सत्यमेव जयते

11

REPORT OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

FOR THE YEAR ENDED 31 MARCH 1989

No 6 of 1990

UNION GOVERNMENT
(REVENUE RECEIPTS—DIRECT TAXES)

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PREFATORY REMARKS

This Audit Report on Revenue Receipts-Direct Taxes of the Union Government (Civil) presents the result of audit of receipts under Direct Taxes comprising income-tax, wealth-tax, gift-tax, estate-duty and interest-tax. The Report is arranged in the following order :—

(*i*) Chapter 1 incorporates the statistical information regarding the working results of the tax administration and audit;

(*ii*) Chapter 2 includes three system appraisals on Assessment of lottery business, Deduction of tax at source and Mistakes in assessments completed under the summary assessment procedure;

(*iii*) Chapter 3 mentions the results of audit of corporation tax;

(*iv*) Chapter 4 deals, similarly, with the points that arose in the audit of income tax;

(*v*) Chapter 5 covers points that arose in audit of wealth-tax, gift-tax, estate-duty and interest tax.

The points brought out in this Report are those which have come to notice during the course of test audit.

OVERVIEW

Introductory

1. This Report presents the results of audit of the revenue receipts of the Union Government relating to direct taxes, for the year 1988-89, and also evaluates the adequacy and observance of the regulations and procedures framed by the Revenue department with a view to securing an effective check on the assessment, collection and proper accountal and allocation of taxes. Out of the total number of 17,653 audit observations issued to the various Commissioners of Income-tax during the year with a gross revenue effect of Rs. 25,895.39 lakhs, only 945 important audit findings with a total tax effect of Rs. 9,170.85 lakhs have been included in this report. Besides, the findings in respect of three system appraisals have been included in a separate chapter. Further, an appraisal on 'Amnesty Scheme, 1985' has also been brought out as a separate volume during the current year [**Para 1.19**].

The total collections from all the direct taxes for the year 1988-89 were Rs.* 8,828.68 crores (Rs. 6757.18 crores for 1987-88), of which the proceeds from Corporation-tax were Rs.* 4,407.21 crores (Rs. 3,432.92 crores for 1987-88). The total cost of collection was Rs. 187.28* crores. As compared to 1987-88, the collection was higher by 30.65 percent during 1988-89 [**Para 1.01 and 1.04**]

The total number of assessees at the end of the year 1988-89 was ** 75,37,266. During the year* 2,73,109 new assessees were added to the tax-base, registering an increase of 3.76 percent as compared to the previous year [**Para 1.05**].

The total number of assessments pending at the end of the year 1988-89 was**13,00,059 and the arrears of demands as on that date were Rs.** 5,802.11 crores. The arrears in collection worked out to ** 65.72 per cent of the collection for the year as a whole [**Para 1.06 and 1.07**].

System Appraisals

II. Assessment of Lottery business

The test-check in audit of the assessments of persons connected with lottery business, such as organising agents, stockists, etc; revealed absence of detailed and co-ordinated scrutiny and other shortcomings, suggesting inadequate and ineffective monitoring and internal controls, and lack of proper procedures. The audit findings are:

— Substantial undercharge of tax of over Rs. 6 crores;

— Large scale avoidance of tax by adoption of questionable modes;

— Inadequate safeguard against surreptitious sale of winning tickets and dissipation of income;

— Omission to centralise assessments of those associated mainly with lottery business for proper co-ordination;

— Absence of one single source for collection and collation of information of lottery assessees so as to widen the tax base;

— Wide fluctuating profits as between assessees and assessment years;

— Absence of evidence of cross-check with tax deduction returns, to book liable tax payers not filing returns;

— Delays and deficiencies in deduction of tax at source, and narrow ambit of compulsory source-deduction of tax to lottery payments;

— Widespread non-compliance of anti-evasion measures as regards complusory maintenance of accounts, tax audit and payments only through cheques, drafts etc.,

Notable cases included in the review are :

(i) There was incorrect exemption in a summary assessment of profits of Rs. 60 lakhs in the case of a Sports Trust which had organised two lottery draws without any licence. There was also suppression of sale of tickets by Rs. 1.13 crores (Rs. 77.12 lakhs) [**Para 2.01·11(iii) (a), (c)**].

(ii) In three other cases though the trusts had become void due to violation of the lottery rules, the income was nevertheless exempted. Further, the sales of tickets were suppressed by Rs. 191.51 lakhs. Refund of prize money of Rs. 25 lakhs on unsold tickets was also not accounted for in one case (Rs. 240.55 lakhs) [**Para 2.01.11 (i), (ii) & (iv)**].

(iii) On the basis of a post-dated court affidavit the claim of an individual that the prize money of Rs. 2.22 crores in a raffle was jointly won with his wife and two sons, was accepted without proper investigation though the affidavit of one of the members had not been accepted [**Para 2.01.20**].

(iv) A registered society which was permitted to raise funds for repayment of Government loans through lotteries and had earned Rs. 405.26 lakhs in the business, arranged the conduct of lotteries through another society, agreeing to advance a loan of 30 per cent of the net proceeds of the lottery business for 21 years at a nominal interest of one per cent. Although the former society had diverted its income for objects other than that of the society, and the service society was also liable to tax proceedings, the department failed to initiate any assessment proceedings on both the societies [**Para 2.01.23**].

III. Deduction of tax at source

Consistent with the theme of PAYE (Pay-as-you-earn), the Income-tax Act provides for advance collection of tax by deduction of tax at source. Almost all regular incomes/payments are liable to tax deduction at source and more than 30 per cent of the annual tax is collected in this form. Supplemented by the prescribed rules and

*Figures furnished by the Controller General of Accounts are provisional.

**Figures furnished by the Ministry of Finance are provisional.

procedures, these provisions are intended to safeguard against any possible escapement of income by suppression of income, or by not filing of tax returns.

The Public Accounts Committee, as early as in 1977-78, while commenting on the working of salary circles, had recommended effective control over the system of tax deduction at source.

The review of the system by audit disclosed errors and deficiencies in the procedure of collection of tax at source, such as:

— Non/short deduction of tax and delays/omissions in remittance of deducted tax involving interest/penalty leviable of Rs. 7.48 crores;

— Non-compliance in furnishing of periodical returns by tax payers coupled with monitoring lapses by the department, with penalty effect of Rs. 3.89 crores;

— Non/incomplete maintenance of control registers and non-reconciliation of tax deductions regularly;

— No regular reconciliation with b nk challans;

— No visible improvement in administration of 'tax deducted at source' despite creation of exclusive T.D.S. Sections;

— No machinery for efiective co-ordination cross check and verification of inland and foreign deduction certificates;

— Slow progress in allotment of Tax Deduction Account Number; and

— Absence of internal audit and administrative supervisions [**Para 2.02.7**].

IV. Summary assessment procedure

The review of Summary Assessment Scheme included in the Audit Report 1986-87 had revealed hardly any significant reduction in pendency or added voluntary compliance, the twin objectives of the Scheme. The sample scrutiny prescribed with a view to check any abuse of the Scheme, according to the findings of the review had apparently failed. Besides, substantial under-assessment of tax were also noticed in such cases. These irregularities continued to recur in no small measure, as evidenced during subsequent audits and as reflected in the Audit Report 1987-88

During the test-audit of the year 1988-89 several mistakes and omissions of the nature reported in the previous Audit Reports were continued to be observed and the important cases have been highlighted in the review. The under-assessment of tax in 6,547 representative cases included in this review comes to Rs. 18.48 crores [**Para 2.03.4**].

V. Results of test audit

The mistakes noticed during test-audit ranged from simple arithmetical errors to major points of law and procedure involving substantial amounts of revenue. A number of mistakes were attributable to lack of correlation between various direct taxes assessments.

Some selected cases involving substantial revenue or subtle points of law included in the Audit Report are summarised in the following paragraphs. The tax effect and the reference number of the relevant paragraphs in the Report are indicated in bracket against each case.

Corporation-tax

VI. Avoidable mistakes in computation of income and tax

Arithmetical mistakes caused due to negligence in the computation of income and tax contributed to under-assessment of Rs. 11.21 crores by way of tax in just 679 cases. The errors included adoption of incorrect figures/digits, errors in totalling and transcription, double allowance and the like, and were indicative of the deficiencies in the internal controls and procedures, including internal audit. [**Para 1.19**]

A few representative cases are given hereunder :

(*i*) In the case of a company, while giving effect to an appellate order allowing deduction for a sum of Rs. 80.03 lakhs in the assessment year 1985-86, the deduction allowed earlier for the same amount, in the subsequent assessment year 1986-87, was not withdrawn, resulting in double deduction of Rs. 80.03 lakhs (Rs. 42.02 lakhs) [**Para 3.06.1(v)(b) Item 1**].

(*ii*) In another case, a sum of Rs. 36.07 lakhs representing difference in opening value of work in progress in 1982-83, was not reduced from the total income in 1983-84, leading to over-computation of loss by like amount (Rs. 25.88 lakhs) [**Para 3.06.1(iv) Item 5**].

(*iii*) In a third case, there was excess computation of loss by Rs. 21.60 lakhs due to adoption of the total disallowances as Rs. 107.49 lakhs instead of as Rs. 129.09 lakhs (Rs. 12.47 lakhs) [**Para 3.06.1 (iv) Item 7**].

VII. Failure to observe the provisions of the Finance Acts

(*i*) In the case of three companies incorrect determination of status led to incorrect application of the rate of tax and an aggregate undercharge of tax of Rs. 16.05 lakhs. (Rs. 16.05 lakhs) [**Para 3.07.1**].

(*ii*) There was short levy of tax of Rs. 20.98 lakhs in five cases of non-resident companies due to incorrect application of the concessional rates, to interest earned prior to the date of operation of the convention governing double taxation agreement between Government of India and United Kingdom (Rs. 20.98 lakhs) [**Para 3.07.4**].

VIII. Incorrect status adopted in assessments

Assessment of three companies, which did not satisfy the prescribed tests, viz., listing in a recognised stock exchange and holding of a certain percentage of the shares by any of the specified authorities/bodies throughout the previous year, as widely held companies led to undercharge of tax of Rs. 7.74 lakhs (Rs. 7.74 lakhs) [**Para 3.08.1,2,3**].

IX. Incorrect computation of business income

Mistakes in computation of business income were noticed in 3,603 cases involving tax effect of Rs. 92.60 crores. Many of the concerned assessments were finalised by senior officers of the department [**Para 1.19**].

Some important cases are :

(*i*) Erroneous allowance of the entire expenditure of Rs. 60.56 lakhs on issue of debentures for expansion of business incurred by a company running a hotel, instead of allowing it to be deducted in the equal instalments subject to certain limits as provided under the Act, led to excess deduction of Rs. 58.06 lakhs (Rs. 51.79 lakhs) [**Para 3.13.1**].

(*ii*) Allowance of a sum of Rs. 1.58 crores, being actual payment of gratuity by a company which took over several sick textiles mills adjustable only against 'gratuity provision account' created at the time of take over, led to excess computation of loss by like amount (Rs. 88.66 lakhs) [**Para 3.17.1(i)**].

(*iii*) Allowance of a sum of Rs. 35.71 lakhs in a company's case towards shifting of machinery from one place to another, though inadmissible as being capital expenditure, resulted in under-assessment of income of Rs. 35.71 lakhs (Rs. 24.49 lakhs) [**Para 3.17.2**].

(*iv*) Allowance of capital expenditure incurred on drawings, designs and know-how led to under-assessment of income of Rs. 24.91 lakhs in the case of a company (Rs. 20.68 lakhs) [**Para 3.17.3**].

(*v*) Provision made by a bank for bad and doubtful debts in relation to advances made by rural branches is admissible as deduction subject to certain limits. Allowance of the deduction in excess of the provisions made in one case led to excess carry forward of unabsorbed depreciation of Rs. 21.36 lakhs (Rs. 12.33 lakhs) [Para **3.19.2**].

(*vi*) Erroneous allowance of loss due to fluctuations in the rate of exchange of currency amounting to Rs. 2.43 crores in one company's case led to excess carry forward of loss of an equal amount (Rs. 1.40 crores) [**Para 3.20**].

(*vii*) Disallowance of only nominal amounts out of advertisement, publicity, etc., and on guest house expenses, instead of at the rate as estimated by two companies for another year with more or less the same turnover, led to under-assessment of income of Rs. 36.26 lakhs and Rs. 36.30 lakhs (Rs. 47.78 lakhs) [**Para 3.21.1, 3.22.1**].

(*viii*) Allowance of expenditure on maintenance of guest houses abroad, contrary to the provisions of the Act, in one case, resulted in income being computed short by Rs. 11.31 lakhs (Rs. 11.94 lakhs) [**Para 3.22.2**].

(*ix*) (a) Erroneous allowance of a provision of Rs, 43.87 lakhs under 'Provision for tank repairs account, though not an ascertained liability, led to under-assessment of income of Rs. 43.87 lakhs (Rs. 37.04 lakhs) [**Para 3.23.1**].

(b) In another case, allowance of a sum of Rs. 34.55 lakhs, being provision for amortisation of sunk cost of mining equipment, led to excess computation of loss of like amount (Rs. 19.47 lakhs) [**Para 3.23.2**].

(c) In two other cases, erroneous allowance was granted in respect of provisions for loss on account of obsolescence of stores and for absolete inventory, amounting to Rs. 19.84 lakhs and Rs. 19.68 lakhs respectively (Rs. 29.93 lakhs) [**Para 3.23.11, 12**].

(*x*) From assessment year 1984-85, liabilities towards certain taxes and contributions to provident fund, gratuity fund, etc., are not admissible as deduction unless actually paid during the relevant previous year. In five cases alone, there was incorrect allowance of unpaid liabilities aggregating to Rs. 4.10 crores (Rs. 2.39 crores) [**Para 3.26** Sr. **Nos. 1, 2, 3, 4, 5**].

(*xi*) In the case of a general finance and investment company, legal heirs of certificate holders, in the event of the latter's death six months after the date of acceptance of the proposal, are entitled to refund of the subscriptions paid without any interest. Regardless of this, the company was incorrectly allowed a sum of Rs. 1.42 crores by way of interest liability in such cases for four years (Rs. 1.35 crores) [**Para 3.27.1**].

(*xii*) In another case, the difference of Rs. 30.84 lakhs between the bonus provision and actual payment, was not disallowed as returned by assessee company (Rs. 17.81 lakhs) [**Para 3.27.2**].

(*xiii*) Omission to assess the bank interest of Rs. 1.30 crores allowed as a deduction in earlier years, but waived under arrangement with the creditors, as income of an assessee company led to the under assessment of a like amount (Rs. 76.85 lakhs) [**Para 3.27.3**].

(*xiv*) Allowance of loss due to revaluation of investments in securities of Rs. 16.73 lakhs in the case of a non-resident banking company, led to under-assessment of income of Rs. 16.73 lakhs (Rs. 13.35 lakhs) [**Para 3.27.4**].

(*xv*) In the case of a public sector company, the excess of receipts over expenditure of Rs. 12.43 lakhs was erroneously adopted as a loss resulting in over-computation of loss by Rs. 24.86 lakhs (Rs. 14.01 lakhs) [**Para 3.27.5(i)**].

(*xvi*) In the case of a Government Shipping Company, liability towards certain payments of Rs. 1.78 crores allowed in assessment year 1983-84 was again allowed in assessment year 1984-85 instead of the admissible amount of Rs. 1.22 crores, leading to excess deduction of over Rs. 55 lakhs. (Rs. 31.96 lakhs) [**Para 3.27.5(iv)**].

(*xvii*) Omission to disallow the difference in interest payable pertaining to earlier previous years, of Rs. 36.71 lakhs debited to accounts by an assessee company following mercantile system of accounting led to under assessment of income of a like amount (Rs. 21.20 lakhs) [**Para 3.27.5(v)**].

(*xviii*) Assessment of compensation received by a company under an arbitration award of July 1984 in the assessment year 1985-86 instead of in 1986-87, led to incorrect carry forward of loss of Rs. 39.97 lakhs beyond the permissible period (Rs. 20.06 lakhs) [**Para 3.27.6**].

(*xix*) Allowance of pre-incorporation expenses of Rs. 3.13 crores in the case of a company, which was being written off separately as preliminary expenses, led to excess computation of loss by Rs. 3.13 crores (Rs. 1.85 crores) [**Para 3.27.13**].

X. Irregularities in allowing depreciation and investment allowance

In respect of capital assets, barring a few exceptions employed in business, the Act provides for depreciation and investment allowance subject to certain conditions and restrictions. Mistakes in allowing these deductions were noticed in 1,497 cases involving a revenue effect of Rs. 38.52 crores [**Para 1.19**].

A few examples are :

Depreciation

(*i*) In two company cases, allowance of depreciation at 15 per cent instead of at the correct rate of 10 per cent on plant and machinery led to excess allowance of depreciation of Rs. 41.10 lakhs (Rs. 24.05 lakhs) [**Para 3.30.1 Items 1, 2**].

(*ii*) In another case, a mistake in calculation of depreciation allowance on machinery and enabling works during revision of assessment to give effect to reduced depreciation, led to excess allowance of depreciation of Rs. 30.65 lakhs (Rs. 17.70 lakhs) [**Para 3.30.1 Item 8**].

(*iii*) Allowance of depreciation at higher rate to construction machinery, machinery relating to plastics and goods factories, and petro-chemical complex, led to grant of excess depreciation of Rs. 22.65 lakhs in three cases (Rs. 16.12 lakhs) [**Para 3.30.1 Items 6,9, 10**].

