(3)	<p>Proportionate expenditure in respect of exempt interest income of Rs. 3.12 crore earned u/s 10 (23G) was not disallowed.</p> <p>The Department accepted (November 2007) the audit observation.</p>	1.12
27	M/s UCO Bank Kolkata - II	2002-03 143(3)	<p>Assessee bank earned dividend income u/s 115 O for Rs. 7.26 crore which was allowed as exempt u/s 10(33) of Act by the assessing officer. But related expenses for earning such exempt income, worked out as Rs. 1.94 crore were not disallowed.</p> <p>The Department has taken remedial action. (August 2007).</p>	0.69
Private Banks				
28	M/s J&K Bank Ltd, Jammu	2002-03 143(3)	The assessee has been allowed a deduction of Rs. 12.11 crore under section 80M of the Act representing gross dividend received during 2002-03 without disallowing corresponding expenses incurred in earning this dividend income.	4.59

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
29	M/s Federal Bank Ltd, Kochi,	2003-04 143(3)	Deduction of Rs. 6.36 crore under section 80M of the Act was allowed but the expenditure incurred to earn this income was not disallowed. This expenditure relatable to the dividend income (computed in accordance with the formula adopted by the assessing officer in the case of interest in tax free bonds) would work out to Rs. 4.42 crore. The Department has revised the assessment in December 2006 disallowing the expenditure under section 14A in respect of dividend received.	1.66
30	M/s Bharat Overseas Bank Ltd, Chennai I	2004-05 143(3)	The amounts of 'unclaimed balances' of Rs. 4.07 crore represented inoperative savings accounts, current accounts and overdue deposits which had not been operated for more than five years and expired drafts not encashed for more than 5 years. These were required to be treated as income under section 41(1).	1.46
31	M/s Karur Vysya Bank Ltd, Trichy I	2004-05 143(3)	The amounts of 'unclaimed deposits' of Rs. 3.05 crore represented inoperative savings accounts, current accounts and overdue deposits which were not operated for more than five years and expired drafts not encashed for more than 5 years. These were required to be treated as income under section 41(1).	1.10
32	M/s Karur Vysya Bank Ltd, Trichy I	2001-02 2002-03 143(3)	Expenditure of Rs. 1.72 crore to earn exempt income from investment was omitted to be disallowed.	0.65
Irregular allowance of deductions (Paragraph 1.16)				
Public Sector Banks				
33	M/s Indian Overseas Bank, Chennai I	2004-05 143(3)	Deduction of Rs. 7.17 crore was allowed towards 'exchange gain on return of capital on account of repatriation'. Exchange gain had arisen in course of repatriation and recognised in the profit and loss account. Thus, deduction of such gain which was in the nature of revenue receipt, was incorrect.	2.57
34	M/s Indian Overseas Bank, Chennai I	2003-04 143(3)	Deduction of Rs. 0.09 crore u/s 80G and Rs.6.85 crore u/s 80M was allowed once in the regular assessment and again in the revision made in December 2006.	2.55
35	M/s Allahabad Bank, Kolkata-II	2003-04 143(3)	The assessee issued Initial Public Offer (IPO) in October 2002 and claimed 'IPO expenses' of Rs. 4.97 crore which was allowed in full instead of one fifth as required under section 35D of the Act.	1.82
36	M/s State Bank of Hyderabad, Hyderabad III	2000-01 2001-02 143(3)	Prior period expenses of Rs. 0.64 crore and Rs. 1.32 crore representing interest on deposits, TA bills, Overtime allowances etc. had been allowed incorrectly as the same did not relate to previous years relevant to assessment years 2000-01 and 2001-02. Further in the assessment year 2000-01, AMC charges of Rs. 0.65 crore was not brought to tax	1.18

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
			stating that the method of accounting was changed during the previous year from accrual to cash basis in respect of this item. As the change in method of accounting in respect of single item is not permissible under the Income Tax Act this amount was required to be added back to total income. The Department has taken remedial action (August 2007).	
37	M/s Bank of Maharashtra, Pune- I	2003-04 143(3)	Deduction towards donation under section 80G was allowed though donation did not pertain to the previous year. The Department has accepted (June 2006) the audit observation and rectified the mistake.	1.09
38	M/s Allahabad Bank, Kolkata II	2003-04 143(3)	Employer's contribution towards provident fund amounting to Rs. 1.97 crore was deposited after due date. As the late payment of provident fund dues is not allowable under the provision of section 43B (b), allowance of the same resulted in underassessment of income by Rs. 1.97 crore.	0.73
39	M/s UCO Bank, Kolkata II	2002-03 143(3)	The assessee issued Initial Public Offer (IPO) and claimed 'IPO expenses' for Rs. 1.18 crore which was allowed in full instead of one fifth as required under section 35D of the Act..	0.56
Private Banks				
40	M/s Karur Vysya Bank Ltd, Trichy I	2001-02 2002-03 2004-05 143(3)	Deduction towards ex-gratia payments of Rs. 3.13 crore was disallowed in the assessment year 2003-04 as it was in nature of distribution of profits to employees and it has not been incurred out of any business necessity or statutory obligation. Similar such claims amounting to Rs. 8.78 crore allowed during assessment year 2001-02, 2002-03 and 2004-05 were also required to be disallowed.	3.28
41	M/s Global Trust Bank Ltd, Delhi V	2002-03 143(3)	Rs. 724.22 crore was credited under the head 'interest earned' in the P&L account. However, as per schedule XIII, Rs. 727.91 crore had been credited during the year. The mistake resulted in under assessment of income by Rs. 3.69 crore.	1.32 (P)
42	M/s Tamil Nad Mercantile Bank Ltd, Madurai I	2003-04 2004-05 143(3)	No interest is payable on overdue deposits after its maturity. Therefore, the interest on overdue deposits paid amounting to Rs. 3.28 crore was not allowable.	1.18
43	M/s Karur Vysya Bank Ltd, Trichy I	2002-03 to 2004-05 143(3)	Deduction of Rs. 2.66 crore was allowed even though the details regarding the actual payment were not furnished.	0.97
44	J&K Bank Ltd, Jammu	2002-03 2003-04 143(3)	Deduction of Rs. 21.23 lakh and Rs. 1.12 crore towards expenditure incurred for development of park was required to be disallowed as the same did not constitute the legitimate business expenditure of the assessee.	0.75

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
Income not offered to tax (Paragraph 1.17)				
Public Sector Banks				
45	M/s Andhra Bank, Hyderabad -I	2002-03	The assessee reduced Rs. 5.16 crore from gross interest income being 'unrealised interest income of earlier years, reversed during current financial year relevant to assessment year' which was not allowable. Further, a provision of Rs. 6.50 crore for 'switching over to 90 days norm for identification on NPAs' was also not admissible.	4.17
46	M/s Indian Overseas Bank, Chennai I	2001-02 to 2004-05	The interest element (estimated at 10%) contained in the Deposit Insurance Credit Guarantee Corporation/Export Credit Guarantee Corporation (DICGC/ECGC) claims of Rs. 91.56 crore received was not treated as income under section 43 D.	3.20
47	M/s State Bank of Patiala,, Patialab	2002-03 143(3)	Bad debts of Rs. 2.93 crore written off during the past year and recovered during the year were credited into P&L account but while computing taxable income, it was not included.	1.05
48	M/s State Bank of Travancore, Thiruvananthapuram	2004-05 143(3)	During the assessment year 2004-05, the policy where recoveries made in NPA accounts are first taken to principal amount due in the accounts and balances, if any, is recognised as interest income, was followed instead of the policy of adjusting the recoveries first to interest and balance, if any, to the principal, which was followed till then. This change in the method of accounting resulted in the interest income for the assessment year 2004-05 being lower by Rs. 1.98 crore.	0.71
Private Banks				
49	M/s Lakshmi Vilas Bank Ltd, Trichy I	2002-03 to 2004-05	The interest element (estimated at 10%) contained in the Deposit Insurance Credit Guarantee Corporation/Export Credit Guarantee Corporation (DICGC/ECGC) claims of Rs. 23.44 crore received was not treated as income under section 43 D.	0.82
50	M/s Tamil Nad Mercantile Bank Ltd, Madurai I	2001-02 to 2004-05	The interest element (estimated at 10%) contained in the Deposit Insurance Credit Guarantee Corporation/Export Credit Guarantee Corporation (DICGC/ECGC) claims of Rs. 18.37 crore received was not treated as income under section 43 D.	0.64
51	M/s Karur Vysya Bank Ltd, Trichy I	2001-02 to 2004-05	The interest element (estimated at 10%) contained in the Deposit Insurance Credit Guarantee Corporation/Export Credit Guarantee Corporation (DICGC/ECGC) claims of Rs. 17.63 crore received was not treated as income under section 43 D.	0.62
Incorrect allowance of depreciation and set off of losses (Paragraph 1.18)				
Private Bank				
52	M/s Global Trust Bank Ltd; (now amalgamated with M/s Oriental Bank of	2002-03 2003-04 143(3)	Depreciation at 60 percent on LAN/WAN and ATM was allowed under the head 'computer hardware'. As LAN/WAN and ATM should be treated under the heading 'plant and machinery' for which applicable rate of depreciation is 25 percent, excess depreciation of Rs. 3.34 crore and Rs. 74.34 lakh was	1.47 (P)

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
	Commerce) Delhi V		allowed. Though the Department has not accepted (November 2006) the observation on the ground that these were integral part of computers/telecommunication device, they have taken the same stand as audit in the next assessment year 2004-05.	
Allowance of provisions, capital expenditure & liabilities (Paragraph 1.20)				
Public Sector Banks				
53	M/s Indian Overseas Bank, Chennai I	2003-04 143(3)	Deduction on account of provision of Rs. 12.00 crore for wage arrears (for which negotiations were yet to be finalised) was not added back to income.	4.41
54	M/s Andhra Bank, Hyderabad	2001-02 143(3)	Deduction of Rs. 4.50 crore on account of provision towards standard assets was allowed though the standard assets are to be treated as good and cannot be considered for creating provisions for bad and doubtful debts. The Department has taken remedial action (August 2007).	2.21
55	M/s Indian Overseas Bank, Chennai I	2002-03 143(3)	Incorrect claim of deduction of Rs. 1.64 crore towards expenditure met out of 'reserves', was required to be disallowed as it had not been passed through the profit and loss account.	0.58
Private Banks				
56	M/s Tamil Nad Mercantile Bank Ltd, Madurai I	2003-04 2004-05 143(3)	Rs. 3.15 crore and Rs. 6.92 crore during the assessment years 2003-04 and 2004-05 in respect of provision for pension was claimed and allowed as deduction. As the above amounts represent provision towards contingent liability, it is not allowable.	3.64
57	M/s Karur Vysya Bank Ltd, Trichy I	2004-05 143(3)	Provision of Rs. 8.00 crore towards 'arrears of wages' (for which negotiations were yet to be finalised) was not added back.	2.87
58	M/s J&K Bank Ltd, Jammu	2002-03 to 2004-05 143(3)	The assessee had claimed and was allowed deduction of Rs. 8.19 crore and Rs. 1.72 crore on account of cost of computer software and additions/renovation of the bank property respectively. As the expenditure incurred was of enduring nature, it was required to be capitalised and applicable rate of depreciation was to be allowed.	2.57
59	M/s Tamil Nad Mercantile Bank Ltd, Madurai I	2004-05 143(3)	Provision of Rs. 4.80 crore towards arrears of salary pending wage settlement was not added back.	1.72
60	M/s Karur Vysya Bank Ltd, Trichy I	2001-02 2002-03 143(3)	Deduction towards direct payment of pension amounting to Rs. 3.54 crore was allowed in the assessment years 2001-02 and 2002-03 in addition to the contribution to the pension fund. As the bank contributes to pension fund, pensionary benefits are	1.33