(*iv*) Allowance of depreciation on general building, including water supply system, varying from 7.5 per cent to 15 per cent against 5 per cent as admissible, led to depreciation being allowed in excess by Rs. 14.17 lakhs in one case (Rs. 8.18 lakhs) [**Para 3.30.1 Item 19**].

(*v*) Adoption of incorrect rate of depreciation in another case on roads, culverts and bridges, water supply and drainage and mobile equipment, led to excess depreciation of Rs. 43.63 lakhs (Rs. 24.92 lakhs) [**Para 3.30.1 Item 21**].

(*vi*) Erroneous allowance of depreciation on hotel building treating it as factory building instead of non-factory building, led to depreciation being allowed in excess by Rs. 55.35 lakhs (Rs. 31.96 lakhs) [**Para 3.30.9 (i)**].

(*vii*) Adoption of incorrect written down value of plant and machinery, etc., in seven cases resulted in under-assessment of income of Rs. 21.60 lakhs and excess carry forward of loss, unabsorbed depreciation of Rs. 15.46 lakhs (Rs. 24.16 lakhs) [**Para 3.30.12**].

(*viii*) From the assessment year 1984-85, initial depreciation allowed on building is also to be deducted in computing the written down value. Omission to deduct initial depreciation of Rs. 3.54 crores in arriving at the written down value of a hotel building led to excess grant of depreciation of Rs. 17.71 lakhs (Rs. 16.55 lakhs) [**Para 3.30.13**].

(*ix*) Incorrect working of depreciation while giving effect to reduction from the cost of plant and machinery, of capital subsidy of Rs. 22.50 crores received from a State Government in the case of a State Electricity Board, led to excess grant of depreciation of Rs. 23.31 lakhs (Rs. 12.24 lakhs) [**Para 3.30.14**].

(*x*) Omission to consider the initial depreciation allowed on plant and machinery in ten company cases led to excess grant of depreciation of Rs. 69.15 lakhs and excess carry forward of unabsorbed depreciation of Rs. 12.22 lakhs (Rs. 48.26 lakhs) [**Para 3.30.16**].

(*xi*) In the assessment of a Government corporation, allowance of additional depreciation on old assets, led to excess computation of loss by Rs. 37.49 crores (Rs. 21.65 crores) [**Para 3.31.1**].

(*xii*) There was excess set off of unabsorbed depreciation by an amount of Rs. 22.14 lakhs in the case of a private limited company (Rs. 15.11 lakhs) [**Para 3.32.1**].

(*xiii*) In two cases, allowance of additional depreciation and extra shift allowance on electrical fittings, though not permissible, led to under-assessment of income of Rs. 11.99 lakhs (Rs. 7.96 lakhs) [**Para 3.36.3(ii), (iii)**].

Investment allowance

(*i*) There was incorrect grant of investment allowance of Rs. 16.17 lakhs in the case of a company executing civil construction works (Rs. 9.34 lakhs) [**Para 3.37.2**].

(*ii*) Investment allowance of Rs. 26.86 lakhs allowed to a company which was not a small scale industrial undertaking and which was engaged in the manufacture of domestic electrical appliances, resulted in under-assessment of income of Rs. 26.86 lakhs (Rs. 20.52 lakhs) [**Para 3.37.5(i)**].

(*iii*) A closely held company was dissolved and all assets were transferred to three companies. Though the transfer did not constitute 'amalgamation' within the definition of the term and the transfer had taken place within the prohibited period of 8 years, investment allowance of Rs. 35.34 lakhs allowed in one case was not withdrawn (Rs. 21.40 lakhs) [**Para 3.37.7**].

(*iv*) Grant of investment allowance on full cost of plant and machinery, without being reduced by the subsidy of Rs. 16.14 crores received from a State Government, led to excess grant of investment allowance of Rs. 4.03 crores in the case of a State Electricity Board (Rs. 2.11 crores) [**Para 3.37.10**].

(*v*) Failure to make appropriate adjustment with reference to variation in rupee liability consequent on fluctuation in the rate of exchange led to excess allowance of investment allowance of Rs. 54.89 lakhs in one ceas (Rs. 30.94 lakhs) [**Para 3.37.12(i)**].

(*vi*) In four company cases, investment allowance of Rs. 4.81 crores was erroneously allowed although the requisite reserve was not created (Rs. 2.76 crores) **[Para 3.37.13 (i to iv)]**.

(*vii*) Excess and irregular carry forward and set off of unabsorbed investment allowance of Rs. 73.48 lakhs in three company cases involved undercharge of tax of Rs. 53.94 lakhs (Rs. 53.94 lakhs) **[Para 3.38.1, 2, 3]**.

XI. Income escaping assessment

Omission to assess incomes of the relevant previous years accounted for a total under-assessment of tax of Rs. 19.20 crores in 1,527 cases **[Para 1.19]**.

A few instances are :

(*i*) An amalgamated company credited a sum of Rs. 1.44 crores being remission of interest due to financial institutions and banks, and allowed as deduction in earlier years to the general reserve account but the same was omitted to be assessed as income leading to under-assessment of income of equal amount (Rs. 1.05 crores) **[Para 3.41.2]**.

(*ii*) In another case, an amount of Rs. 51.79 lakhs credited to accounts out of excess provisions relating to earlier years was not treated as income (Rs. 29.90 lakhs) **[Para 3.41.3]**.

(*iii*) Sales tax collected constitutes trading receipts. Effective from assessment year 1984-85, deduction is allowed towards sales tax payable to the extent actually paid to Government during the year. Non-assessment of sales tax collections to the extent unpaid to Government account led to over-computation of loss by Rs. 1.28 crores in the case of a limited company (Rs. 74.44 lakhs) **[Para 3.41.1 Item I]**.

(*iv*) In the case of a nationalised bank, omission to take into account the surplus on account of revaluation of securities while allowing the depreciation on such revaluation as per appellate orders, led to under assessment of income of Rs. 1.17 crores (Rs. 69.63 lakhs) **[Para 3.41.9]**.

(*v*) Omission to assess the stock with the disposal officers and in the show room, aggregating to Rs. 83.15 lakhs as closing stock, in the assessment of a Government company, led to short computation of income by Rs. 83.15 lakhs (Rs. 46.87 lakhs) **[Para 3.41.10]**.

(*vi*) Incorrect assessment of detention charges and demurrage charges of Rs. 16.72 lakhs and Rs. 2.13 crores as income of shipping business in the case of two non-resident shipping companies led to short assessment of income of Rs. 2.13 crores (Rs. 86.04 lakhs) **[Paras 3.29, 3.41.11]**.

XII. Incorrect carry forward and set off of losses

Unabsorbed business losses are, under the Act, entitled to be carried forward and set off against business income of later years upto a period of 8 years. So is the case of unabsorbed depreciation but the period is indefinite. Owing to incorrect set off of losses, unabsorbed depreciation, etc., there was under-assessment of tax of Rs. 23.87 crores in 290 cases **[Para 1.19]**.

Some important cases are :—

(*i*) In the case of three companies, due to set off of incorrect amounts in later years there was excess carry forward of loss and unabsorbed depreciation of Rs. 29.84 lakhs (Rs. 17.83 lakhs) **[Para 3.42.1, 2, 3]**.

(*ii*) Carry forward and set off of unabsorbed losses, depreciation, etc., have a given order under the Act. Due to omission to follow the prescribed order of priority in one case, there was under-assessment of income and excess carry forward of losses aggregating to Rs. 7.85 lakhs (Rs. 4.64 lakhs) **[Para 3.42.14]**.

XIII. Mistakes in assessments while giving effect to appellate orders

(*i*) While giving effect to an appellate order in the case of a State Electricity Board, a sum of Rs. 1.07 crores being provision for doubtful debts on sale of energy was erroneously allowed, though the disallowance thereof in original assessment was actually confirmed in appeal (Rs. 60.32 lakhs) **[Para 3.43.1]**.

(*ii*) In another case, a sum of Rs. 68.82 lakhs disallowed on various counts in the original assessment was allowed in first appeal and was given relief. While the department's further appeal to Tribunal was dismissed, the assessing officer again allowed a relief of Rs. 68.82 lakhs resulting in double deduction (Rs. 40.69 lakhs) **[Para 3.43.2]**.

(*iii*) While giving effect to an appellate order upholding the disallowance of Rs. 24.12 lakhs being provision for bonus, the assessing officer erroneously allowed relief instead (Rs. 13.93 lakhs) **[Para 3.43.3]**.

XIV. Irregular exemptions and excess reliefs

Total income is computed under the Act after allowing deductions in respect of certain payments like donations, etc., and in respect of certain incomes from industrial undertakings, export turnover, etc., subject to prescribed conditions and limits. Mistakes in correctly applying these provisions were noticed in 1,202 cases with revenue effect of Rs. 14.88 crores **[Para 1.19]**.

(*i*) No deduction is admissible if the total income before considering the deductions is nil or a loss, after, *interalia*, set off of unabsorbed business losses, depreciation, etc. There was incorrect allowance of brought forward deductions aggregating to Rs. 36.68 lakhs towards donations, profits from new industrial undertaking in backward areas, export turnover and inter-corporate dividends, in the case of a public limited company whose total income worked out to a loss (Rs. 21.18 lakhs) **[Para 3.44.1]**.

(*ii*) Omission to reckon the total income after adjustment of brought forward losses, unabsorbed depreciation and investment allowance, etc., for the purpose of eligibility to the deductions in the case of three companies, led to incorrect deductions being allowed to the extent of Rs. 57.08 lakhs (Rs. 34.56 lakhs) **[Para 3.44.3, 4, 5]**.

(*iii*) The aggregate of admissible deductions towards donations, export turnover, etc. is to be limited to the gross total income under the Act and is also to be restricted to seventy per cent of the pre-incentive total income with the balance allowed to be carried forward. Incorrect carry forward of deductions in excess of the pre-incentive total income, of Rs. 21.43 lakhs, in two cases, led to excess carry forward of Rs. 21.43 lakhs (Rs. 14.26 lakhs) [**Para 3.44.6, 7**].

(*iv*) Under the Income-tax Rules, only forty per cent of the income from sale of tea grown and manufactured is regarded as income liable to tax while the remaining sixty percent is reckoned as agricultural income. Allowance of certain deductions with reference to the total profits in the case of two tea companies led to excess deduction of Rs.33.30 lakhs (Rs. 18.88 lakh) [**Para 3.46.1, 2**].

(*v*) Omission to revise the deduction in respect of profits from execution of projects outside India consequent on set off of unabsorbed investment allowance reducing the income, led to under-assessment of income of Rs. 51.47 lakhs (Rs. 38.96 lakhs) [**Para 3.47**].

(*vi*) In the case of a multinational company, a deduction of Rs. 36.93 lakhs was allowed in relation to export which included also exports from its units situated in a Free Trade Zone, profits wherefrom were totally exempt from tax. Incorrect allowance of deduction on the exempt income led to excess deduction of Rs. 20.19 lakhs (Rs. 16.76 lakhs) [**Para 3.48.1**].

(*vii*) In another case allowance of the incentive deduction for export, for which the company acted as merely an intermediary, led to excess deduction of Rs. 28.55 lakhs (Rs. 19.48 lakhs) [**Para 3.48.2**].

(*viii*) Deduction in respect of royalty, etc., received from a foreign enterprise is, according to judicial decision, to be computed with reference to the quantum ot income included in the gross total income. Allowance of the deduction on an income of Rs. 3.13 crores instead of on the business income from royalty computed at Rs. 2.74 crores, led to under-assessment of income of Rs. 39.64 lakhs (Rs. 27.05 lakhs) [**Para 3.53.1**].

(*ix*) Where the aggregate of the deductions under the specified provisions of the Act exceeds the total income computed without any such deduction, the amount to be deducted will be limited to seventy per cent thereof. Mistakes in applying the above provisions in three cases had the effect of short assessment of income by Rs. 70.52 lakhs (Rs. 44.17 lakhs) [**Para 3.55.1, 2, 3**].

(*x*) In another case, carry forward of the unabsorbed deduction was not correctly adopted at Rs. 7,31,890 as revised, but allowed at Rs. 21,29,987 as determined in the original order leading to short computation of income by Rs. 13.98 lakhs (Rs. 8.07 lakhs) [**Para 3.55.4**].

XV. Non/incorrect levy of interest

(*i*) In the case of a company interest leviable for belated filing of return aggregating to Rs. 32.68 lakhs for two years was not charged (Rs. 32.68 lakhs) [**Para 3.57.1 Sr. No. 1**].

(*ii*) In another case there was non-levy of interest of Rs. 29.43 lakhs for short payment of advance tax (Rs. 29.43 lakhs) [**Para 3.58.1. Sr. No. 1**].

(*iii*) There was omission to levy interest for belated payment of tax in three cases aggregating to Rs. 45.07 lakhs and in another case Rs. 10.09 lakhs for failure to credit tax deducted at source of Rs. 19.49 lakhs to the Government (Rs. 55.17 lakhs) [**Paras 3.59.1 Sr. Nos. 1,2,3,3.61 S. No. 1**].

XVI. Mistakes in assessments of surtax

(*i*) Surtax is levied on the chargeable profits computed from the total income for income-tax as reduced, *inter alia*, by the net amounts of inter-corporate dividends and income-tax payable. Allowance of the aforesaid deductions on gross amounts together with excess allowance of statutory deduction by Rs. 51.49 lakhs in the case of a company resulted in chargeable profits being computed at nil instead of an income of Rs. 1.34 crores (Rs. 33.59 lakhs) [**Para 3.69.3(i)**].

(*ii*) Incorrect inclusion of bonus reserve aggregating to Rs. 2.63 crores in the capital computation of a Government corporation led to under-assessment of chargeable profits by Rs. 39.52 lakhs (Rs. 17.74 lakhs) [**Para 3.69.3 (iv)**].

(*iii*) Reserves created by revaluation of book assets are not regarded as 'Capital' for surtax. In two cases, capital reserves totalling to Rs. 36.74 crores consequent on revaluation of land and building and other book assets, led to less computation of chargeable profits by Rs. 73.12 lakhs (Rs. 28.89 lakhs) [**Para 3.69.6(i), (ii)**].

(*iv*) Omission to reduce the capital of a widely held company with reference to foreign income of Rs. 1.08 crores not included in total income, led to excess computation of capital base by Rs. 1.66 crores and short computation of chargeable profits by Rs. 24.90 lakhs (Rs. 11.20 lakhs) [**Para 3.69.6(iv)**].

(*v*) Inordinate delays in completion of surtax assessments in six cases led to postponement of collection of revenue of Rs. 1.06 crores [**Para 3.72**].

XVII. Income tax

Some important mistakes in the assessments of non-company tax payers are:

(*i*) Omission to add back investment allowance reserve of Rs. 76.48 lakhs debited to the profit and loss account in the case of an 'association of persons' led to undercharge of tax of Rs. 34.36 lakhs (Rs.34.36 lakhs) [**Para 4.06 Sr. No 1**].

(*ii*) Trusts carrying on business are held assessable as association of persons represented by their beneficiaries except where all the beneficiaries are minors, even if the shares of the beneficiaries are definite and ascertainable. In other cases, the trustee is assessable as a representative assessee Five trusts which were carrying on business were not assessee as 'Association of Persons' on their income aggregating to Rs. 26.92 lakhs (Rs.20.11 lakhs) [**Para 4.09.1**].

(*iii*) Trusts created for the benefit of any particular community are not eligile for exemption from levy of tax. Incorrect exemption in the case of one such trust led to short levy of tax of Rs. 10.51 lakhs (Rs.10.51 lakhs) [**Para 4.09.2**].

(*iv*) Omission to disallow unpaid sales-tax, purchase tax, provident fund, etc., as required under law in 16 cases led to under-assessment of income of Rs. 76.98 lakhs (Rs .38.09 lakhs) [**Para 4 .14 .1**].

(v) Where a businesss comes to an end, the closing stock of business has to be valued at the market price. Omission to revalue closing stock in two firms' cases on their dissolution and take-over by others, led to short computation of taxable income of Rs. 24.08 lakhs (Rs. 16.30 lakhs) [**Para 4.15.1 (i), (ii)**].

(*vi*) Allowance of extra shift depreciation in excess of the ordinary depreciation led to depreciation of Rs. 10.61 lakhs being allowed in excess (Rs .4.77 lakhs) [**Para 4.21.3**].

(*vii*) Incorrect grant of investment allowance in four cases, not actually engaged in any manufacture or production, led to excess allowance of the deduction by Rs. 26.99 lakhs (Rs.17.81 lakhs) [**Para 4.22.1 Sr. No. 1 to 4**].

(*viii*) According to judicial decision, colourable devices cannot be part of tax planning and it is open to the tax authorities to go behind the transaction to determine the real transaction. There was omission to charge capital gains of Rs.45.49 lakhs in the hands of partners of a firm who had sold their house property to a company through the medium of capital contribution to a firm (Rs.29.88 lakhs) [**Para 4.24.1 (i)**].

(*ix*) Omission to charge capital gains arising on acquisition of property settled in trust by a deceased, by a State Government, the proceeds of which were appropriated towards payment of estate duty of the settlor, led to capital gains escaping assessment of Rs.16.66 lakhs (Rs. 10.76 lakhs) [**Para 4.25.1**].

(*x*) Omission to assess the revised share income in the hands of the partners, on completion of firm's assessments, in six cases led to short assessment of income of Rs. 82.80 lakhs (Rs. 45.23 lakhs) [**Para 4.27.1 S. No. 1 to 6**].

(*xi*) Adoption of compensation of Rs. 14 lakhs for loss of profitability awarded under an arbitration proceeding to a firm, as loss instead of as income, together with certain other mistakes in assessment, led to demand of tax of Rs.23.28 lakhs on re-assessment (Rs.23.28 lakhs) [**Para 4.28**].