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
			to be met out of pension fund only. Direct payment of pension was disallowed in the assessment years 2003-04 and 2004-05. Adopting a consistent stand, claims allowed in respect of assessment years 2001-02 and 2002-03 need to be withdrawn.	
61	M/s Lakshmi Vilas Bank Ltd, Trichy I	2001-02 143(3)	Provision of Rs. 1.46 crore towards 'leave encashment' was not added back.	0.58
Foreign Bank				
62	M/s UFJ Bank, Ltd, DIT (IT) Delhi	2003-04 143(3)	The assessee had claimed and was allowed an expenditure of Rs. 4.49 crore on loss on sale on investment. Loss on sale of investment being of capital nature should have been disallowed.	1.89 (P)
Incorrect allowance of expenditure on investments (Paragraph 1.21)				
Private Banks				
63	M/s Tamil Nad Mercantile Bank Ltd, Madurai I,	2001-02 to 2004-05	Broken period interest paid on purchase of HTM securities amounting to Rs. 8.34 crore was incorrectly allowed as deduction.	3.04
64	M/s Karur Vysya Bank Ltd, Trichy I	2002-03 143(3)	Net broken period interest of Rs. 6.49 crore paid was allowed incorrectly though similar claims of Rs. 24.99 crore and Rs. 30.20 crore were disallowed for the assessment years 2003-04 and 2004-05.	2.32
Incorrect deduction of income from securities (Paragraph 1.22)				
Private Bank				
65	M/s Karur Vysya Bank Ltd, Trichy I	2001-02 143 (3)	Incorrect method of accounting followed by the bank resulted in underassessment of income of Rs. 5.79 crore.	2.29
Incorrect computation of income under special provisions (Paragraph 1.23)				
Public Sector Banks				
66	M/s Indian Bank, Chennai I	2002-03 143(3)	Incorrect deduction towards unabsorbed depreciation/business loss resulted in under assessment of book profit by Rs. 58.44 crore.	4.47
67	M/s Indian Overseas Bank, Chennai I	2002-03 143(3)	Arithmetical mistake in the computation of book profit u/s 115 JB resulted in under assessment of income by Rs. 35.42 crore.	2.71
68	M/s Indian Overseas Bank, Chennai I	2001-02 143(3)	Incorrect deduction from the book profits towards brought forward losses or unabsorbed depreciation amounting to Rs. 8.55 crore as against 'Nil' amount.	0.72
Foreign Bank				
69	M/s Calyon Bank, DIT(IT), Mumbai	2002-03 143(3)	Income at (-) Rs. 12.55 crore under normal provision and nil income under section 115JB was assessed though income under section 115JB worked out to Rs. 12.30 crore.	1.21
Incorrect allowance of deduction towards head office expenses / interest relating to foreign banks (Paragraph 1.24)				
Foreign Banks				
70	M/s BNP Paribas, DIT(IT), Mumbai	2002-03 to 2004-05 143(3)	Interest amounting to Rs. 4.89 crore paid to head office/overseas branches was allowed as deduction though it is not an allowable expenditure as the payment is made to self.	1.98

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
71	M/s Bank of Nova Scotia, DIT(IT), Mumbai)	2004-05 143(3)	Interest amounting to Rs. 2.81 crore paid to head office/overseas branches was allowed as deduction though it is not an allowable expenditure as the payment is made to self.	1.15
Incorrect computation of income and other mistakes (Paragraph 1.25)				
Public Sector Banks				
72	M/s State Bank of Saurashtra, Ahmedabad-VI	2002-03 143(3)	Withholding of refund due to the assessee after processing of return under section 143(1) was irregular and interest paid under section 244A to the extent of Rs. 4.89 crore could have been avoided. The Department has accepted (June 2007) the audit observation.	4.89
73	M/s Indian Bank, Chennai I	2002-03 143(3)	Under the special provisions, deduction of the entire amount of provisions and contingencies of Rs. 273.93 crore was given though CIT (A) gave relief to the extent of Rs. 213.59 crore only. This resulted in excess relief of Rs. 60.34 crore.	4.62
74	M/s Punjab and Sindh Bank, Delhi V	2003-04 143(3)	Interest charged under section 234B for default in payment of advance tax was incorrectly charged to Rs. 3.06 crore instead of Rs. 6.23 crore.	3.17
75	M/s State Bank of Patiala; Patiala	2003-04 143(3)	Interest under section 234B was incorrectly charged for 11 months for Rs. 2.61 crore instead of 23 months for Rs. 5.37 crore. The period from 01 April 2003 to 22 February 2005 which works out to 23 months was incorrectly counted as 11 months.	2.51
76	M/s Allahabad Bank, Kolkata -II	2004-05 143(3)	Deduction of Rs. 497.38 crore towards bad debt was allowed though as per the assessee's accounts, the total bad debt written off was Rs. 490.46 crore. This resulted in excess allowance of bad debts of Rs. 6.92 crore. The Department has accepted (June 2007) the audit observation.	2.48
77	M/s Union Bank of India, Mumbai City II	2003-04 143(3)	Interest under section 234D amounting to Rs. 7.82 crore was levied instead of the correct amount of Rs. 9.56 crore. The Department has accepted (August 2005) the audit observation and taken remedial action.	1.74
78	M/s State Bank of Saurashtra, Ahmedabad-VI	2004-05 143(3)	Interest under section 234D amounting to Rs. 3.40 crore was levied instead of correct amount of Rs. 1.70 crore.	1.70 (over-charge)
79	M/s State Bank of Saurashtra, Ahmedabad-VI	2003-04 143(3)	There was inordinate delay of four months in giving effect to the appeal order which resulted in extra payment of interest. The Department has accepted (June 2007) the audit observation.	1.00