(*xii*) As is judicially held, income of an educational institution is exempt to the extent the income had a direct relation or was incidental to the running of the institution. Incorrect set off of income from unexplained investments in house property against losses in running an educational institution led to non-assessment of income of Rs.5.26 lakhs (Rs.5.19 lakhs) [**Para 4.31.1**].

(*xiii*) In the case of a labour co-operative society, due to the induction of certain outsiders as its members, there was, contrary to law, an incorrect exemption of income of Rs.12.75 lakhs (Rs 5.61 lakhs) [**Para 4 .33 .1**].

(*xiv*) There was non-levy of interest for short payment of advance tax in the case of an individual for the period upto the date of regular assessment beyond the date of draft assessment order (Rs.34.18 lakhs) [**Para 4.35.1 (i)**].

OTHER DIRECT TAXES

XVIII. Wealth-tax

(*i*) Assets for the purposes of 'net wealth' include also right to a trade mark. Omission to assess the value of trade mark led to escapement of wealth of Rs.1.01 crores in the case of five Hindu undivided families (Rs. 5.07 lakhs) [**Para 5.04.1 (i)**].

(*ii*) An individual was assessed on one-third share in certain lands instead of on the value of the entire land though he was the owner of the entire land, which led to escapement of wealth of Rs.51.28 lakhs (Rs. 6.30 lakhs) [**Para 5.04.3(ii)**].

(*iii*) Non-completion of wealth-tax assessments for intervening assessment years 1978-79 to 1981-82, even after vacation of a stay order of High Court in November 1987, led to non-levy of wealth-tax of Rs. 11.11 lakhs (Rs. 11.11 lakhs) [**Para 5.12**].

XIX. Gift-tax

(*i*) Omission to initiate gift-tax proceedings to assess deemed gift on sale of shares by a private limited company, being the difference between the market value and the sale consideration, led to non-levy of gift-tax on Rs. 6.47 crores (Rs. 4.77 crores) [**Para 5.18.1 (i)**]

(*ii*)Non-assessment of gift representing the difference between the market value and book value of goodwill and finished goods in the hands of partners of a disolved firm on transfer of assets to a private limited company led to gift escaping assessment of Rs. 64.20 lakhs (Rs. 40.18 lakhs) [**Para 5.18.3**].

XX. Estate duty

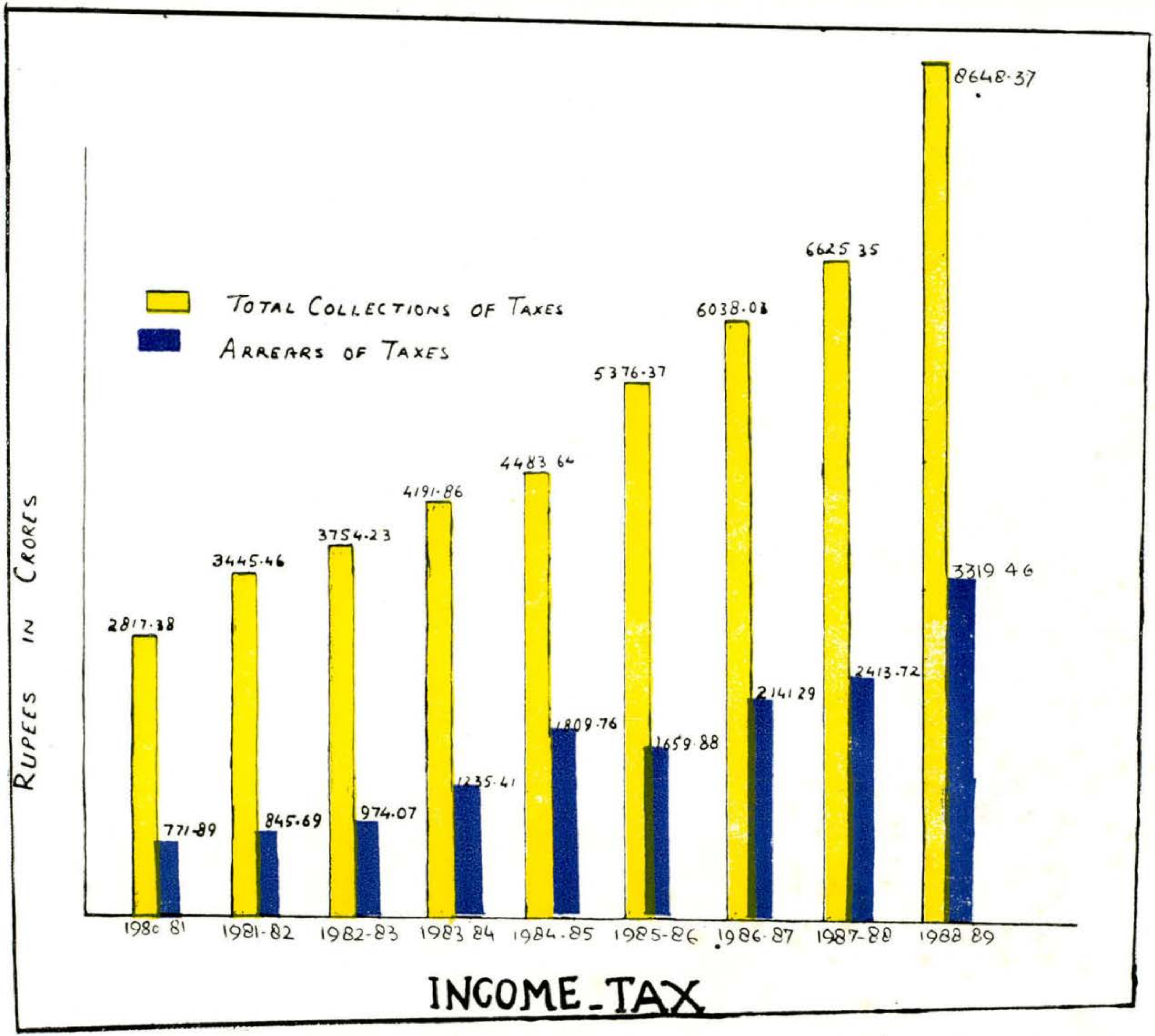
(*i*) Assessment of only the life interest in respect of settlement under a trust by a deceased, where the deceased had reserved an interest in the property for life, instead of the entire value of the property, led to under-assessment of estate of Rs. 7.38 lakhs (Rs. 2.58 lakhs) [**Para 5.26.4**].

(*ii*) Allowance of interest liability of Rs. 5.82 lakhs in one case for belated payment of tax liabilities which arose after the date of death, being not a debt created during the life time of the deceased, led to undercharge of chargeable estate (Rs. 3.86 lakhs) [**Para 5.27.1**].

XXI. Interest-tax

(*i*) Non-assessment of interest on sticky loans aggregating to Rs. 2.80 crores, despite a Supreme Court decision on the general issue, led to under-assessment of chargeable interest of equal amount (Rs. 19.65 lakhs) [**Para 5.31.1, 2**].

(*ii*) Delays in completing interest-tax assessments ranging from 4 to 7 years from date of filing returns and from 2 to 4 years after completion of income-tax assessments, led to postponement of collection of revenue of Rs. 83.84 lakhs in 3 cases (Rs.83.84 lakhs) [**Para 5.32,1, 2, 3**].


Total Collections of Taxes
Arrears of Taxes
Rupees in Crores
2817·38
771·89
3445·46
845·69
3754·23
974·07
4191·86
1235·41
4483 64
1809·76
5376·37
1659·88
6038·08
2141 29
6625 35
2413·72
8648·37
3319 46
1980 81
1981-82
1982-83
1983 84
1984-85
1985-86
1986-87
1987-88
1988 89

INCOME-TAX

CHAPTER 1

GENERAL

1.01 *Receipts under various Direct Taxes*

The total proceeds from Direct Taxes for the year 1988-89 amounted to Rs. 8,828.68* crores out of which a sum of Rs. 2749.98* crores was assigned to the States. The figures for the three years 1986-87, 1987-88 and 1988-89 are given below:

(In crores of Rupees)

	1986-87	1987-88	1988-89*
020 Corporation Tax	3,159.96	3,432.92	4,407.21
021 Taxes on income other than Corporation Tax	2,878.97	3,192.43	4,241.16
023 Hotel Receipts Tax	—	—	0.16
024 Interest Tax	0.72	9.30	2.73
028 Other Taxes on Income and Expenditure	0.01	5.70	42.16
031 Estate Duty	13.39	8.02	6.04
032 Taxes on Wealth	174.15	100.58	122.48
033 Gift Tax	9.26	8.23	6.74
Gross Total	6,236.46	6,757.18	8,828.68
Less share of net proceeds assigned to the States :	2,159.84	2,589.24	2,749.05
Income-tax			
Estate Duty	10.32	6.20	0.93
Hotel Receipts Tax	—	—	—
Total	2,170.16	2,595.44	2,749.98
Net Receipts	4,066.30	4,161.74	6,078.70

The gross receipts under Direct Taxes during 1988-89 went up by Rs. 2,071.50 crores when compared with the receipts during 1987-88 as against an increase of Rs. 520.72 crores in 1987-88 over those for 1986-87. Receipts under Corportion-tax and Surtax registered an increase of Rs. 974·29 crores while receipts under "Taxes on Income other than Corporation tax" accounted for an increase of Rs. 1,048.73 crores.

1.02 Variations between Budget estimates and Actuals

1. The Actuals for the year 1988-89 under the Major head 020-Corporation tax, 021-Taxes on Income other than Corporation tax, 031-Estate. Duty and 032-Taxes on Wealth exceed the Budget Estimates.

The figures for the years from 1984-85 to 1988-89 under the various heads are given below:

Year	Budget Estimates	Actuals	Variation	Percentage of variation (In crores of Rupees)
020—Corporation Tax				
1984-85	2,568.00	2,555.89	(—)12.11	(—)0.47
1985-86	2,804.00	2,865.08	61.08	2.18
1986-87	3,120.00	3,159.96	39.96	1.28
1987-88	3,452.00	3,432.92	(—)19.08	(—)0.55
1988-89	4,050.00	4,407.21*	357.21	8.82
021—Taxes on Income other than Corporation Tax				
1984-85	1,746.00	1,927.75	181.75	10.41
1985-86	1,964.00	2,511.29	547.29	27.87
1986-87	2,580.00	2,878.97	298.97	11.59
1987-88	2,845.00	3,192.43	347.43	12.21
1988-89	3,650.00	4,241.16*	591.16	16.20

*Figures furnished by the Controller General of Accounts are provisional.

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Year	Budget Estimates	Actuals	Variation	Percentage of variation (In crores of Rupees)
024—Interest Tax				
1984-85	190.00	170.88	(—)19.12	(—)10.06
1985-86	220.00	57.70	(—)162.30	(—)73.77
1986-87	—	0.72	0.72	
1987-88	—	9.30	9.30	
1988-89	—	2.73*	2.73	
031—Estate Duty				
1984-85	20.00	24.37	4.37	21.85
1985-86	22.50	22.26	(—)0.24	(—)1.07
1986-87	15.00	13.39	(—)1.61	(—)10.73
1987-88	10.00	8.02	(—)1.98	(—)19.80
1988-89	3.25	6.04*	2.79	85.84
032—Taxes on Wealth				
1984-85	97.00	107.58	10.58	10.91
1985-86	104.00	153.44	49.44	47.54
1986-87	100.00	174.15	74.15	74.15
1987-88	120.00	100.58	(—)19.42	(—)16.18
1988-89	120.00	122.48*	2.48	2.06
033—Gift Tax				
1984-85	8.50	10.86	2.36	27.76
1985-86	10.00	11.66	1.66	16.60
1986-87	15.00	9.26	(—)5.74	(—)38.27
1987-88	11.00	8.23	(—)2.77	(—)25.18
1988-89	10.00	6.74*	(—)3.26	(—)32.60

2. The details of variations under the heads subordinate to the Major Heads 020 and 021 for the year 1988-89 are given below : —

	Budget	Actuals*	Increase(+) Shortfall(—)	Percentage of variation
				(In crores of Rupees)
020—Corporation Tax				
(*i*) Income-tax on companies	3,959.00	4,221.29	262.29	6.62
(*ii*) Surtax	30.00	8.95	(—)21.05	(—)70.17
(*iii*) Surcharge	50.00	53.76	3.76	7.52
(*iv*) Receipts awaiting transfer to other minor heads	—	71.61	71.61	—
(*v*) Other receipts	11.00	51.60	40.60	378.18
Total	4,050.00	4,407.21	357.21	8.82
021—Taxes on Income-tax other than Corporation Tax				
(i) Income-tax	3,575.00	4,164.39	589.39	16.48
(*ii*) Surcharge	50.00	39.94	(—)10.06	(—)20.12
(*iii*) Receipts awaiting transfer to other minor heads	—	8.77	8.77	
(*iv*) Other receipts	25.00	33.06	8.06	32.24
(*v*) Deduct share of proceeds assigned to states	2,867.06	2,749.06	(—)118.00	(—)4.11
Total	782.94	1,497.10	714.16	91.01

*Figures furnished by the Controller General of Accounts are provisional.

1.03 Analysis of collections

Under the provisions of the Income-tax Act, 1961, income-tax is chargeable for any assessment year in respect of the total income of the previous year at the rates prescribed in the annual Finance Act. The Act, however, provides for pre-assessment collection by way of deduction of tax at source, advance-tax and payment of tax on self-assessment. The post-assessment collection is of residuary taxes not so paid.

1.* The break-up of total collections of Corporation tax, Surtax and Interest-tax from companies and Taxes on income other than Corporation tax from non-companies, at pre-assessment and post-assessment stages, during the year 1988-89 as furnished by the Ministry of Finance is given below:

	Company				Non-company	
	Corporation Tax	Surtax	Interest tax	Total	Income-tax	Total
					(In crores of Rupees)	
Tax deducted at source	841.12	—	—	841.12	1,862.79	2,703.91
Advance-tax	3,347.50	—	—	3,347.50	2,085.00	5,432.50
Self-assessment	337.10	—	—	337.10	454.60	791.70
Regular assessment	492.49	9.43	—	501.92	195.02	696.94
Other receipts	123.67	—	—	123.67	45.69	169.36
Total collections	5,141.88	9.43	—	5,151.31	4,643.10	9,794.41
Refunds	744.27	0.48	—	744.75	404.94	1,149.69
Net collections	4,397.61	8.95	—	4,406.56	4,238.16	8,644.72

2.* The details of tax collections from Government companies and Corporations (including nationalised banks) and foreign companies out of the company assessee in 'I' above, during the year 1988-89 as furnished by the Ministry of Finance, are as under:

(In crores of rupees)

	Government companies and Corporations	Foreign companies	Others	Total
Advance-tax	1,402.65	232.85	1,143.65	2,782.59@
Self-assessment	87.89	21.08	125.71	234.98@
Regular-assessment	180.89	967.54	93.65	1,246.82@
Surtax	6.23	1.00	8.60	15.86@
Interest-tax	2.67	—	37.15	39.82
Total	1,662.36@	1,222.49@	1,412.25@	4,320.10@

3. (i)* The details of tax deduction at source during the year 1988-89 under broad categories are as under :—

	Amount (In crores of Rupees)
Salaries	762.66
Interest on securities	698.19
Dividends	207.35
Interest	262.08
Winnings from lottery or cross word puzzles	36.99
Winnings from horse races	20.50
Payments to contractors and sub-contractors	485.08
Insurance commission	25.17
Payment to non-residents and others	205.89
Total	2,703.91

(ii)* The details of tax deducted at source, the number of statements of tax deducted at source received and the tax actually remitted to Government account for the year 1988-89 under broad categories are as under:-

(Rs. in thousands)

Income	No. of Statements received	Tax deducted as per statements	Tax remitted to Govt. Account	Balance due for remittance: For the year	Balance due for remittance: Upto the end of the year
(a) Salary	74,316	2,92,66,24	2,90,64,60	20,164	20,614
(b) Interest on Securities	13,272	66,90,49	66,87,01	348	348
(c) Dividends	6,819	66,71,47	66,67,11	436	436
(d) Interest	50,839	93,08,59	92,97,38	1,121	1,121
(e) Lottery and Cross-word Puzzles	120	17,12,61	17,11,45	116	116
(f) Winnings from horse races	60	1,65,38	1,63,66	172	172
(g) Contractors/sub-contractors	36,731	2,56,87,29	2,56,33,18	5,411	5,411
(h) Insurance Commission	8,666	28,92,40	28,91,53	87	87
(i) Payments to non-residents	1,483	80,96,61	77,33,04	36,357	36,357
Total	1,92,306	9,04,91,08	8,98,48,96	64,212	64,662

*Figures furnished by the Ministry of Finance are provisional.
@Figures are under reconciliation by the Ministry of Finance.

4. Advance-tax Tax payable and collected by way of advance-tax during the year 1988-89* is as under :—

(In crores of rupees)

	Company				Non-company Income-tax	Total**
	Corporation tax	Surtax	Interest-tax	Total		
1. Arrear demand	105.78	4.61	—	119.33**	115.33	238.00
2. Current demand	2,367.69	6.33	11.67	1,415.61**	657.10	3,518.41
3. Collections						
(a) Out of arrear demand	19.20	1.29	—	20.50**	31.01	55.14
(b) Out of current demand	2,518.45	5.51	11.67	2,537.52**	1,108.03	3,558.79
(c) Total	2,539.54**	6.80	11.67	2,564.21**	1,174.66**	3,728.98
4. Balance demand						
(a) Arrear	96.49	3.32	—	99.81**	86.85	188.88
(b) Current	(—)49.16	0.82	—	(—)48.40**	6.80	(—)6.10
(c) Total	47.33	4.14	—	51.41**	95.95**	182.29

1.04 Cost of collection

1. The expenditure incurred during the year 1988-89 in collecting Corporation-tax, Taxes on Income other than Corporation tax and Interest tax together with the corresponding figures for the preceding three years, is as under:

(In crores of rupees)

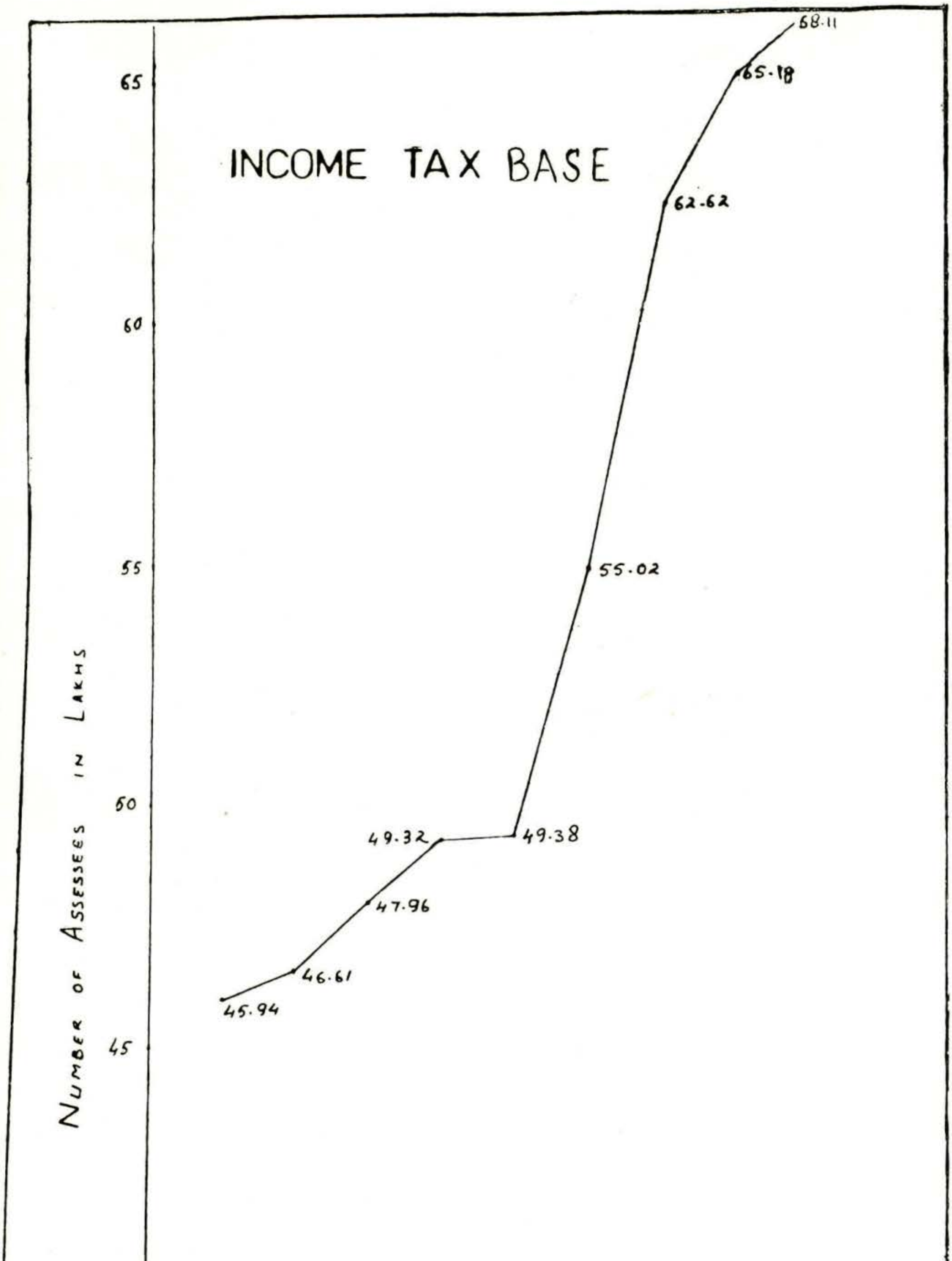
	Gross collection	Expenditure on collection
020—Corporation tax		
1985-86	2,865.08	12.76
1986-87	3,159.96	15.04
1987-88	3,432.92	18.74
1988-89*	4,407.21	20.56
021—Taxes on Income etc.		
1985-86	2,511.29	89.30
1986-87	2,878.97	127.01
1987-88	3,192.43	131.15
1988-89*	4,241.16	148.42
024—Interest Tax		
1985-86	57.70	0.01
1986-87	0.72	0.01
1987-88	9.30	0.02
1988-89*	2.76	0.02
028—Other taxes on income and expenditure		
1985-86	@	
1986-87	0.01	
1987-88	5.70	
1988-89*	42.16	1.28

2. The expenditure incurred during the year 1988-89 in collecting other direct taxes i.e. Taxes on wealth, Gift-tax and Estate duty together with the corresponding figures for the preceding three years, is as under:—

(In crores of rupees)

	Gross collection	Expenditure on collection
031—Estate Duty		
1985-86	22.26	2.26
1986-87	13.39	2.66
1987-88	8.02	3.31
1988-89*	6.04	0.55
032—Taxes on Wealth		
1985-86	153.44	7.94
1986-87	174.15	9.36
1987-88	100.58	11.66
1988-89*	122.48	14.62
033—Gift-tax		
1985-86	11.66	1.13
1986-87	9.26	1.34
1987-88	8.23	1.67
1988-89*	6.74	1.83

*Figures furnished by the Ministry of Finance are provisional.
**Figures are under reconciliation by the Ministry of Finance.
@The actual amount is Rs. 67,156.


INCOME TAX BASE
NUMBER OF ASSESSEES IN LAKHS
65
60
55
50
45
45.94
46.61
47.96
49.32
49.38
55.02
62.62
65.18
68.11
1980-81
1981-82
1982-83
1983-84
1984-85
1985-86
1986-87
1987-88
1988-89

1.05 Number of assessees

1. INCOME-TAX

Under the provisions of the Income-tax Act, 1961, tax is chargeable on the total income of the previous year of every person. The term 'Person' includes an individual, a Hindu undivided family, a company, a firm, an association of persons, or a body of individuals a local authority and an artificial juridical person.

For the assessment year 1988-89 no income-tax was payable on a total income not exceeding Rs.18,000 except in the case of specified Hindu undivided family, registered firms, cooperative society, local authority and company where a lower limit is applicable.

(i) The total number of assessees in the books of the department was 68,11,303 as on 31 March 1989* as against 65,18,333 as on 31 March 1988. The break-up of the assessees on the said two dates was as under:

	As on 31 March 1988	As on 31 March 1989*
Individuals	49,32,977	51,25,342
Hindu undivided families	3,39,347	3,60,985
Firms	10,60,461	11,26,378
Companies	87,985	96,237
Trusts	58,739	67,331
Others	38,824	35,030
Total	65,18,333	68,11,303

*Figures furnished by the Ministry of Finance are provisional.

(ii)* The following table indicates the break-up of assessees according to slabs of income:—

	Individuals	Hindu Undivided families	Firms	Companies	Others	Total
(i) Below taxable limit	8,35,880	73,917	1,16,620	37,833	63,803	11,28,053
(ii) Above taxable limit but up to Rs. 1,00,000	41,73,071	2,75,863	9,11,170	37,432	35,116	54,32,652
(iii) Rs. 1,00,000 to Rs. 5,00,000	1,12,364	10,760	93,220	12,859	2,793	2,31,996
(iv) Above Rs. 5,00,000	4,027	445	5,368	8,113	649	18,602
Total	51,25,342	3,60,985	11,26,378	96,237	1,02,361	68,11,303

2. SURTAX

Under the Companies (Porfits) Surtax Act, 1964, surtax is levied on the 'Chargeable Profits' of a company in so far as they exceed the statutory deduction, which is an amount equal to 10 per cent (15per cent from 1 April 1977) of the capital of the company or Rs. two lakhs, whichever is greater.

The number of surtax assessees in the books of the department as furnished by the Ministry of Finance for the last three years was as under:—

Year ending	No. of assessees
31 March 1987	2,539
31 March 1988	2,444
31 March 1989*	2,340

3. INTEREST-TAX

The number of assessees for Interest-tax in the books of the department as furnished by the Ministry of Finance, for the last three years was as under:—

Year ending	No. of assessees
31 March 1987	78
31 March 1988	82
31 March 1989*	79

*Figures furnished by the Ministry of Finance are provisional.

4. WEALTH-TAX

Under the provisions of the Wealth-tax Act, 1957, wealth-tax is levied for every assessment year on the net wealth of every individual and Hindu undivided family according to the rates specified in the schedule to the Act. No wealth tax is levied on companies with effect from 1 April 1960. However, levy of wealth-tax on companies has been revived in a limited way with effect from 1 April 1984.

For the assessment year 1988-89 no wealth-tax was payable where the net wealth is less than Rs. 2.50 lakhs.

(i) The number of wealth-tax assessees in the books of the department as on 31 March 1988 and 31 March 1989 were as follows:-

	As on 31 March 1988	As on 31 March 1989*
Individuals	5,51,519	5,41,992
Hindu undivided families	70,187	70,366
Companies	10,290	11,471
Others	1,597	1,784
Total	6,33,593	6,25,613

*Figures furnished by the Ministry of Finance are provisional.

(ii)* The following table indicates the break-up of assessees according to slabs of income:

	Individuals	Hindu undivided families	Companies	Others	Total
(i) Below taxable limit	1,10,937	15,298	2,744	1,088	1,30,067
(ii) Above taxable limit but upto Rs. 5,00,000	3,54,165	45,266	7,030	567	4,07,028
(iii) Rs. 5,00,001 to R.s 10,00,000	66,831	8,621	1,254	86	76,792
(iv) Rs. 10,00,001 to Rs. 15,00,000	6,804	829	239	16	7,888
(v) Above Rs. 15,00,000	3,255	352	204	27	3,838
Total	5,41,992	70,366	11,471	1,784	6,25,613

5. GIFT-TAX

Under the provisions of the Gift-tax Act, 1958, gift-tax is levied according to the rates specified in the schedule for every assessment year in respect of gifts of movable or immovable properties made by a person to another person (including Hindu undivided family or a company or an association of persons or body of individuals whether incorporated or not) during the previous year.

During the assessment year 1988-89 no gift tax was payable where the value of taxable gifts did not exceed Rs.20,000.

The number of gift-tax assessment cases for the years 1987-88 and 1988-89 were as follows:—

1987-88	94,892
1988-89*	91,969

6. ESTATE DUTY

Under the provisions of the Estate Duty Act, 1953, in the case of every person dying after 15 October 1953, estate duty at rates fixed in accordance with section 35 of the Act is levied upon the principal value of the estate comprised of all property settled or not settled including agricultural land and which passes on the death.

No estate duty is leviable in respect of estate passing on death occuring on or after 16 March, 1985.

The number of estate duty assessment cases for the years 1987-88 and 1988-89 was as follows:

1987-88	14,813
1988-89*	5,961

1.06 *Arrears of assessments*

The limitation period for completion of assessments is 2 years in the case of Income-tax, 4 years in the case of Welth-tax and Gift-tax.

1. Sanctioned and working strength of officers on assessment duty as on 31.3.1988 and 31.3.1989 were as under:—

Nature of Posts	As on 31-3-1988		As on 31-3-1989*	
	Sanctioned strength	Working strength	Sanctioned strength	Working strength
(a) Income-tax Officers on assessment duty	2,558	2,057	2,362	1,902
(b) Inspecting Assistant Commissioners (Asstt.)	172	161	167	149
(c) Asstt. Controllers of Estate Duty	48	44	48	28

2. INCOME-TAX INCLUDING CORPORATION-TAX

(i) The number of assessments completed during the last five years were as under :—

Financial Year	Number of assessments for disposal			Number of assessments completed				Number of assessments pending at the end of the year		
	Scrutiny	Summary	Total	Scrutiny	Summary	Total	%age	Scrutiny	Summary	Total
1984-85	66,44,955		66,44,955	53,89,217		53,89,217	81.10	12,55,738		12,55,738
1985-86	7,54,497	63,13,752	70,68,249	4,61,521	54,55,436	59,16,957	83.71	2,92,976	8,58,316	11,51,292
1986-87	6,32,409	78,83,020	85,15,429	3,85,656	66,70,396	70,56,052	89.51	2,46,753	12,12,624	14,59,377
1987-88	5,29,761	70,43,560	75,73,321	3,41,570	61,23,953	64,65,523	85.37	1,88,191	9,19,607	11,07,798
1988-89*	4,31,343	66,95,326	71,26,669	2,92,790	58,80,475	61,73,265	86.54	1,38,553	8,14,851	9,53,404**

(ii) Status-wise break-up of Income-tax assessments completed during the years 1987-88 and 1988-89 was as under :—

	1987-88	1988-89*
(i) Individuals	50,42,387	47,54,879
(ii) Hindu undivided families	3,14,783	3,03,532
(iii) Firms	9,58,428	9,33,522
(iv) Companies	89,778	1,21,595
(v) Association of persons etc.	60,147	59,737
Total	64,65,523	61,73,265

*Figures furnished by the Ministry of Finance are provisional.

**Figures in para 1.06.2 (iii), (iv), and (v) are under reconciliation by the Ministry of Finance.

(iii)* Status-wise and income range-wise break-up of pendency of assessments as on 31 March 1989 was as under :—

Sr. No	Status	No. of pending assessments with income Upto Rs. 1,00,000	Rs. 1,00,001 to 5,00,000	Over Rs. 500,000	Total
1	Companies	20,756	12,033	8,432	41,221
2	Firms	1,18,089	33,745	3,445	1,55,279
3	Individual	6,23,176	61,414	2,802	6,87,392
4	Hindu undivided families	41,901	5,187	399	47,487
5	Others	18,814	1,143	516	20,473
	Total	8,22,736	1,13,522	15,594	9,51,852

(iv) Assessment year-wise position of pendency of Income-tax assessments at the end of the last two years was as under:—

	As on 31 March 1988	As on 31 March 1989*
1984-85 and earlier years	62,224	9,249
1985-86	39,288	6,638
1986-87	1,70,375	25,269
1987-88	8,31,911	1,70,557
1988-89	—	7,40,139
Total	11,07,798	9,51,852

(V)* Status-wise and year-wise break-up of pendency of income-tax assessments as on 31 March 1989 was as under :—

Status	1984-85 and earlier year	1985-86	1986-87	1987-88	1988-89	Total
(a) Company assessments						
(i) Regular	108	121	935	11,852	24,739	37,755
(ii) Reopened/set aside	1,405	475	353	638	577	3,448
(iii) Non-Company assessments						
(i) Regular	1,324	2,956	19,609	1,54,261	6,98,132	8,76,282
(ii) Reopened/set aside	6,412	3,086	4,372	3,806	16,691	34,367
Total	9,249	6,638	25,269	1,70,557	7,40,139	9,51,852

The number of assessments pending as on 31 March 1989 was 9,51,852 as compared to 11,07,798 as on 31 March 1988 and 14,59, 377 on 31 March 1987.

3. Wealth-tax, Gift-tax and Estate-Duty

1. WEALTH-TAX

(i)* The number of wealth-tax assessments completed during the year 1988-89 was as under:—

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of year
10,14,593	6,95,326	68.53	3,19,267

(ii) Status-wise break-up of the wealth-tax assessments completed during the years 1987-88 and 1988-89 were as under :—

Status	No. of assessments completed during 1987-88	1988-89*
(i) Individual	8,35,526	609,100
(ii) Hindu undivided families	79,294	67,609
(iii) Companies	7,478	14,973
(iv) Others	884	3,644
Total	9,23,182	6,95,326

*Figures furnished by the Ministry of Finance are provisional.

(iii)* Assessment year-wise position of pendency of assessments at the end of 1988-89 was as under:—

Year	Number of assessments Regular	Reopened/ set aside	Total
1984-85 and earlier year	2,517	4,012	6,529
1985-86	20,971	870	21,841
1986-87	36,645	540	37,185
1987-88	65,040	791	65,831
1988-89	1,87,254	627	1,87,881
Total	3,12,427	6,840	3,19,267

(iv)* Status-wise and wealth rangewise break-up of pendency of wealth-tax assessments at the end of 1988-89 was as under:—

Wealth-range	Number of pending assessments status				
	Individual	HUF's	Companies	Others	Total
Upto Rs. 2 50,000	67,609	10,641	3,767	422	82,439
Rs. 2,50,001 to Rs. 5,00,000	1,38,320	19,859	2,844	529	1,61,552
Rs. 5,00,001 to Rs. 10,00,000	59,690	5,896	1,494	107	67,187
Rs. 10,00,001 to Rs. 15,00,000	3,889	499	196	10	4,594
Over Rs. 15 lakhs	2,841	352	266	36	3,495
Total	2,72,349	37,247	8,567	1,104	3,19,267

2. GIFT-TAX

(i)* The number of gift-tax assessments completed during the year 1988-89 was as under:

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of year
91,969	70,642	76.81	21,327

(ii)* Assessment year-wise position of pendency of assessments at the end of 1988-89 was as under:

Assessment year	No. of assessments		
	Regular	Reopened/ setaside	Total
1984-85 and earlier years	792	229	1,021
1985-86	1,384	102	1,486
1986-87	3,181	92	3,273
1987-88	6,111	59	6,170
1988-89	9,356	21	9,377
Total	20,824	503	21,327

3. ESTATE DUTY

(i)* The number of estate duty assessments completed during the year 1988-89 was as under :—

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments for disposal at the end of the year
5,961	4,226**	70.89	1,735

(ii)* The number of assessments completed according to range of principal value of estate was under :—

Principal value of estate	Number of assessments completed
Upto Rs. 5 lakhs	3,495
Rs. 5,00,001 to Rs. 10,00,000	349
Rs. 10,00,001 to Rs. 15,00,000	205
Above Rs. 15 lakhs	89
Total	4.138**

(iii)* Assessment year-wise position of pendency of assessments at the end of 1988-89 was as under:—

Assessment year	Number of assessments		
	Regular	Reopened/ set aside	Total
1984-85 and earlier year	812	380	1,192
1985-86	135	24	159
1986-87	129	39	168
1987-88	61	30	91
1988-89	103	22	125
Total	1,240	495	1,735

(iv)* Estate value-wise pendency of assessments at the end of the year 1988-89 was as under :—

Principal value of estate	Number of assessments
Upto Rs. 5 lakhs	863
Rs. 5,00,001 to Rs. 10 lakhs	489
Rs. 10,00,001 to Rs. 15 lakhs	226
Over Rs. 15 lakhs	149
Total	1727**

*Figures furnished by the Ministry of Finance are provisional.