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
80	M/s State Bank of Indore, Indore	2003-04 143(3)	The figure for total interest accrued upto the end of the assessment year 2003-04 was taken incorrectly at Rs. 147.56 crore as against the correct figure of Rs. 149.29 crore.	0.89
81	M/s State Bank of Indore, Indore	2003-04 143(3)	While allowing the appeal effect, interest of Rs. 10.56 crore was levied under section 234B as against the leviable amount of Rs. 9.81 crore. The Department has accepted (August 2007) the audit observation.	0.75 (over-charge)
82	M/s Punjab National Bank, Delhi V	2005-06 143(3)	Tax was calculated after deducting long term capital gain of Rs. 1.63 crore twice.	0.67
83	M/s Vijaya Bank, Bangalore III	1997-98 143(3)	TDS credit of Rs. 41.91 lakh along with interest on refund of Rs. 10.62 lakh was not reckoned but Rs. 52.53 lakh equal to TDS was deducted from refund. The Department has rectified the mistake.	0.53 (over-charge)
84	M/s Indian Bank, Chennai I	2002-03 143(3)	There were delays in remittance of TDS ranging from 1 to 719 days in 879 cases involving Rs. 1.68 crore. However, there were no details regarding action initiated for levy of interest.	Not ascertained
85	M/s Indian Overseas Bank, Chennai I	2004-05 143(3)	As per the auditor's report in Form 3CD, there were delays in remittance of TDS ranging from 1 to 383 days in 1699 items. However, action initiated for such delay was not on record.	Not ascertained
86	M/s Allahabad Bank, Kolkata II	2002-03 143(3)	As per the appellate order, in October 2003, deduction of Rs. 122.72 crore were allowed over and above the deduction allowed at Rs. 66.97 crore u/s 36(1)(viiia) already allowed to the bank. On this issue the Department preferred second appeal before the ITAT in January 2004. Audit noticed that while preferring the second appeal before the ITAT, the department misinterpreted the previous orders and challenged the allowance of deduction under section 36(1)(viiia) for Rs. 55.75 crore (being the difference between Rs. 122.72 crore and Rs. 66.97 crore) instead of challenging the deduction of Rs. 122.72 crore allowed over and above Rs. 66.97 crore. The Department has not followed up the case since January 2004 indicating major lack of coordination between the department and ITAT in addressing issues in the interest of revenue.	Nil
Private Banks				
87	M/s J&K Bank Ltd, Jammu	2004-05 143 (3)	While computing the taxable income, Rs, 5.83 crore representing income from long term capital gain was reduced on the ground that it was already included in the miscellaneous income of Rs. 27.31 crore in the profit & loss account and then added back also. Audit scrutiny revealed that above amount was not	2.90

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
			included in the profit & loss account; hence it was not required to be reduced from taxable income.	
88	M/s IDBI Bank Ltd, City 3 Mumbai	2003-04 143(3)	The assessee was allowed a deduction of Rs. 6.65 crore being written off investments in shares and debentures as non-recoverable. Since investment in shares and debentures can not be termed as money lent in the ordinary course of business, no deduction was allowable under section 36(2)(1).	2.44
89	M/s Federal Bank Ltd, Kochi	1994-95 143(3) 250	While computing the taxable income, assessing officer had subtracted the amount of "income from other sources" (Rs. 1.72 crore) from the business income Rs. 21.59 crore instead of adding the same.	2.22
90	M/s South Indian Bank Ltd, Thrissur,	1999-2000 143(3)	Profit on sale of investment in securities offered to tax was short by Rs. 3.09 crore. The Department has accepted (October 2006) the audit observation	1.49
91	M/s Bharat Overseas Bank Ltd, Chennai I	2002-03 143(3)	The assessee was allowed exemption on its business income of Rs. 12.61 crore earned in Thailand. Though the assessee had permanent establishment in both the countries, it was deemed to be a resident of India in view of the effective place of management being in India. Hence the correct method would have been to include it in the total income and allow relief under the tax credit method. The mistake resulted in under assessment of income of Rs. 12.61 crore.	1.33
92	M/s HDFC Bank Ltd, City 2, Mumbai	2002-03 143(3)	Interest under section 220(2) was not levied on delay of two months after due date in payment of tax. The Department has accepted (February 2006) the audit observation and taken remedial action.	1.03
93	M/s ICICI Bank Ltd, City 3, Mumbai	2003-04 143(3)	Interest on excess refund made consequent to assessment completed in summary manner was levied in excess for a month under section 234D.	0.96
94	M/s ICICI Bank Ltd, City 3, Mumbai	2004-05 143(3)	Bonus debited to profit and loss account which was not paid till the date of filing return, was not added back to the taxable income under section 43B.	0.94
95	M/s Karur Vysya Bank Ltd, Trichy I	2003-04 143(3)	Arithmetic mistake in the assessment order resulted in under assessment of income of Rs. 1.37 crore. The Department has accepted (March 2007) the audit observation and stated that remedial action would be taken.	0.50
Foreign Banks				
96	M/s Standard Chartered Bank, DIT(IT), Mumbai	2004-05 143(3)	Refund was not issued after assessment under section 143(1). Instead it was issued only after finalisation of scrutiny assessment. Thus, the delay in issue of refund resulted in increase in interest liability of the Government.	3.44
97	M/s Standard Chartered Bank,	2002-03 143(3)	The assessing officer disallowed Rs. 20.30 crore towards acquisition of retail assets portfolio as	2.98

Sl. no	Assessee and CIT charge	Assessment year and type of assessment	Nature of mistake	Tax effect
	DIT(IT), Mumbai		capital expenditure. However, in computation of income, amount of Rs. 14.10 crore was added back instead of Rs. 20.30 crore. The Department has taken remedial action under section 154 of the Act.	
98	M/s Abu Dhabi Commercial Bank, DIT(IT), Mumbai	2004-05 143 (3)	Refund was not issued after assessment under section 143(1). Instead refund was issued only after finalisation of scrutiny assessment. Thus, the delay in issue of refund resulted in increase in interest liability of the Government.	1.88
99	M/s HSBC Bank Ltd, DIT(IT), Mumbai	2004-05 143(3)	Interest was allowed under section 244A though the refund amount was less than ten per cent of the tax determined. The Department has accepted (March 2007) the audit observation.	1.50
100	M/s Calyon Bank, DIT(IT) Mumbai	2004-05 143(3)	The assessee was allowed a deduction of Rs. 2.88 crore being bad debts written off against provisions for diminution in the value of investments in shares and debentures which could not be termed as money lent in ordinary course of business under section 36(2)(1).	1.18 (P)
101	M/s Barclays Bank PLC, DIT(IT), Mumbai	2003-04 143 (3)	Tax was levied at the rate of 30 per cent on Short Term Capital Gain arising out of the sale of fixed assets instead of the applicable rate of 40 per cent. The Department has accepted (June 2007) the audit observation and taken remedial action.	0.96
102	M/s State Bank of Mauritius Ltd, DIT (IT) Mumbai	2001-02 143 (3) /250	While giving effect to the CIT (A)'s order in February 2006, income of Rs. 25.84 crore was adopted as the starting point instead of the correct amount of Rs. 24.39 crore which was arrived at after allowing the admissible depreciation in the scrutiny assessment resulting in over assessment of income of Rs. 1.46 crore. The Department has accepted (July 2006) the audit observation and taken remedial action.	0.70 (over assessment)

Appendix 3

REVIEW ON APPRECIATION OF THIRD PARTY REPORTING/CERTIFICATION IN ASSESSMENT PROCEEDINGS
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(Referred to in paragraph 2.3.1)

Important provisions of the Act in respect of audit of accounts and the tax audit reports by an accountant

Sl. no.	Form no.	Audit of accounts and/or report/certificate of an accountant	Section
1	3AA	Deduction towards additional depreciation.	32(i)(ia)
2	3AAA	Deduction in respect of investment deposit account.	32AB (5)
3	3AC	Assessee carrying on the business of growing and manufacturing tea/coffee/rubber claiming deduction.	33AB
4	3AD	Assessee carrying on business consisting of the prospecting for or extraction or production of, petroleum or natural gas or both in India and in relation to which the Central Government has entered into an agreement for the purpose of deposit in Special Account/Site Restoration Account.	33ABA
5	3CA/3CB/ 3CD	Assessee carrying on business or profession whose sales, turnover or gross receipts exceed Rs. 40 lakh (Rs. 10 lakh in the case of profession), and assessee who claim their income to be lower than the profits or gains deemed to be the profits and gains of their business.	44AB
6	3CE	Certification in respect of income by way of royalty/fees for technical services.	44DA(2)
7	3CEA	Computation of capital gain in case of slump sales.	50B
8	3CEB	Report under section 92E relating to international transaction(s).	92E
9	6B	Assessee who have been ordered by the assessing officer with the previous approval of the CCIT/CIT under section 142(2A) to get their books of accounts audited having regard to the nature and complexity of the accounts of the assessee in the interest of the revenue.	142(2A)
10	10B	Public charitable or religious trust or institutions.	12A(b)
11	10C	Assessee other than companies or co-operative societies claiming deduction under section 80HH in respect of profits from newly established industrial undertaking or hotel business in backward areas.	80HH
12	10CC	Assessee other than companies or co-operative societies claiming deduction under section 80HHA in respect of profits from newly established industrial undertaking in rural areas.	80HHA
13	10CCAA	Assessee claiming deduction under section 80HHBA in respect of profits and gains from housing projects.	80HHBA
14	10CCAB	Assessee being supporting manufacturer claiming deduction under section 80HHC in respect of profits on sale of goods and the merchandise to the recognised export house/trading house.	80HHC
15	10CCABA	Verification of certificate to be issued by a undertaking in the Special Economic Zone.	80HHC
16	10CCAC	Assessee claiming deduction under section 80HHC in respect of export profit.	80HHC
17	10CCAD	Assessee claiming deduction under section 80HHD in respect of earnings in convertible foreign exchange.	80HHD
18	10CCAF	Assessee claiming deduction under section 80HHE in respect of profits from the export of computer software.	80HHE
19	10CCAG	Assessee being supporting software developers claiming deduction under section 80HHE in respect of profit on sale of computer software to exporting company.	80HHE

Sl. no.	Form no.	Audit of accounts and/or report/certificate of an accountant	Section
20	10CCAI	Assessees being Indian companies, claiming deduction under section 80HHF in respect of profit derived to the business of export or transfer out of India of film software etc.	80HHF
21	10CCB	Assessees claiming deduction in respect of eligible business under section 80I or 80IA or 80IB or 80IC.	80I, 80IA, 80IB, 80IC
22	29B	Computation of book profit for determination of minimum alternate tax.	115JB
23	56F	Exemption on profit and gains from export in free trade zone.	10A
24	56G	Special provision in respect of newly established hundred percent export oriented undertaking.	10B

Appendix 4
(Referred to in paragraph 2.4.1)

Criteria adopted for selection of units and records for audit

Charges	Units selected for checking assessment records	Financial Year 2006-07 and till date of audit	Financial Year 2005-06	Financial Year 2004-05
Delhi, Maharashtra, Tamil Nadu, West Bengal, Karnataka, Gujarat	25 percent of annual units	Summary cases: Between 173- 207 records in each unit. Scrutiny cases: 100 percent	Summary cases: Between 125-150 records in each unit. Scrutiny cases: 50 percent	Summary cases: Between 100-125 records in each unit Scrutiny cases: 25 percent
Charges other than above	30 percent of annual units	Summary cases: Between 173- 207 records in each unit. Scrutiny cases: 100 percent	Summary cases: Between 125-150 records in each unit. Scrutiny cases: 50 percent	Summary cases: Between 100-125 records in each unit Scrutiny cases: 25 percent

Appendix 5
(Referred to in paragraph 2.7.2)

Inadequate information in tax audit reports resulting in additions made by assessing officers

(Rs. in lakh)					
Sl. no.	Name of the Assessee/ CIT charge	Assessment year	Type of assessment	Details of the additions made by the department	Revenue impact
1	E-Serve International Ltd. CIT 9, Mumbai	2004-05	Scrutiny	Deduction of Rs. 41.08 crore under section 10A and 80HHE denied by the department during scrutiny on the ground that the activities carried out by the assessee did not amount to export of software.	1474.04
2	M/s Kanoria Chemicals & Industries Ltd. CIT IV, Kolkata	2003-04	Scrutiny	A deduction of Rs. 28.53 crore under section 80IA was reported in the audit report and claimed by the assessee, whereas the assessing officer allowed deduction of Rs. 12.83 crore only. Further, capital expenditure as reported in tax audit report was 'nil', but the assessing officer during assessment disallowed Rs.2.95 crore on account of capital expenditure debited in the Profit and Loss account under the head "Department Restructuring Expenditure".	685.00
3	M/s Tata Metalik Ltd. CIT I, Kolkata	2003-04	Scrutiny	A deduction of Rs. 10.82 crore under section 80IA was reported in the audit report and claimed by assessee. This was, however, entirely disallowed by the assessing officer on the ground that the assessee did not satisfy the condition to be eligible for deduction.	398.00
4	West Bengal Industrial Infrastructure Development Corporation CIT IV, Kolkata	2003-04	Scrutiny	A deduction of Rs. 2.89 crore under section 80IA was reported in the audit report and claimed by assessee. This was, however, entirely disallowed by the assessing officer on the ground that the assessee did not satisfy the condition to be eligible for deduction.	106.00