**Figures are under reconciliation by the Ministry of Finance.

4. SUR TAX

(i)* The number of sur tax assessments completed during the year 1988-89 was as under :

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of year
5 120	1 072	20.93	4 048**

(ii)* Assessment year-wise position of pendency of assessments at the end of the year 1988-89 was as under:

Assessment year	Number of assessments
1984-85 and earlier years	995
1985-86	636
1986-87	974
1987-88	1,006
1988-89	372
Total	3,983**

5. INTEREST-TAX

(i)* The number of interest tax assessments completed during the year 1988-89 was as under :—

No. of assessments for disposal	No. of assessments completed	Percentage	No. of assessments pending at the end of the year
441	163	39.96	278

(ii)* Assessment year-wise position of pendency of assessments at the end of the year 1988-89 was as under :

Assessment year	No. of assessments
1984-85 and earlier years	214
1985-86	26
1986-87	30
1987-88	3
1988-89	5
Total	278

1.07 Arrears of Tax Demands

1. The Income-tax Act, 1961, provides that when any tax, interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, a notice of demand shall be served upon the assessee. The amount specified as payable in the notice of demand has to be paid within 35 days unless the time for payment is extended by the Income-tax Officer on application made by the assessee. The Act has been amended with effect from 1 October 1975 to provide that an appeal against an assessment order would be barred unless the admitted portion of the tax has been paid before filing the appeal.

(i) Corporation-tax (including sur tax) and Income-tax

(a) *The total demand of tax raised and remaining uncollected as on 31 March 1989 was Rs. 5,291.66 crores, out of which arrears of Rs. 3,148.51 crores related to companies. The arrears included Rs. 1,630.02 crores in respect of which the permissible period of 35 days had not expired as on 31 March 1989. Rs. 12.63 crores claimed to have been paid but remaining to be verified/adjusted, Rs. 1,159.55 crores stayed/kept in abeyance and Rs. 77.98 crores for which instalments had been granted and instalments not fallen due.

(b) *The details of demands of Income-tax (including corporation-tax) stayed/kept in abeyance as on 31 March 1989 were as under :—

	(In crores of rupees)
(1) By courts	93.65
(2) Under Section 245(F) (2) (Applications to Settlement Commission)	98.34
(3) By Tribunal	37.02
(4) By Income-tax authorities due to	
(i) Appeals and revisions	700.77
(ii) Double Income-tax Claims	4.22
(iii) Restriction on remittances Section 220 (7)	12.95
(iv) Other reasons	212.60
Total	1,159.55

(c) *The amounts of Corporation-tax, Income-tax, interest and penalty making up the gross arrears and the year-wise details thereof are given below :—

	Corporation tax	Income-tax	Interest	Penalty	Total@
				(In crores of Rupees)	
Arrears of 1984-85 and earlier years	109.28	209.06	170.79	65.57	554.70
1985-86	59.38	88.94	84.42	19.49	252.23
1986-87	147.77	129.91	177.52	38.94	494.14
1987-88	443.55	223.89	372.00	83.91	1 123.35
1988-89	1 396.17	511.51	749.24	169.24	2 826.16
Total	2 156.15	1 163.31	1 553.97	377.15	5 250.58

(d) *The following table gives the break-up of the gross arrears of Rs. 5,291.66 crores by certain slabs of in-come.

(In crores of rupees)

	Company cases			Non-company cases			Total		
	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears	No. of cases	Gross arrears	Net arrears
Up to Rs. 1 lakh in each case	76,675	351.71	142.94	36,66,045	835.35	485.12	37,42,710	1,187.06	628.06
Over Rs. 1 lakh up to Rs. 5 lakhs in each case	5,657	118.66	67.49	14,090	260.34	156.21	19,747	379.00	223.70
Over Rs. 5 lakhs up to Rs. 10 lakhs in each case	1,764	136.25	61.95	1,988	135.29	76.34	3,752	271.54	138.29
Over Rs. 10 lakhs up to Rs. 25 lakhs in each case	1,361	247.94	109.19	1,396	193.88	101.31	2,757	441.82	210.50
Over Rs. 25 lakhs in each case	1,389	2,288.45	474.09	867	723.79	291.07	2,256	3,012.24	765.16
Total	86,846	3,143.01	855.66	36,84,386	2,148.65	1,110.05	37,71 232	5,291.66	1,965.71

*Figures furnished by the Ministry of Finance are provisional.
**Figures are under reconcilaition by the Ministry of Finance.
@Information from CIT Allahabad is awaited as stated by the Ministry of Finance.

(e) *Classification of tax in arrears (Gross)

	Amount (Rs. in crores)		
	Arrears	Current	Total
1. (a) Amount due from companies in liquidation :			
(i) Pending consideration of write-off/scaling down petitions	3.91	—	3.91
(ii) Others	7.52	3.10	10.62
(iii) Total	11.43	3.10	14.53
(b) Amounts due from non-company assessees involved in insolvency proceedings :			
(i) Pending consideration of scaling down petitions/write off	10.62	—	10.62
(ii) Others	1.87	5.91	7.78
(iii) Total	12.49	5.91	18.40
(c) Total of (a) (iii) and (b) (iii)	23.92	9.01	32.93
2. (a) Amounts due from assessees who have left India and who have no known assets.	0.11	—	0.11
(b) Amounts due from assessees who are not traceable and or who have no known assets.			
(i) Pending consideration of write-off/scaling down petitions.	0.61	—	0.61
(ii) Others.	4.16	0.76	4.92
(iii) Total	4.77	0.76	5.53
(c) Total of (a) and (b) (iii)	4.88	0.76	5.64
3. Amounts due from undertakings which have been nationalised or taken over by the Govt., where the erstwhile owners do not have enough assets to pay the tax.			
(i) Pending consideration of scaling down petitions/write off.	—	—	—
(ii) Others	0.82	—	0.82
(iii) Total	0.82		0.82
4. All other amounts in arrears			
(i) Pending consideration of scaling down petitions/write off.	1.24	139.83	141.07
(ii) Which are not being realised for various reasons of genuine hardships.	329.45	379.73	709.18
(iii) Balance being the realisable amount.	2 093.02	2 308.85	4 401.87
(iv) Total.	2 423.71	2 828.41	5 252.12
(v) Total of 1(c), 2(c) , 3(iii) and 4(iv).	2 453.33	2 838.18	5 291.51@

(ii)* The amounts of Interest tax in arrears and the year-wise break-up thereof are given below :—

	No. of cases	Amount (in crores of rupees)
Arrears of 1984-85 and earlier years	—	—
1985-86	—	—
1986-87	—	—
1987-88	21	1.10
1988-89	36	5.79
Total	57	6.89

(iii) *Other Direct Taxes (Wealth-tax, Gift-tax and Estate duty)

The following table gives the year-wise arrears of demands outstanding and the number of cases relating there to under the three other Direct-taxes, i.e. Wealth-tax, Gift-tax and Estate duty as on 31 March 1989.

(Amount in lakhs of Rs.)

	Wealth-tax		Gift-tax		Estate-duty	
	Number	Amount	Number	Amount	Number	Amount
1984-85 and earlier years	1 27 503	9 552.54	25 684	650.98	13 614	2 694.70
1985-86	44 995	3 572.10	7 429	206.20	3 738	1 077.06
1986-87	55 952	4 740.75	10 389	318.83	3 144	1 024.79
1987-88	91 142	7 088.20	14 412	392.88	4 636	1 068.72
1988-89	1 29 839	15 645.26	23 514	877.62	2 698	1 445.77
Total	4 49 431	40 598.85	81 428	2 446.51	27 830	7 311.04

*Figures furnished by the Ministry of Finance are provisional.

@Figures are under reconciliation by the Ministry of Finance.

2. Under the provisions of the Income-tax Act, 1961 every demand of tax, interest, penalty or fine payable under the Act should be paid within thirty five days of the service of notice of demand. On the default of an assessee in this respect, the Income-tax officer may forward a certificate specifying the demand in arrears to the Tax Recovery Officer for recovery of the demand. The Tax Rcovery Officer will serve a notice on the defaulter requiring him to pay the demand within fifteen days. If the amount mentioned in the notice is not paid within the time specified therein or. with in such further time as the Tax Recovery Officer may grant in his discretion, the Tax Recovery Officer shall proceed to realise the amount together with interest at the rate of 12 per cent (15 per cent from 1 October 1984) on the outstandings till the date of recovery by one or more of the following modes:

(a) by attachment and sale of the defaulter's movable property;

(b) by attachment and sale of the defaulter's immovable property;

(c) by arrest of the defaulter and his detention in prison;

(d) by appointing a receiver for the management of the defaulter's movable and immovable properties.

(i)* The number of officers engaged in tax recovery work during 1988-89 was as follows:—

Particulars	Sanctioned strength	Working Strength
Commissioners (Recovery)	4	3
Tax Recovery Officers	151	137

(ii) The tax demands certified to the Tax Recovery Officers and the progress of recovery to end of 1988-89 are given in the following table :—

(In crores of rupees)

	Demand Certified		Total	Demand recovered during the year	Balance at the end of the year
	At the begining of the year	During the year			
1984-85	1,248.73	359.00	1,607.73	534.36	1,073.37
1985-86	1,073.37	305.54	1,378.91	403.80	975.11
1986-87	975.11	206.94	1,181.05	399.26	782.79
1987-88	826.77	436.52	1,263.29	359.89	903.40
1988-89*	720.99	473.56	1,194.55	305.85	888.70
Total	4 844.97	1,781.56	6,626.53	2,003.16	4,623.37

(iii)* Year-wise break-up of pending certificates and amount of demand:—

Year of receipts of recovery certificates	No. of certificates	(Rs. in crores) Amount involved
1984-85	11,48,172	291.34
1985-86	1,03,599	56.41
1986-87	64,014	75.47
1987-88	63,300	140.51
1988-89	1,87,617	324.97
Total	15,66,702	888.70

(iv)* Tax-wise and amount-wise analysis of pending certificates :—

(In crores of rupees)

Range of demand	Corporation-tax		Income-tax		Wealth-tax	
	No.	Amount	No.	Amount	No.	Amount
(*i*) upto Rs. 10 000	14,289	3.48	11,93,161	207.98	1,52,154	38.80
(*ii*) Over Rs. 10 000 and below Rs. 1 lakh	9,893	18.97	1,23,893	133.31	19,278	26.60
(*iii*) Over Rs. 1 lakh	1,729	41.00	17,888	369.39	829	35.38
Total	25,911	63.45	13,34,942	710.68	1,72,261	100.78

*Figures furnished by the Ministry of Finance are provisional.

Range of demand	Gift-tax		Estate-duty		Interest tax		Total	
	No.	Amount	No.	Amount	No.	Amount	No.	Amount
(i) Upto Rs. 10 000	29,738	7.39	423	—	361	0.45	13,90,126	258.10
(ii) Over Rs. 10 000 and below Rs. 1 lakh	2,788	3.95	—	—	158	0.17	1,56,010	183.00
(iii) Over Rs. 1 lakh	118	1.82	—	—	2	0.01	20,566	447.60
Total	32,644	13.16	423	—	521	0.63	15,66,702	888.70

(v)* Year-wise disposal and pendency:

Year	No. of cases at the beginning of the year		No. added during the year		Total		No. actually disposed		No. pending at the close of the year	
	Movable	Immo-vable	Movable	Immo-vable	Movable	Immo-vable	Movable	Immo-vable	Movable	Immo-vable
1984-85 and earlier years	3,970	3,251	842	1,509	4 812	4,760	2,124	1,576	2,688	3,184
1985-86	2,688	3,184	1,326	649	4,014	3,833	1,867	659	2,147	3,174
1986-87	2,147	3,174	1,855	693	4,002	3,867	1,216	286	2,786	3,581
1987-88	2,858	3,570	1,063	554	3,921	4,124	724	181	3,197	3,943
1988-89	2,584	3,664	871	1,320	3,455	4,984	528	281	2,927	4,703
Total	14,247	16,843	5,957	4,725	20,204	21,568	6,459	2,983	13,745	18,585

3.* Disposal of attached property—Year-wise details of attached properties awaiting disposal at the end of 1988-89 as furnihshed by the Ministry of Finance were as under:—

(In Crores of Rupees)

Year of attachment	Number of cases				Total		Appointment of Receivers for management of properties	
	Movable		Immovable		No.	Amount		
	No.	Amt.	No.	Amt.			No.	Amt.
1984-85	763	2.14	1,316	30.36	2,079	32.50	—	—
1985-86	307	2.62	463	35.10	770	37.72	1	0.12
1986-87	442	2.37	654	23.38	1,096	25.75	—	—
1987-88	212	3.78	818	27.14	1,030	30.92	—	—
1988-89	1,203	23.15	1,452	55.87	2,655	79.02	—	—
Total	2,927	34.06	4,703	1,71.85	7,630	205.91	1	0.12

1.08 Appeals, Revision Petitions and Writs

1. Under the provisions of the Income-tax Act, 1961 if an assessee is not satisfied with an assessment, a refund order etc. he can file an appeal to the Appellate Assistant Commissioner. The Act also provides for appeal by the assessee direct to the Commissioner (Appeals).

A second appeal can be taken to the Income-tax Appellate Tribunal. After the Tribunal's decision, reference on a point of law can be taken to the High Court from which an appeal lies to the Supreme Court. The assessee can also initiate writ proceedings under Article 226 of the Constitution.

A tax payer can approach the Commissioner of Income-tax to revise an order passed by an Income-tax Officer or by an Appellate Assistant Commissioner within one year form the date of such orders. The Commissioner can also take up for revision an order which, in his view, is prejudicial to the interest of revenue.

(i) **Income-Tax**

(a) Particulars of Income-tax appeals and revision petitions pending as on 31 March 1989 were as under:—

(i)* No. of In-come tax appeals pending with:	
(a) Appellate Assistant Cammissioner	98,843
(b) Commissioner of Income-tax (Appeals)	1,02,853
(ii)* No. of Income-tax revision petitions pending	16,412
Total	2,18,108

*Figures furnished by the Ministry of Finance are provisional.

(b) (i) Year-wise details of appeals pending with Appellate Assistant Commissioner for the five years ending 1984-85 to 1988-89 were as under:

Financial year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	Pending at the end of the year
1984-85	1,95,221	1,48,191	1,58,955	1,84,457
1985-86	1,84,457	1,26,019	1,61,131	1,49,345
1986-87	1,49,345	94,912	1,13,907	1,30,350
1987-88	1,33,405	77,264	1,01,256	1,09,413
1988-89*	1,02,397	70,593	74,147	98,843

(ii)* Year-wise breakup of high demand appeals pending with Appellate Assistant Commissioner at the end of the year 1988-89 with reference to their year of institution was as under :

Year of Institution	No. pending	Year of Institution	No. pending
1984-85 and earlier years	250	1987-88	419
1985-86	120	1988-89	642
1986-87	329	Total	1,760

(c) (i) Year-wise details of appeals pending with Commissioners of Income-tax (Appeals) for the five years ending 1984-85 to 1988-89 were as under:

Financial Year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	No. pending at the end of the year
1984-85	55,058	58,517	46,437	67,138
1985-86	67,138	70,119	45,840	91,417
1986-87	91,417	64,519	47,845	1,08,091
1987-88	1,09,070	72,980	67,032	1,14,044
1988-89*	1,07,887	73,532	78,566	1,02,853

(ii)* Year-wise break of high demand appeals pending with Commissioners of Income-tax (Appeals) at the end of the year 1988-89 with reference to their year of institution was as under:

Year of institution	No. pending	Year of Institution	No. pending
1984-85 and earlier years	338	1987-88	4,120
1985-86	698	1988-89	7,974
1986-87	2,152	Total	15,282

(d) (i) Particulars of revision petitions for the five years ending 1984-85 to 1988-89 were as under:

Financial Year	No. for disposal at the beginning of the year	No. added during the year	No. disposed of during the year	No. pending at the end of the year
1984-85	13,018	9,770	7,563	15,225
1985-86	15,225	9,819	8,121	16,923
1986-87	16,923	10,116	9,557	17,482
1987-88	17,534	9,247	9,907	16,874
1988-89*	16,490	8,516	8,594	16,412

*Figures furnished by the Ministry of Finance are provisional.