Appendix 6
(Referred to in paragraph 2.8.1)

Inadequate disclosure in tax audit reports not acted upon by assessing officers

(Rs. in lakh)

Sl. no.	Name of the assessee/CIT charge	Assessment year(s)/type of assessment	Details of non/inadequate disclosure in Tax Audit Report/Certificates and omission on the part of the department in making additions to taxable income	Revenue impact	Department's reply
1	M/s Jodhpur Vidyut Vitran Nigam Ltd. CIT I, Jodhpur	2002-03 Summary	Interest on loan from bank/financial institutions included (i) Rs. 2.43 crore on FDR loan which the assessee had never availed, (ii) Rs. 9.66 crore on working capital loan from financial institution/bank taken by Rajasthan Vidyut Prasaran Nigam Ltd. and not by the assessee company.	431.69	Reply has not been received (November 2007).
2	M/s Cochin Shipyards Ltd. CIT, Cochi	2004-05 Scrutiny	Revenue subsidy of Rs. 6.53 crore not credited in the Profit and Loss account.	368.00	The assessing officer stated (March 2007) that part of the amount was not credited to the profit and loss account because in the event of failure to deliver the vessel, the amount was repayable. The reply is not acceptable as the said condition was one which would not come into play at all in the normal course of the business.
3	M/s Cindy Engineering Pvt. Ltd. CIT I, Kolkata	2004-05 Scrutiny	Non deduction of TDS, by the assessee, on commission of Rs. 36.67 crore.	256.04	Reply has not been received (November 2007).
4	M/s Shri Adinath Rajindra Jain Swetamber Padi Indore (Trust) CIT I, Indore	2004-05 Scrutiny 2005-06 Summary	Accountant in the audit report (Form 10B) did not disclose that assessee was having accumulated income in excess of limits as specified under section 11 of the Act. As a result, accumulated income of Rs. 6.12 crore escaped assessment.	220.00	Reply has not been received (November 2007).
5	M/s Yamuna Gases and Chemicals Limited CIT, Panchkula	2004-05 Scrutiny	Depreciation claimed which otherwise should have been nil as assets had not been put to use.	183.00	Reply has not been received (November 2007).

Sl. no.	Name of the assessee/CIT charge	Assessment year(s)/type of assessment	Details of non/inadequate disclosure in Tax Audit Report/Certificates and omission on the part of the department in making additions to taxable income	Revenue impact	Department's reply
6	M/s Double Dot Finance Ltd. CIT 4, Mumbai	2004-05 Scrutiny	Set off and carry forward of loss though assessee had discontinued business	160.43	Reply has not been received (November 2007).
7	M/s Hirakud Industrial Works Ltd. CIT, Sambalpur	2004-05 Scrutiny	Losses brought/carried forward amounting to Rs. 7.46 crore instead of correct amount of Rs. 3.72 crore.	155.00	Reply has not been received (November 2007).
8	Hindustan Petroleum Corpn Ltd. CIT 1, Mumbai	2004-05 Scrutiny	Incorrect adjustment of cenvat credit.	147.69	Reply has not been received (November 2007).
9	M/s UP State Industrial Development Corporation CIT II, Kanpur	2002-03 Scrutiny	Interest income of Rs. 3.13 crore was not accounted for.	142.64	Reply has not been received (November 2007).
10	Cognizant Technologies CIT I, Chennai	2005-06 Summary	Provision for performance incentive and annual day, though contingent in nature, were made by the assessee.	142.43	Reply has not been received (November 2007).
11	V.Rama Rao CIT VI, Hyderabad	2006-07 Summary	Non deduction of TDS, by the assessee, on payment to sub-contractor (lorry hire charges) of Rs. 3.41 crore.	131.12	Reply has not been received (November 2007).
12	M/s. UAN-RAJU-IVRCL Construction JV CIT II, Hyderabad	2005-06 Summary	Deduction under section 80IA claimed and allowed in spite of the fact that the assessee was only a works contractor and not the owner of the project.	124.00	The department replied (May 2007) that the rectification could not be carried out under section 143(1) but it would be looked into.
13	M/s Bharti Infotel Ltd. CIT I, Delhi	2004-05 Scrutiny	Provision for doubtful debts, an unascertained liability, was not added back.	120.00	Reply has not been received (November 2007).
14	Tina Overseas Ltd. CIT VI, Delhi	2004-05 Scrutiny	Deduction under section 80IB was allowed before adjusting the brought forward business losses/unabsorbed depreciation.	117.64	Reply has not been received (November 2007).
15	M/s Meda Constructions CIT, Tirupati	2006-07 Summary	Non deduction of TDS, by the assessee, on sub-contract payments of Rs. 3.02 crore.	115.84	Reply has not been received (November 2007).
16	Orissa Small Industries Corpn. CIT, Cuttack	2005-06 Scrutiny	Loss carried forward in excess.	102.06	Reply has not been received (November 2007).

Appendix 7
(Referred to in paragraph 2.9.1)
Information not assessed by the assessing officers

(Rs. in lakh)

Sl. no.	Name of the assessee/ CIT charge	Assessment year(s)/ type of assessment	Nature of mistake	Revenue impact	Department's reply
1	Air Control & Chemical Engg. Co. Ltd. CIT I, Ahemdabad	2004-05 Summary	Though the information in respect of an income of Rs. 2.51 crore on account of sundry creditors written off was available in the 'Notes to Accounts', the assessing officer did not take it into account while completing assessment.	179.22	The department did not accept (April 2007) the audit observation on the plea of summary assessment. The reply is not tenable as mistakes arising from summary assessments conferring otherwise unentitled benefits to the assesses and prejudicial to interest of revenue could be rectified under the powers separately available to the assessing officers under the Act.
2	M/s Fertilizer Corporation of India Ltd. CIT VI, Delhi	2003-04 Scrutiny	Irregular deduction on unpaid compensation (VRS scheme) under section 35DDA was allowed by the department though the fact of unpaid compensation was mentioned in the 'Notes to Accounts'.	166.63	Reply has not been received (November 2007).
3	M/s South Indian Bank Employees Gratuity Trust CIT, Trichur	2004-05 Scrutiny	Investments made by the Trust not as per the Income Tax Rules, 1962.	165.00	Reply has not been received (November 2007).
4	M/s Elnet Technologies Ltd. CIT I, Chennai	2003-04 Scrutiny	As per the tax audit report, profit chargeable to tax under section 41 was Rs. 2.95 crore on account of interest written back. During scrutiny proceedings this income was not assessed.	144.69	Reply has not been received (November 2007).
5	M/s Ashok Leyland Finance Ltd. CIT I, Chennai	2002-03 Scrutiny	As per the tax audit report, service tax of Rs. 2.34 crore was not paid. According to section 43B, statutory liabilities remaining unpaid were to be added back to the income. However, this was not done.	117.17	Reply has not been received (November 2007).
6	Greater Calcutta Gas Supply Corporation Ltd. CIT III, Kolkata	2003-04 Scrutiny	Contingent liability though reported in tax audit report but was not disallowed by the assessing officer.	112.74	Reply has not been received (November 2007).

Appendix 8
(Referred to in paragraph 2.10.1)

Statement indicating details of cases where tax audit reports were not signed, membership number not given

Sl. no.	State	No. of cases	Particulars
1	Andhra Pradesh	14	Membership no. not given
2	Andhra Pradesh	08	Incomplete certification by accountant regarding tax deduction at source.
3	Bihar	02	Membership no not given
4	Chandigarh	09	Membership no not given
5	Delhi	09	Membership no not given
6	Gujarat	13	Membership no not given
7	Gujarat	02	Audit Report not signed
8	Himachal Pradesh	145	Membership no not given
9	Karnataka	83	Membership no not given
10	Kerala	100	Membership no not given
11	Kerala	04	Audit Report not signed
12	Madhya Pradesh	219	Membership no not given
13	Orissa	91	Membership no not given
14	Rajasthan	11	Membership no not given
15	Tamil Nadu	146	Membership no not given
16	Tamil Nadu	30	Annexures to Audit Reports not signed.
17	Tamil Nadu	83	Quantitative details of raw materials, finished products not certified by accountant.
18	Uttar Pradesh	01	Form 3CB/ Form 3CD not signed
19	Uttar Pradesh	19	Membership no not given
20	West Bengal	40	Membership no not given
Total		1029	

Appendix 9
(Referred to in paragraph 2.10.2.1)

Statement indicating details of cases where accountants gave non-committal remarks

Sl. no.	State	No of cases
1	Andhra Pradesh	03
2	Bihar	10
3	Gujarat	18
4	Himachal Pradesh	89
5	Karnataka	75
6	Madhya Pradesh	62
7	Rajasthan	19
8	Tamil Nadu	138
9	Uttar Pradesh	17
Total		431

Appendix 10

(Referred to in paragraph 2.11.7)
Format of control register of tax audit cases under section 44AB

Sl. no.	PAN/GIR	Name of Assessee	Status	Asstt. Years	Due date of tax audit report	Date of filing of tax audit report	Auditor's name & Membership number	Total Turnover	Period of default	Date of initiation of penalty proceeding	Date and amount of penalty levied	Irregularity in audit report if any	Whether selected for asstt u/s 143 (3)
1	2	3	4	5	6	7	8	9	10	11	12	13	14

Appendix 11
(Referred to in paragraph 2.11.8)

Statement indicating details of the status of maintenance of control register and submission of Quarterly Progress Report

Sl. no.	State	Status of maintenance of Control Register	Status of submission of Quarterly Progress Report	Remarks
1	Andhra Pradesh	Not maintained	Not being submitted	Information in respect of 12 units collected. Out of that, in 1 unit, the department stated that maintenance of the control register would be ensured in future.
2	Assam	Not maintained	Not being submitted	
3	Bihar	Not maintained	Not being submitted	
4	Chandigarh	Not maintained	Not being submitted	
5	Delhi	Not maintained	Not being submitted	
6	Goa	Not maintained	Not being submitted	
7	Gujarat	Not maintained	Being submitted in 2 out of 7 units	
8	Himachal Pradesh	Not maintained	Not being submitted	
9	Jharkhand	Not maintained	Not being submitted	
10	Karnataka	Not maintained	Being submitted in 5 out of 10 circle offices	
11	Kerala	Not maintained in 6 out of 7 assessment units covered under review	No information available	In Circle I, Kollam under CIT, Trivandrum register was maintained only upto 2001-02.
12	Madhya Pradesh	Being maintained in 2 out of 4 units	Not being submitted	
13	Maharashtra	Not maintained	Not being submitted	
14	Orissa	Not maintained	Not being submitted	
15	Punjab	Not maintained	Not being submitted	In respect of one unit, department stated that the requisite register would be maintained in future.
16	Rajasthan	Not maintained	Not being submitted	
17	Tamil Nadu	Not maintained	Not being submitted	
18	Uttar Pradesh	Not maintained	Not being submitted	Information in respect of 13 units collected. Out of that in 5 units department stated that maintenance of the control register would be ensured in future.
19	West Bengal	Not maintained	Not being submitted	In 1 unit, control register being maintained from 2007-08 onwards.

Appendix 12
(Referred to in paragraph 2.11.15)

Statement indicating details of the penalty levied for non-filing/ delayed filing of tax audit report

(Rs. in lakh)

Sl. no.	State	No. of cases	Amount of penalty
1	Andhra Pradesh	10	6.84
2	Chandigarh	2	2.00
3	Gujarat	3	3.25
4	Haryana	2	3.00
5	Jharkhand	5	3.60
6	Karnataka	16	9.52
7	Kerala	27	18.73
8	Madhya Pradesh	21	14.52
9	Orissa	5	3.27
10	Rajasthan	1	0.20
11	Tamil Nadu	14	14.00
12	West Bengal	3	1.12
Total		109	80.05

Appendix 13
(Referred to in paragraph 2.11.16)

Format of Annexure 'B' as referred to in instruction no. 1976 dated 3.11.1999

Sl. no.	Particulars	During the quarter	Upto the end of the quarter
1	No. of returns received.		
2	No. of cases out of (1) where audit u/s 44AB was required.		
3	No. of cases out of (2) where audit reports have been filled.		
4	No. of cases out of (2) above where audit reports were not filled.		
5	No. of cases out of (3) where audit reports were filled beyond the due date.		
6	No. of cases in which penalty proceedings were initiated during the quarter.		
7	No. of cases where penalty levied.		
8	Amount of penalty levied.		
9	No. of cases in which irregularities in audit report noticed.		
10	No. of cases out of (9) where the action u/s 288 was taken.		
11	No. of cases out of (3) selected for assessment u/s 143(3).		