(ii)* Year-wise break up of revision petitions pending at the end of the year 1988-89 with reference to their year of institution was as under:

Year of institution	No. Pending
1984-85 and earlier years	3,380
1985-86	1,713
1986-87	2,215
1987-88	3,815
1988-89	5,289
Total	16,412

(a)* Particulars of Wealth-tax Gift-Tax, and Estate-duty appeals and revision petitions pending as on 31 March, 1989 were as under:

No. of appeals pending with :	Wealth-tax	Gift-tax	Estate-Duty
(*i*) Appellate Assistant Commissioner	37,232	1,679	22
(*ii*) Commissioners of Income-tax (Appeals)	11,640	417	3,383
(*iii*) No. of revision petitions pending	3,648	146	**
Total	52,520	2,242	3,405

(b)* Particulars of appeal cases with Appellate Assistant Commissioners and Commissioner (Appeals) and revision petitions with Commissioners for the year 1988-89 were as under:

(i) With Appellate Assistant Commissioners

	Pending at the beginning of the year	Added during the year	Total	No. disposed of during the year	No. pending at the end of the year
(*i*) Wealth-tax	39,716	22,076	61,792	24,560	37,232
(*ii*) Gift-tax	1,754	801	2,555	876	1,679
(*iii*) Estate-duty	37	26	63	41	22
(*iv*) Super profits tax/Surtax	4	8	12	6	6
(*v*) Interest-tax	265	208	473	145	328
Total	41,776	23,119	64,895	25,628	39,267

(ii)* With Commissioners of Income-tax (Appeals)

	Pending at the beginning of the year	Added during the year	Total	No. disposed of during the year	No. pending at the end of the year
(*i*) Wealth-tax	11,856	7,577	19,433	7,793	11,640
(*ii*) Gift-tax	494	349	843	426	417
(*iii*) Estate duty	3,608	1,090	4,698	1,315	3,383
(*iv*) Super profit tax/surtax	610	263	873	384	489
(*v*) Interest-tax	45	66	111	72	39
Total	16,613	9,345	25,958	9,990	15,968

(iii)* Revision petitions with Commissioners

(*i*) Wealth-Tax	3,178	1,373	4,551	903	3,648
(*ii*) Gift-Tax	149	43	192	46	146
(*iii*) Supper profit Tax/surtax	10	17	27	3	24
(*iv*) Interest tax	25	—	25	25	—
Total	3,362	1,433	4,795	977	3,818

*Figures furnished by the Ministry of Finance are provisional.

**Figures awaited from the Ministry of Finance.

(c)* Year-wise break-up of pendency of high demand appeals at the end of the year 1988-89 with reference to their year of institution was as under:-

(i) With Appellate Assistant Commissioners

Year of institution	Wealth-tax	Gift tax	Estate-duty	Interest tax	Super profit/ surtax	Total
1984-85 and earlier years	169	—	—	—	—	169
1985-86	73	2	—	—	—	75
1986-87	89	1	—	—	—	90
1987-88	105	4	—	—	—	109
1988-89	87	16	—	6	—	109
Total	523	23	—	6	—	552

(ii) With Commissioners of Income-Tax (appeals)

	Wealth-tax	Gift tax	Estate-duty	Interest tax	Super profit/ surtax	Total
1984-85	124	1	36	—	3	164
1985-86	134	10	50	—	8	202
1986-87	289	15	65	—	23	392
1987-88	493	30	263	—	40	826
1988-89	1,045	35	235	6	38	1,359
Total	2,085	91	649	6	112	2,943

(d)* Year-wise pendency of revision petition with Commissioners

Year of filing of petition	No. pending
1984-85	1,371
1985-86	351
1986-87	343
1987-88	779
1988-89	866
Total	3,710

(e)* Writ petitions pending:

	In Supreme Court	In High Court	Total
(1) on 31 March 1989	270	4,431	4,701
(ii) Out of (1) above :			
Pending for :			
Over 5 years	70	1,495	1,565
3 to 5 years	57	789	846
1 to 3 years	92	1,211	1,303
Up to 1 year	51	936	987
Total	270	4,431	4,701

(iv) Cases pending with Judicial Courts.

	In Supreme Court	In High Court	Total
(*i*) On 31 March 1989	2,420	26,524	28,944
(*ii*) Out of (*i*) above :			
Pending for :			
Over 5 years	719	3,741	4,460
3 to 5 years	427	4,962	5,389
1 to 3 years	775	10,369	11,144
Upto 1 year	499	7,452	7,951
Total	2,420	26,524	28,944

1.09 Reliefs and refunds

1. Where the amount of tax paid exceeds the amount of tax payable the assessee is entitled to a refund of the excess. If the refund is not granted by the department within three months from the end of the month in which the claim is made, simple interest at the prescribed rate become payable to the assessee on the amount of such refund (vide Section 237 read with Section 243 of the Income-tax Act.)

(i) (a) The particulars of cases of direct refunds on which claims were made, the claims settled and the balance outstanding during 1984-85 to 1988-89 were as under:

Financial year	Opening Balance	Claims received during the year	Total	No. of refunds	Balance outstanding
1984-85	25,733	1,05,845	1,31,578	1,10,845	20,733
1985-86	20,733	1,17,217	1,37,950	1,20,788	17,162
1986-87	17,162	1,16,863	1,34,025	1,08,169	25,856@
1987-88	25,731@	84,976	1,10,707	98,239	12,468
1988-89*	12,176	1,01,096	1,13,272	96,634	16,638

*Figure furnished by the Ministry of Finance are provisional.
@ Under reconciliation by the Ministry of Finance.

(b)* Year-wise analysis of the outstanding direct refund claims as on 31 March 1989.

Financial year in which application was made	No. of cases pending
1984-85	33
1985-86	28
1986-87	296
1987-88	1,679
1988-89	14,602
Total	16,638

(ii) (a) The Act also provides for refund of any amount which may become due to an assessee as a result of any order passed in appeal or other proceedings without his having to make any claim on that behalf. Simple interest at the prescribed rate is payable to the assessee in such cases too.

Cases resulting in refund as a result of appellate orders and revision orders etc., during each of the five years ending 1988-89 were as under:

Financial Year	Opening Balance	Additions	Disposal	Balance
1984-85	1,651	28,573	28,397	1,827
1985-86	1,827	28,406	28,363	1,870
1986-87	1,870	29,125	29,322	1,673@
1987-88	1,957@	22,657	22,596	1,018
1988-89*	1,750	19,117	19,880	987

(b)* Year-wise analysis of balance as on 31 March 1989 was as under:

Financial year	No. of cases pending
1984-85	—
1985-86	—
1986-87	46
1987-88	42
1988-89	899
Tatal	987

1.10 Interest

The Act provides for payment of interest by the assessees for certain defaults such as delayed submission of returns, delayed payment of taxes etc. In some cases such as those where advance-tax has been paid in excess or where a refund due to the assessee is delayed, Government have also to pay interest.

The particulars of interest paid on refunds by Government under the different provisions of the Act during the years 1986-87, 1987-88 and 1988-89 are given below—

(Rs. in thousands)

Section of Income-tax Act under which interest paid	1986-87		1987-88		1988-89*	
	No. of assessment	Amount	No. of assessment	Amount	No. of assessment	Amount
214	83,379	71,330	88,399	1,42,291.2	85,194	3,35,129
243	1,267	498	478	662	16	2,315
244	3,456	71,266	2,849	1,15,329.1	3,368	1,45,053

1.11 Cases settled by Settlement Commission

Under the provisions of the Income-tax Act, 1961 and the wealth-tax Act, 1957, an assessee may at any stage of a case relating to him make an application to the Settlement Commission to have the cases settled. The powers and procedures of the Settlement Commission are specified in the Act. Every order of Settlement passed by the Settlement Commission is conclusive as to the matter stated therein.

The number of cases settled by the Settlement Commission during the last five years was as under:

(i) Income-tax

Financial year	No. of cases for disposal	No. of cases disposed of	Percentage	No. of cases pending
1984-85	1,988	270	13.57	1,718
1985-86	1,890	204	10.79	1,686
1986-87	863	59	6.84	804
1987-88	1,011	71	7.02	940
1988-89*	1,029	110	10.69	919

*Figures furnished by the Ministry of Finance are provisional

@Figures are under reconciliation by the Ministry of Finance.

(ii) Wealth-tax

Financial year	No. of cases for disposal	No. of cases disposed of	Percentage	No. of cases pending
1984-85	733	86	11.73	647
1985-86	683	57	8.34	626
1986-87	298	9	3.02	289
1987-88	371	26	7.01	345
1988-89*	420	66	15.71	354

*Figures furnished by the Ministry of Finance are provisional.

(iii) Yearwise position of tax determined (including interest and penalty) in cases settled by Settlement Commission.

Financial year	Income-tax	Wealth-tax
	(In lakhs of rupees)	
1984-85	225.19	23.43
1985-86	741.75	78.79
1986-87	0.07	**
1987-88*	0.02	@
1988-89£	0.97	@@

*Figures are under reconciliation by the Ministry of Finance.
**The actual figure is Rs. 546.50.
@The actual figure is Rs. 263.
@@The actual figure is Rs. 316.
£Figures furnished by the Ministry of finance are provisional.

(iv)* No of cases pending for admission before settlement commission 212

(v)* No. of cases held up with settlement commission for want of comments of the department. 49

1.12 Penalties and prosecutions.

Failure to furnish return of income/wealth/gift or filing a false return invites penalties under the relevant tax law. It also constitutes an offence for which the tax payer can be prosecuted. The tax law also provide for levy of penalty and prosecution for failure to produce accounts and documents, failure to deduct or pay tax, etc.

(i) Income-tax and Corporation-tax

(a) penalty proceedings initiated, disposed of and pending for each of the three years ending 1988-89 were as under:—

Year	Cases pending at the beginning of the year	Added during the year	Total	No. of cases disposed of during the year	Cases pending
1986-87	6,86,830	4,62,870	11,49,700	5,73,201	5,76,499
1987-88	5,81,697	4,12,005	9,93,702	5,30.777	4,62,925
1988-89*	3,92,039	3,84,198	7,76,237	4,09,448	3,66,789

(b) Prosecutions launched, convicted/compounded and cases pending in the courts for the three years ending 1988-89 were as under :—

Year	Pending at the beginning of the year	Complaints filed, during the year	Total	No. of cases disposed of during the year	No. of cases			Total	Balance
					Convicted	Compounded	Acquitted		
1986-87	8,081	4,543	12,624	663	56	258	349	663	11,961
1987-88	12,801	6,622	19,423	812	297	251	274	822	18,611
1988-89*	17,263	7,205	24,468	985	184	604	197	985	23,483

(c) Penalty and composition money levied, collected and pending for the three years 1986-87 to 1988-89 were as under:—

(Rs. in thousands)

Year	Opening Balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	Composition Money	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money
1986-87	6,74,919**	12,573	3,46,314	13.054	1,53,825	6,125	8,67,408	19,502
1987-88	10,07,780	10,059	4,21,453	4,189	2,15,459	6,287	12,13,774	7,961
1988-89**	9,63,683	3,896	9,99,298	3,812	2,23,831	3,892	17,39,150	3,816

(ii) Other Direct Taxes

(a) Penalty proceedings initiated, disposed of and pending for each of the three years ending 1988-89 are given below:—

Year	Pending at the beginning of the year	Added during the year	Total	No. of cases disposed of during the year	Cases pending
1986-87	1,20,887	68,393	1,89,280	75,445	1,13,835
1987-88	1,08,497	59,343	1,67,840	73,650	94,190
1988-89**	80,043	39,109	1,19,152	52,917	66,235

*Figures furnished by the Ministry of Finance are provisional.

**Figures are under reconciliation by the Ministry of Finance.

(b) Prosecutions launched, convicted/compounded and cases pending in the Courts for the three years ending 1988-89 are given below:—

Year	Pending at the beginning of the year	Complaints filed during the year	Total	No. of cases disposed of	No. of cases: Convicted	Compounded	Acquitted	Total	Cases pending
1986-87	540	119	659	114	112	—	2	114	545
1987-88**	608	368	976	29	5	2	15	22	947
1988-89*	2,721	679	3,400	3	—	—	3	3	3,397

(c) Penalty and composition money levied, collected and pending for the three years 1986-87 to 1988-89 are given below:—

(Rs. in thousands)

Year	Opening Balance		Levied during the year		Collected during the year		Balance outstanding	
	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money	Penalty	Composition money
1986-87	50,833	50	33,943.3	10	11,554	50	73,222.3	10
1987-88	1,22,282	95	37,586	744	34,539	453	1,25,329	386
1988-89*	74,234	366	45,460	62	34,516	241	85,178	187

1.13 Searches and Seizures

Sections 132, 132-A and 132-B of the Income-tax Act, 1961 provide for search and seizure operations. A search has to be authorised by a Director of Inspection, Commissioner of Income-tax or a specified Dy. Director of Inspection or Inspecting Assistant Commissioner. Where any money, bullion, Jewellery or other valuable article or thing is seized, the Income-tax Officer has, after necessary investigations, to make an order with the approval of the I.A.C. within 90 days of the seizure, estimating the undisclosed income in a summary manner on the basis of the material available with him and calculating the amount of tax on the income so estimated, specifying the amount that will be required to satisfy any existing liability and retain in his custody such assets as are, in his opinion sufficient to satisfy the aggregate of the tax demands and forthwith release the remaining portion, if any, of the assets to the persons from whose custody they were seized. The books of accounts and other documents cannot be retained by the authorised officer for more than 180 days from the date of seizure unless the Commissioner approved of the retention for a longer period.

(i) The number of cases in which searches and seizures were conducted for the three years ending 1986-87 to 1988-89 was as under :—

Year	No. of cases where cash, jewellery etc. assets were seized: No.	Value (Rs. in thousands)	No. of cases where no assets were seized
1986-87	4,376	7,69,700	2,406
1987-88	3,735	14,16,793	3,136
1988-89*	2,610	9,56,165	2,120

(ii) (a) particulars of orders under Section 132(5) passed during the three years ending 1988-89 were as under:

Year	Opening balance of cases	Search cases during the year	Total	No. of cases where orders were passed during the year	No. of cases pending at the end of the year
1986-87	2,548	3,325	5,873	3,678	2,195
1987-88**	1,496	2,865	4,361	2,907	1,454
1988-89*	1,195	2,739	3,934	2,412	1,522

(b) Particulars of income determined in the orders under section 132(5), tax involved therein, assets retained and assets returned of the three years ending 1988-89 were as under:—

(Rs. in thousands)

Year	No. of cases where orders were passed	Income determined in the orders	Tax involved therein	Value of assets retained	Value of assets returned
1986-87	1,693	14,14,474	10,05,150	5,13,231	65,912
1987-88	2,220	20,45,954	16,18,189	6,11,553	1,42,632
1988-89*	2,400	26,15,492	21,41,137	13,21,591	1,02,941

*Figures furnished by the Ministry of Finance are provisional.
**Figures are under reconciliation by the Ministry of Finance.

(iii) (a) The number of search cases out of(ii) (b) where final assessments were completed and pending for the three years ending 1988-89 was as under :—

Year	Opening Balance of orders u/s 132 (5)	Orders U/s 132(5) passed during the year	Total	No. of cases where final assessments were completed			Balance cases
				Where concealed income was found	With No. concealed income	Total	
1986-87	1,136	1,443	2,579	684	285	969	1,610
1987-88**	1,595	2,420	4,015	1,157	683	1,840	2,175
1988-89*	1,527	2,864	4,391	1,214	674	1,888	2,503

(b)* Year-wise particulars of pendency of orders under section 132 (5) where final assessments were pending as on 31 March 1989 were as under :—

Year in which summary assessments were made	No. of cases where final assessments were pending	Out of (2) No. of cases with Settlement Commission
(1)	(2)	(3)
1986-87	599	158
1987-88	1,189	152
1988-89	1,742	360

(c) Particulars of income determined, tax levied, balance-tax outstanding after adjustment of value of assets retained on final assessment for the three years ending 1988-89 were as under :

(Rs. in thousands)

Year	No. of cases where final assessments were completed	Income-determined	Demand raised			Demand adjusted out of retained assets	Balance Pending recovery		
			Tax	Penalty	Total		Tax	Penalty	Total
1986-87	1,475	8,66,422	5,02,553	4,859	5,07,412	78,216	4,25,176	4,020	4,29,196
1987-88	2,411	12,33,663	8,15,260	85,103	9,00,363	57,792	7,65,368	77,203	8,42,571
1988-89*	3,692	19,28,770	11,39,033	78,693	12,17,726	72,976	10,69,928	74,822	11,44,750

(d) The number of cases of prosecutions launched, compounded and convictions obtained for the three years ending 1988-89 was as under :

Year	No. of prosecutions launched			No. of cases compounded	No. of cases in which convictions were obtained	No. of cases pending
	Opening Balance	During the year	Total			
1986-87	2,723	931	3,654	128	12	3,373
1987-88**	3,336	835	4,171	163	7	4,008
1988-89*	2,548	921	3,469	326	41	3,143

(c) Particulars of cases of assets returned, interest paid and cases pending for three years ending 1988-89 were as under :—

Year	No. of cases where assets were due for return			Number of cases where assets returned during the year	Number of cases where interest paid	Balance cases pending
	Opening balance	Added during the year	Total			
1986-87	95	133	228	103	1	125
1987-88**	144	290	434	183	9	251
1988-89*	162	174	336	172	4	164

*Figures furnished by the Ministry of Finance are provisional.
**Figures are under reconciliation by the Ministry of Finance.

1.14 Survey

1. Number of cases where the powers of survey (other than those relating to ostentatious expenditure) were exercised for the three years ending 1988-89.

Year	No. of premises surveyed
1986-87	42,816
1987-88	9,659
1988-89*	7,804

2.* Number of cases where evidence about ostentatious expenditure was collected under section 133A(5).

Year	No. of cases
1986-87	46
1987-88	219
1988-89	116

1.15 Acquisition of Immovable Properties

1. Acquisition proceedings introduced with effect from 15 November 1972, empowers the Central Government to acquire an immovable property, where such property is transferred by sale or exchange and the true consideration for such transfer is concealed with the objective of evading tax. The scope of these provisions has been extended through the Income-tax (Amendment) Act, 1981 with effect from 1 July 1982 to cover :—

(a) transfer of flats or premises owned through the medium of co-operative societies and companies ;

(b) agreements of sale followed by part performance viz., by actual physical possession of the property by the de facto buyer ; and

(c) long term leases i.e. leases for a period of 12 years or more.

The provisions were introduced in the Statute on the recommendations of the Direct Taxes Enquiry Committee, popularly known as Wanchoo Committee (1971) report on black money. The objective of the legislation is to counter evasion of tax through under-statement of the value of immovable property in sale deeds and also to check the circulation of black money, by empowering the Central Government to acquire immovable properties, including agricultural lands.

2. Acquisition proceedings under these provisions can be initiated where an immovable property of fair market value exceeding Rs. 25,000 (Rs. 1 lakh with effect from 1 June 1984) is transferred for any apparent monetary consideration, which is less than the fair market value by more than 15 per cent of the apparent monetary consideration. The compensation payable on acquisition is the amount of the monetary consideration shown in the transfer document plus 15 per cent of such amount. Regarding taking over and management of the immovable properties vested in the Government under the provisions of the Income-tax Act, it was agreed in November 1976 in the Ministry of Works and Housing and the Ministry of Finance, that the Central Public Works Department would take over the immovable properties from the Revenue authorities after the forfeiture had become absolute, and under all formalities relating to appeal etc., provided under the law have been completed and manage the same. Accordingly, the Central Board of Direct Taxes issued instructions in May 1977.

3. With effect from 1 October 1986, the provisions of Chapter XXA of the Income-tax Act, 1961 do not apply to or in relation to the transfer of any immovable property made after the 30 September 1986 (Section 269 RR).

(i) *Number of Assistant Commissioners of Income-tax engaged on the work for the year 1988-89.

	Sanctioned strength	Working strength
At the commencement of the year	34	26
At the close of the year	37	13

(ii) The number of intimations in Form 37-G received from the Registering Authorities during the three years ending 1988-89 was as under :—

Year	No. of Intimations received
1986-87	2,43,871
1987-88	52,401
1988-89*	21,617

(iii) (a) The number of notices issued, dropped, acquisition orders passed and notices pending for three years ending 1988-89 was as under :—

Year	Opening Balance	No. of notices issued during the year	Total	No. of notices dropped during the year	No. of cases where orders were passed	No. Pending
1986-87	43,097	18,726	61,823	54,170	87	7,566
1987-88	12,037	2,051	14,088	7,730	99	6,259
1988-89*	5,155	10,201	15,356	13,620	70	1,666

*Figures furnished by the Ministry of Finance are provisional.

(b) *Year-wise particulars of pendency as on 31 March 1989 were as under :—

Year of institution	No. of notices pending
1986-87 and earlier year	860
1987-88	785
1988-89	21
Total	1,666

(iv) The number of cases where acquisition orders were passed, properties acquired and the balance pending for the three years ending 1988-89 was as under :—

Year	No. of cases where orders were passed			No. of cases where properties were actually taken over	Balance No.
	Opening balance	During the year	Total		
1986-87	664	31	695	—	695
1987-88	1,252	99	1,351	—	1,351
1988-89*	753	46	799	—	799

(v)** The particulars of disposal of cquired properties :—

Year	Details of properties acquired		No. of properties disposed of	Nature of disposal						Properties awaiting disposal	
				By sale		Appropriation for own use		Other			
	No.	Compen-sation paid		No	Sale value	No.	Compensation paid	No	Amount	No	Compensa-tion paid
	(1)		(2)	(3)		(4)		(5)		(6)	
	(a)	(b)		(a)	(b)	(a)	(b)	(a)	(b)	(a)	(b)

1.16 Purchase by Central Government of immovable properties in certain cases of transfer

With a view to counter tax evasion and to curb the circulation of black money in real estate transactions, a new Chapter XXC was inserted in the Income-tax Act, 1961, with effect from 1 October, 1986 empowering the Central Government to purchase immovable properties in certain cases of transfer. To begin with, these provisions are made applicable in respect of properties proposed to be transferred for an apparent consideration exceeding Rs. 10 lakhs in each case in the metropolitan cities of Bombay, Calcutta, Delhi and Madras. It has been extended to Bangalore and Ahmedabad from 1 October, 1987.

*During the Financial year ended March 1989 details of properties purchased by the Central Government were as under :—

	Delhi	Bombay	Calcutta	Madras	Ahmedabad	Total
(*i*) No. of statements received in Form 37-I	581	1,206	159	383	59	2,388
(*ii*) No. of properties purchased	21	36	9	25	4	95
(*iii*) Value of properties purchased (Rs. in crore')	8.68	15.58	7.54	8.17	16	55.97
(*iv*) No. of value of properties where consideration exceeds Rs. 50 lakhs	6	10	3	4	1	24

1.17 Functioning of Valuation Cells

1. The Central Government established in October 1968 a departmental Valuation Cell manned by Engineering Officers taken on deputation from the Central Public Works Department to assist the assessing officers under various direct tax laws. Certain details about the functioning of the valuation units under the Cell are given in the following sub paragraphs :—

(i) No. of valuation units/Districts :—

Year	No. of valuation units	No. of valuation Districts
1984-85	79	11
1985-86	78	12
1986-87	78	13
1987-88	71	13
1988-89	71	13

(ii) No. of cases referred to valuation cells, disposed of and pending at the end of the each of three years ending 1988-89

	Year	No. for disposal at the beginning of the year	No. of cases referred during the year	Disposed of during the year	Pending at the end of the year
(*a*) Income-tax	1986-87	4,613	7,048	9,364	2,297
	1987-88	2,297	4,601	5,513	1,385
	1988-89	4,613	7,048	9,364	2,297

*Figures furnished by the Ministry of Finance are provisional.
**Information from the Ministry of Finance is awaited.

(b) Wealth-tax	1986-87	4,870	8,660	9,874	3,656
	1987-88	3,656	11,078	10,178	4,556
	1988-89	4,870	8,660	9,874	3,656
(c) Gift-tax	1986-87	56	161	132	85
	1987-88	85	143	174	54
	1988-89	56	161	132	85
(d) Estate Duty	1986-87	96	129	162	63
	1987-88	63	59	92	30
	1988-89	96	129	162	63

1.18 Revenue demands written off by the department

1. Income-tax

A demand of Rs. 1,623.24 lakhs in 1,36,564 cases was written off by the department during the year 1988-89* and of this, a sum of Rs. 20.68 lakhs related to 302 company assessees and Rs. 1602.56 lakhs to 1,36,262 non-company assessees. Income-tax demand written off by the department during the year 1988-89* are given below category-wise :

(Amount in lakhs of Rupees)

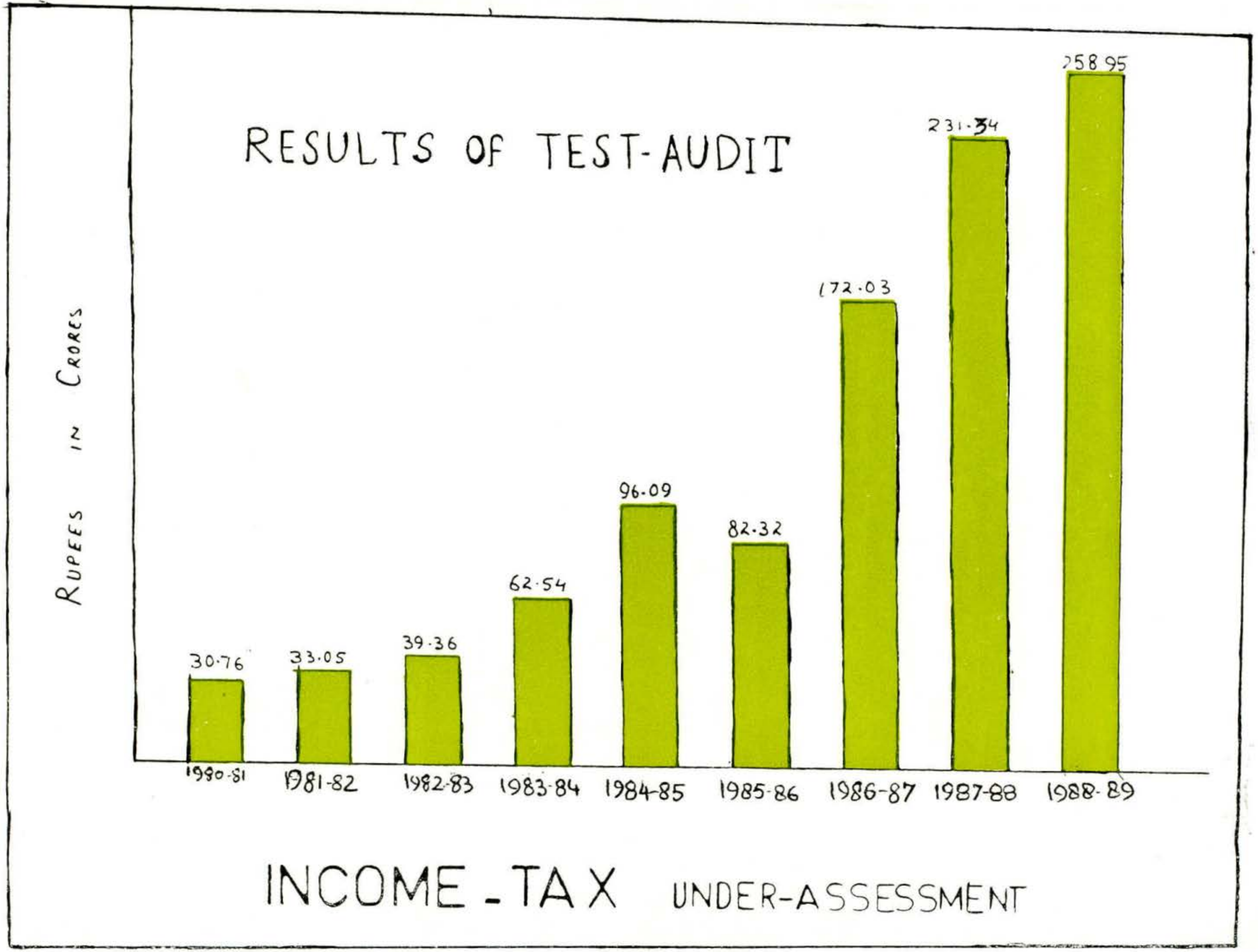
	Companies		Non-companies		Total	
	No.	Amount	No.	Amount	No.	Amount
I. (a) Assessees having died leaving behind no assets or have become insolvent or gone into liquidation	2	80	376	2,117	378	2,197
(b) Companies which have gone into liquidation or are defunct	235	830	34	1,813.6	269	2,643.6
Total	237	910	410	3,930.6	647	4,840.6
II. Assessees being untraceable	65	1,158	33,317	35,397.3	33,382	36,555.3
III. Assessees having left India	—	—	234	932	234	932
IV. Other reasons :						
(a) Assessees having no attachable assets	—	—	7,334	4,263.5	7,334	4,263.5
(b) Amount being petty, etc.	—	—	75,994	97,143.5	75,994	97,143.5
(c) Amount written off as a result of scaling down of demand	—	—	18,930	18,578.7	18,930	18,578.7
Total	—	—	1,02,258	1,19,985.7	1,02,258	1,19,985.7
V. Amount written off on grounds of equity or as a matter of international courtesy or where time, labour and expenses involved in legal remedies for realisation are considered disproportionate to the amount of recovery	—	—	43	10	43	10
Grand Total	302	2,068	1,36,262	1,60,255.6	1,36,564	1,62,323.6

2*. Wealth-tax, Gift-tax and Estate Duty demands written off by the department during the year 1988-89 are given below category wise

(Amount in lakhs of Rs.)

	Wealth-tax		Gift-tax		Estate-Duty	
	No.	Amount	No.	Amount	No.	Amount
I. (a) Assessee having died leaving behind no assets	1	6	—	—	—	—
(b) Assessee having become insolvent	—	—	—	—	—	—
Total	1	6	—	—	—	—
II. Assessees being untraceable	27	52	13	18	—	—
III. Assessee having left India	—	—	7	2	—	—
IV. Other reasons :						
(a) Assessees who are alive but have no attachable assets	—	—	—	—	—	—
(b) Amount being petty, etc.	301	49	195	5	—	—
(c) Amount written off as a result of settlement with assessees	—	—	—	—	—	—
Total	301	49	195	5	—	—
V. Amount written off on grounds of equity or as a matter of international courtesy or where the time, labour and expenses involved in legal remedies for realisation are considered disproportionate to the amount of recovery	—	—	—	—	—	—
GRAND TOTAL	329	107	215	25	—	—

*Figures furnished by the Ministry of Finance are provisional.


RESULTS OF TEST-AUDIT
RUPEES IN CRORES
30·76
33·05
39·36
62·54
96·09
82·32
172·03
231·34
258·95
1980-81
1981-82
1982-83
1983-84
1984-85
1985-86
1986-87
1987-88
1988-89
INCOME-TAX UNDER-ASSESSMENT

1.19 Results of test audit in general

1. During the period 1 April 1988 to 31 March 1989 in the test audit of the documents of the Income-tax Offices etc., 17,653 cases of under-assessment involving a total revenue effect of Rs. 25,895.39 lakhs were noticed. Besides these, various defects in following prescribed procedure also came to the notice of audit.

(i) Corporation-tax and Income-tax

During the period under report, test audit of the documents of the Income-tax Offices revealed total under-assessment of tax of Rs. 24,946.74 lakhs in 14,864 cases. Of the total 14,864 cases of under-assessment, short levy of tax of Rs. 21,224.70 lakhs was noticed in 5,300 cases alone. The remaining 9,564 cases accounted for under-assessment of tax of Rs. 3,722.04 lakhs.

The under-assessment of tax of Rs. 24,946.74 lakhs was due to mistakes categorised broadly under the following heads :

		No. of cases	Amount (In lakhs of rupees)
1.	Avoidable mistakes in computation of Income and tax	679	1,121.38
2.	Failure to observe the provisions of the Finance Acts	409	421.96
3.	Incorrect status adopted in assessments	240	149.06
4.	Incorrect computation of salary income	523	73.59
5.	Incorrect computation of income from house property	290	128.31
6.	Incorrect computation of business income	3,603	9,260.26
7.	Irregularties in allowing depreciation, investment allowance and development rebate	1,497	3,852.94
8.	Irregular computation of capital gains	194	365.18
9.	Mistakes in assessment of firms and partners	502	239.40
10.	Omission to include income of spouse/minor child etc.	40	32.70
11.	Income escaping assessment	1,527	1,920.17
12.	Irregular set off of losses	290	2,387.61
13.	Mistakes in assessments while giving effect to appellate orders	70	102.00
14.	Irregular exemptions and excess relief given	1,202	1,488.35
15.	Excess or irregular refunds	287	118.64
16.	Non-levy/incorrect levy of interest for delay in submission of returns, delay in payment of tax etc.	1,070	546.01
17.	Avoidable or incorrect payment of interest by Government	102	241.25
18.	Omission/short levy of penalty	923	589.41
19.	Other topics of interest/miscellaneous	1,264	1,037.49
20.	Under assessment of surtax	152	871.03
	Total	14,864	24,946.74

(ii) Wealth-tax

During test audit of assessments made under the wealth-tax Act, 1957, short levy of Rs. 383.80 lakhs was noticed in 2188 cases.

The under-assessment of tax of Rs. 383.80 lakhs was due to mistakes categorised under the following heads :—

		No. of cases	Amount (In lakhs of rupees)
1.	Wealth escaping assessment	682	106.84
2.	Incorrect valuation of assets	444	94.22
3.	Mistakes in computation of net wealth	226	50.63
4.	Incorrect status adopted in assessments	95	6.92
5.	Irregular/excessive allowance and exemptions	262	22.15
6.	Mistakes in calculation of tax	132	11.04
7.	Non-levy or incorrect levy of additional wealth-tax	30	37.02
8.	Non-levy or incorrect levy of penalty and non levy of interest	199	50.05
9.	Miscellaneous	118	4.93
	Total	2,188	383.80

(iii) Gift-tax

During the test audit of gift-tax assessments it was noticed that in 350 cases there was short levy of Rs. 466.25 lakhs.

(iv) Estate Duty

In the test audit of estate-duty assessments it was noticed that in 251 cases there was short levy of estate duty of Rs. 98.60 lakhs.

1.20 Outstanding audit objections

As on 31 March 1989, 81,785 audit objections involving revenue of Rs. 638.97 crores (approximately) raised by both the Internal Audit of the Department and the Statutory Audit, are pending without settlement. Of these, 10,866 major cases (with tax effect of Rs. 10,000 and above, under the income tax and Rs. 1,000 and above under the other direct taxes) are of the Internal Audit, accounting for Rs. 210.86 crores. The remaining 70,919 cases were statutory audit objections, involving Rs. 428.11 crores.