Appendix 14

**Audit of assessments relating to infrastructure development
(Deductions under section 80IA of the Income Tax Act)**

(As referred to in paragraph 3.6.3.25)

(Rs. in lakh)

Non adjustment of losses as per section 80IA					
Sl. no.	Name of the assessee/CIT charge	Assessment Year(s)	Type of assessment	Incorrect allowance of deduction	Revenue impact
1	Roshni Power Tech Ltd. CIT III, Hyderabad	2004-05	Scrutiny	108	38.65
2	Trident Power Systems Ltd. CIT II, Hyderabad	2005-06	Summary	102	37.31
3	Eagle Press Ltd. CIT I, Chennai	2002-03	Scrutiny	93.34	33.49
4	Ucal Fuel systems Ltd. CIT I, Chennai	2002-03	Scrutiny	76.87	27.44
5	Patankar Wind Farm Pvt. Ltd., CIT 3, Pune	2003-04	Scrutiny	61.51	22.61
6	Pondicherry Chlorates Ltd., CIT I Madurai	2001-02 2002-03 2003-04	Scrutiny Summary Scrutiny	53.92	21.34
7	Ambika Agarbathis and Aroma Ltd., CIT I, Chennai	2000-01 and 2001-02 2002-03 to 2004-05	Scrutiny Summary	58.3	25.99
8	Pearl Plastic Products CIT 5, Pune	2002-03 2003-04 and 2004-05	Summary Scrutiny	53.09	19.20
9	Rose Matches Pvt Ltd. CIT I, Madurai	2002-03 2003-04 and 2004-05	Summary Scrutiny	39.73	16.87
10	K. Rajinikanth CIT I, Coimbatore	2001-02 2002-03	Summary Scrutiny	38.35	16.04
11	M/s. Khivraj Motors Ltd. CIT I, Chennai	2001-02	Summary	26.41	13.71
12	K.S.P.S Natarajan & Co. CIT I, Madurai	2000-01 2001-02 2002-03 to 2003-04	Summary Scrutiny Summary	27.34	11.89
13	Rajparis Civil Construction (P) Ltd. CIT-III, Chennai	2002-03 and 2003-04	Scrutiny	20.32	10.47
14	Sterlite Industries Ltd. CIT III, Chennai	2004-05	Scrutiny	664.46	Not quantified
15	City Online Services Ltd. CIT I, Hyderabad	2004-05 and 2005-06	Summary	68.23	24.63
Total				1491.87	315.34
<p><i>Note: In respect of Sl. no.3 the department has accepted the objection and initiated remedial action. In respect of Sl. No. 4, 7and 11 the department has initiated remedial action</i></p>					

Appendix 15
(As referred to in paragraph 3.6.11.7)

(Rs. in crore)

Sl. no.	Name of assessee/ Assessment Year	Net profit as per profit & loss account	Income after allowing deductions other than deduction u/s 80IA	Deduction u/s 80IA	Income after allowing deduction u/s 80IA (4) - (5)	Tax on (6)	Income under MAT	Tax under MAT
1	2	3	4	5	6	7	8	9
1	Bharti Cellular Ltd.,							
	2002-03	104.73	185.81	178.66	7.15	2.55	105.53	8.07
	2003-04	(-208.03)	(-76.96)	Nil	(-76.96)	Nil	(-208.03)	Nil
	2004-05	334.31	209.40	Nil	Nil#	Nil	(-84.45)	Nil
	2005-06	(-786.43)	33.09	Nil	Nil#	Nil	(-183.59)	Nil
2	BSNL							
	2002-03	6852.18	(-1036.73)	0	(-1036.73)	Nil	7097.87	542.99
	2003-04	2657.91	4769.97	0	4769.97	1752.96	Nil	0
	2004-05	8996.16	8978.69	8689.48	289.21	103.75	12576.35	966.81
	2005-06	7920.08	8656.56	7869.19	787.37	Nil	10145.50	795.53
3	Reliance Infocomm Ltd.,							
	2002-03	(-9.80)		Nil	(-10.60)	Nil	Nil	Nil
	2003-04	1.38	(-10.60)	Nil	(-10.60)	Nil	0.01	0.001
	2004-05	(-390.31)	(-1015.92)	Nil	(-1015.92)	Nil	Nil	Nil
	2005-06	55.32	(-1091.55)	Nil	(-1091.55)	Nil	55.35	4.31
4	Idea							
	2002-03	(-212.45)	(-391.65)	Nil	(-391.65)	Nil	NA	NA
	2003-04	(-159.81)	(-174.70)	Nil	(-174.70)	Nil	NA	NA
	2004-05	(-206.91)	(-173.37)	Nil	(-173.37)	Nil	NA	NA
	2005-06	26.05	(-64.78)	Nil	(-64.78)	Nil	NA	NA
5	Spice Telecom (Now Spice Communication Pvt Ltd)							
	2002-03	3.98	3.43	Nil	3.43#	Nil	Nil	Nil
	2003-04	(-15.64)	21.53	Nil	21.53#	Nil	Nil	Nil
	2004-05	38.10	47.70	Nil	47.40#	Nil	Nil	Nil
	2005-06	(-33.02)	24.28	Nil	24.28#	Nil	Nil	Nil
6	Tata Tele Services							
	2002-03	(-195.43)	Nil	Nil	(-306.33)	Nil	Nil	Nil
	2003-04	*(-381.57)	Nil	Nil	FNA	Nil	Nil	Nil
	2004-05	(-786.40)	Nil	Nil	(-843.66)	Nil	Nil	Nil
	2005-06	(-1664.07)	Nil	Nil	(-1810.12)	Nil	Nil	Nil
# Income assessed at 'nil' after set off of brought forward losses and unabsorbed depreciation.								
* Data compiled from assessment records relating to assessment year 2004-05								
FNA File not made available to audit								