(i) Internal Audit

As per the information furnished by the Directorate of Inspection (Income-tax and Audit) of the department, the number of major objections of the Internal Audit disposed of during the five year period of 1984-85 to 1988-89 and the number pending as at the end of these years are given below :—

Financial Year	No. of cases for disposal and amount	No. of cases disposed of and amount	Percentage of disposal to total number of cases for disposal	No. of pending cases and amount
1984-85	15,985	6,647	42	9,338
	145.24	55.74	38	89.50
1985-86	15,737	8,006	51	7,731
	229.78	93.15	41	136.63
1986-87	15,666	5,514	35	10,152
	414.44	94.46	21	319.98
1987-88	18,284	7,189	39	11,095
	451.22	234.49	52	216.73
1988-89	18,840	7,974	42	10,866
	411.75	200.89	49	210.86

The year-wise analysis of the age of the pending items at the end of 1988-89 viz. one year old, 2 years old etc. and revenue effect involved are given below :—

Year in which objections raised	No. of cases	Revenue effect
	(Amount in crores of rupees)	
1984-85 and earlier years	118	2.07
1985-86	655	23.77
1986-87	1,929	29.06
1987-88	1,751	36.07
1988-89	6,413	119.89
Total	10,866	210.86

The Public Accounts Committee in their 150th Report (Eighth Lok Sabha) with a view to avoid action becoming time-barred, have recommended that internal audit objections should also be analysed with reference to the year of assessment apart from the year in which the objections were raised so that greater attention could be given to the settlement of objections relating to earlier years.

(*ii*) *Statutory Audit*

As on 31 March 1989, 70,919 objections involving a revenue of Rs. 428.11 crores, are outstanding without final action. The year-wise particulars of the pendency, as compared to the position as on 31 March 1988 are as follows :—

(*a*) Statement showing year-wise particulars of pendency of objections, as compared to the position as on 31 March 1988.

(Amount in crores of rupees)

Year	Position	Income-tax		Wealth-tax		Gift-tax		Estate Duty		Total	
		Items	Revenue effect	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect	Items	Revenue effect
Upto 1983-84 and earlier years	(*i*) 31-3-88	30,651	75.52	5,855	9.19	1,137	5.94	669	8.94	38,312	99.59
	(*ii*) 31-3-89	26,400	61.39	4,571	8.33	786	5.40	532	8.46	32,289	83.58
1984-85	(*i*) 31-3-88	6,932	35.83	1,127	1.25	217	1.90	166	0.41	8,442	39.39
	(*ii*) 31-3-89	5,415	26.47	792	0.63	171	1.79	95	0.32	6,473	29.21
1985-86	(*i*) 31-3-88	9,496	45.76	1,452	2.05	232	1.09	199	0.47	11,379	49.37
	(*ii*) 31-3-89	7,760	33.99	1,106	1.79	188	1.05	136	0.38	9,190	37.21
1986-87	(*i*) 31-3-88	11,236	104.92	1,837	2.39	345	3.05	346	0.84	13,764	111.20
	(*ii*) 31-3-89	8,759	89.91	1,412	1.87	238	2.93	214	0.69	10,623	95.40
1987-88	(*i*) 31-3-89	9,985	172.02	1,759	4.77	331	4.60	269	1.32	12,344	182.71
Total	(*i*) 31-3-88	58,315	262.03	10,271	14.88	1,931	11.98	1,380	10.66	71,897	299.55
	(*ii*) 31-3-89	58,319	383.78	9,640	17.39	1,714	15.77	1,246	11.17	70,919	428.11

During the year 1988-89 though there was a decrease in the number of outstanding objections by 978 (1 per cent) items, the revenue effect of the outstanding objections had increased by Rs. 128.56 crores over that of the earlier year.

(*b*) There were 373 cases where the income-tax involved in each individual case exceeded rupees 10 lakhs. The charge wise and year-wise break-up of these cases are :—

Sl. No.	Name of Charge	Upto 1983-84 and earlier years		1984-85		1985-86		1986-87		1987-88		Total	
		Items	Amount	Items	Amount	Items	Amount	Items	Amount	Items	Amount	Items	Amount
										(Amount in lakhs of rupees)			
1	Maharashtra	20	623.99	3	47.14	14	363.09	24	1,659.10	59	2,189.27	120	4,882.59
2	Uttar Pradesh	1	14.33	1	988.38	—	—	4	502.53	4	315.81	10	1,821.05
3	Assam	2	34.59	1	19.70	—	—	—	—	6	357.80	9	412.09
4	Bihar	—	—	1	36.06	1	17.52	2	47.40	8	218.48	12	319.46
5	Madhya Pradesh	—	—	—	—	9	428.83	1	16.12	3	65.36	13	510.31
6	Kerala	—	—	1	15.53	1	13.41	—	—	1	11.72	3	40.66
7	West Bengal	4	145.05	3	69.78	—	—	11	277.07	35	1,873.97	53	2,365.87
8	Rajasthan	—	—	—	—	—	—	2	47.15	2	23.89	4	71.04
9	Tamil Nadu	1	132.38	—	—	7	160.79	35	1,301.83	18	816.84	61	2,411.84
10	Karnataka	1	13.21	1	12.06	2	73.81	3	84.71	14	876.57	21	1,060.36
11	Andhra Pradesh	—	—	—	—	3	53.09	2	24.94	3	50.31	8	128.34
12	Gujarat	3	65.40	—	—	—	—	2	29.08	8	155.53	13	250.01
13	Delhi	7	249.21	—	—	3	37.13	5	354.42	30	1,888.27	45	2,529.03
14	Haryana	—	—	—	—	—	—	1	12.42	—	—	1	12.42
	Total	39	1,278.16	11	1,188.65	40	1,147.67	92	4,356.77	191	8,843.82	373	16,815.07

(*c*) The particulars of the number of cases where the wealth-tax involved in each case exceeded rupees 5 lakhs are as under :—

Sl. No.	Name of charge	Upto 1983-84 and earlier years		1984-85		1985-86		1986-87		1987-88		Total	
		Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount
										(Amount in lakhs of rupees)			
1	Maharashtra	2	39.49	—	—	—	—	1	12.95	1	15.94	4	68.38
2	Kerala	—	—	—	—	—	—	1	5.83	—	—	1	5.83
3	Madhya Pradesh	3	56.23	—	—	3	65.90	—	—	—	—	6	122.06
4	Andhra Pradesh	1	122.06	—	—	—	—	—	—	—	—	1	122.06
5	Delhi	1	21.30	—	—	1	5.62	—	—	—	—	2	26.92
6	Tamil Nadu	—	—	—	—	—	—	—	—	5	127.49	5	127.49
7	West Bengal	—	—	—	—	—	—	—	—	2	26.10	2	26.10
8	Karnataka	—	—	—	—	—	—	—	—	1	54.33	1	54.33
9	Gujarat	—	—	—	—	—	—	—	—	1	6.35	1	6.35
	Total	7	239.08	—	—	4	71.52	2	18.78	10	230.21	23	559.59

(*d*) The particulars of the number of cases where the total gift tax involved in each case exceeded Rupees 5 lakhs are given below:—

Sl. No.	Name of charge	Upto 1983-84 and earlier years		1984-85		1985-86		1986-87		1987-88		Total	
		Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount
										(Amount in lakhs of rupees)			
1	Maharashtra	3	40.41	2	122.28	—	—	—	—	3	242.03	8	404.72
2	Tamil Nadu	—	—	—	—	2	25.24	2	153.33	2	55.74	6	234.31
3	Gujarat	9	247.34	—	—	—	—	—	—	5	63.35	14	310.69
4	Haryana	—	—	—	—	—	—	1	32.98	—	—	1	32.98
5	Kerala	—	—	—	—	2	26.77	—	—	—	—	2	26.77
6	Karnataka	—	—	—	—	—	—	—	—	3	72.58	3	72.58
	Total	12	287.75	2	122.28	4	52.01	3	186.31	13	433.70	34	1,082.05

(e) The particulars of the number of cases where the total estate duty involved in each case exceeded rupees 5 lakhs are as shown below :—

Sl. No.	Name of charge	Upto 1983-84 and earlier years		1984-85		1985-86		1986-87		1987-88		Total	
		Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount	Item Nos.	Amount
										(Amount in lakhs of rupees)			
1	Tamil Nadu	—	—	—	—	—	—	—	—	1	21.56	1	21.56
2	Andhra Pradesh	6	701.62	—	—	—	—	—	—	—	—	6	701.62
3	Madhya Pradesh	1	46.81	—	—	—	—	—	—	—	—	1	46.81
4	West Bengal	—	—	1	5.08	—	—	—	—	1	6.22	2	11.30
	Total	7	748.43	1	5.08	—	—	—	—	2	27.78	10	781.29

The total number and amount of pendency in respect of major audit objections involving Rs. 10 lakhs and above as regards income-tax and Rs. 5 lakhs and above as regards other direct taxes, is given below :—

	No. of cases	Amount (Rs. in crores)
(i) Income-tax	373	168.15
(ii) Other Direct Taxes	67	24.23
Total	440	192.38

Out of a total pendency of 70,919 cases, involving a revenue effect of Rs. 428.11 crores, 440 cases accounted for a revenue effect of Rs. 192.38 crores (45 per cent). The Department should devote more attention to cases involving larger revenue effect by assigning priority in the matter of their settlement.

(iii) Steps taken to settle objections

(a) The inadequacy of control machanism in the department to ensure timely settlement of audit objections, despite recommendations of the Public Accounts Committee to that effect in its report, and the loss of revenue due to time bar in certain cases were pointed out in Audit Reports 1984-85 to 1987-88. In their 150th report (Eighth Lok Sabha) empahsising the role of statutory audit as an important instrument in the mechanism evolved under the constitution for ensuring accountability of the executive in its financial management to the Legislature, the Committee considered it, 'unfortunate that adequate attention has not been given to prompt settlement of audit objections and a very large number of objections with a considerably large tax effect continue to be outstanding for want of settlement. The Committee accordingly observed 'that mere issuing of instructions could not be of much avail in improving the situation unless adequate steps are taken to ensure effective implementation of the instructions.

The machinery of inter-departmental periodical meetings between the officers of the two departments introduced from Feburary 1984, for the settlement of outstanding audit objections and to sort out contentious issues as, indicated in the Audit Report 1984-85, has not borne the desired result during the year 1988-89 also in as much as 32,289 outstanding objections involving revenue effect of Rs. 83.58 crores relating to 1983-84 and earlier years were outstanding as on 31 March 1989.

The control system apparently continues to be inadequate and the pace of settlement of the outstanding objections continues to be slow.

The Action Plan target of the department for 1988-89 included disposal of 90 per cent of all pending major audit objections (both of internal and statutory audits) and stipulated that in respect of all objections received upto 31 December 1988, replies should be sent by 31 March 1989. The targets are no where near achievement during the current year 1988-89 also.

(b) Remedial action barred by time

(i) The Central Board of Direct Taxes have issued specific instructions to take timely action on audit objections so as to avoid cases becoming time-barred leading to loss of revenue. The Public Accounts Committee (150th Report—Eighth Lok Sabha) have also recommended that the Board may review old outstanding objections in cooperation with audit.

Nevertheless, instances were noticed in test check during 1988-89 where remedial action became barred by limitation, resulting in loss of revenue of Rs. 4.13 lakhs. A few of such cases are :—

Sl. No.	State	Assessment year	Nature of objection	Date of pointing out of mistake by Receipt Audit	Date upto which rectificatory action could be taken	Loss of revenue (Rupees)
1	Karnataka	1981-82	Non-completion of assessment within time limit	September 1988	March 1987	1,08,870
2	Tamil Nadu	1980-81	Do.	July 1988	March 1987	41,860

In one case the Ministry of Finance have accepted the objection.

(*ii*) In the assessment of a public sector road transport corporation, for the assessment year 1978-79 completed in June 1981 (revised in March 1982 and June 1986), weighted deduction of Rs. 9,33,333 at one and one-third the payment made to an Institute of Road Transport and Rs. 3,53,706 in respect of payment to a Training Institute was allowed. As the approval of the programme of the Institute by the prescribed authority was not available and time limit to revise the assessment was available upto June 1983, the non-withdrawal of the excess deduction of Rs. 3,51,235 (Rs. 2,33,333 plus Rs. 1,17,902), despite Internal Audit Party of the department pointed out the mistake in November 1987, resulted in loss of revenue of Rs. 2,62,199 including surtax, due to time bar.

The Ministry of Finance have accepted the objection.

(*c*) *Omission to take timely action on internal audit objections.*

According to the executive instructions issued in 1977, mistakes pointed out by Internal Audit parties of the department should be rectified by the assessing authorities promptly. The remedial action should be initiated within a month and completed as far as possible within three months of the report of Internal Audit. In spite of the Internal Audit Wing pointing out mistakes in assessments involving large revenue effect and despite the above instructions of the Board, failures to take remedial action on internal audit objections were noticed in audit. In respect of objections having substantial tax effect the Public Accounts Committee (150th Report-Eighth Lok Sabha) have recommended that serious note might be taken of and remedial action ensured within a prescribed time limit, in any case not exceeding 6 months from the date of raising objections by audit.

Certain instances where the department failed to take timely action on internal audit objections, which were noticed in test check during 1988-89, are given below :—

Sl. No.	State	Assessment year	Nature of objection	Date of pointing out of the mistake by Internal/Special Audit of the department	Date of pointing out omission by Receipt Audit	Tax effect (Rupees)
1	Tamil Nadu	1985-86	Mistake in carry forward of unabsorbed depreciation allowance	June 1987	July 1988	6,96,447
2	Tamil Nadu	1984-85	Incorrect deductions of non-allowable reserves	August 1987	September 1988	4,77,185
3	Tamil Nadu	1978-79	Mistake in adding back of depreciation while computing business income.	September 1985	April 1987	88,993

(iv) *Non-receipt of Board's comments on draft paragraphs*

Under the existing arrangement, sufficient time (about 7-8 months) is made available to the Income-tax Department for dealing with all important audit observations, having substantial tax effect so that Department's comments and Ministry's remarks could be incorporated in the Audit Report, while reporting such cases. The Public Accounts Committee have also recommended (150th Report—Eighth Lok Sabha) that the existing procedure need to be tightened and dilatory practices need to be speeded up sufficiently to ensure that replies to audit paragraphs are invariably furnished within the prescribed period of six weeks from the date of issue. However, despite Board's instructions that all important audit observations should receive the personal attention of the Commissioners of Income-tax for expeditious action, inordinate delays continue to occur in the receipt of Department's replies. For Audit Report 1988-89, 1,442 draft paras (on Income-tax, Wealth-tax, Gift-tax, Estate Duty and Interest tax cases) involving a revenue effect of Rs. 107 crores were issued to the Board during January 1989 to August 1989 but Board's replies have been received only in respect of 676 draft paragraphs (47 per cent) so far (December 1989).

The paragraph was referred to the Ministry of Finance for comments in October 1989; the reply from the Government has not so far been received (November 1989).

CHAPTER 2

SYSTEM APPRAISALS

2.01 Assessments of lottery business

Introductory

2.01.1 Lotteries organised by the Government of India or the Government of a State appear in the Union list in the VII Schedule to the Constitution of India and the Parliament is vested with the powers to make laws governing such lotteries. Lotteries organized by any other agency come under the general entry 'Betting and Gambling' in the State list, and would be subject to regulation by Acts enacted by the respective States.

Several State Governments presently conduct lotteries as a means to mobilise additional resources for financing developmental activities and public utility services. Under the provisions of the State Lottery Acts/Rules, licences are also issued for promotion of private lotteries for social welfare purposes.

General features of lottery scheme

2.01.2 Test audit revealed that 14 State Governments conduct lotteries departmentally, while many other State Governments conduct them through private agencies, who either pay royalties to the State Governments or act as sole selling agents on commission basis. Some of the promotors of private lotteries also depend on organising agents to conduct the lotteries on guaranteed profits basis or appoint stockists and agents on payment of commission, for arraging the sales of lottery tickets.

Law and procedure

2.01.3 Prior to 1 April 1972, casual and non-recurring receipts were not regarded as income under the Income-tax Act, 1961. The Direct Taxes Enquiry Committee appointed by the Government of India in 1971, known as Wanchoo Committee, considered this position and recommended withdrawal of the exemption on the ground that it provided scope for avoidance of tax and conversion of black money into white through purchase of prize winning tickets at a premium. Accordingly, the Act was amended in 1972 by rendering income from lotteries assessable to tax under the head 'Income from other sources'. The law as it stood upto the assessment year 1986-87 provided for deductions in respect of expenses in earning the income from winnings from lotteries, while computing the income by way of winnings from lotteries. With effect from 1 April 1987 (assessment year 1987-88) winnings from lotteries is taxed at the rate of 40 per cent, subject to a flat deduction of Rs. 5,000 (for the aggregate casual receipts), without any further allowance or deduction in earning the income.

The Act makes it obligatory for every person responsible for paying winnings from lottery to deduct income-tax at source, at the rates specified in the Finance Act of the relevant year. He is also required by law to send to his jurisdictional Income-tax Officer statements of such deductions in a prescribed form, every quarter, by July 15, October 15, January 15 and April 15, covering deductions made during the immediately preceding quarter.

Under the Income-tax Act, all persons carrying on any business (including the business of lotteries) have to maintain books of account and documents, if their annual income exceeds Rs. 25,000, or the gross receipts or turnover exceed Rs. 2,50,000, in any one of the three years immediately preceding the previous year relevant to the assessment year. The Act also makes it obligatory for those with total sales, turnover or gross receipts in excess of rupees forty lakhs in any previous year to get their accounts audited by any accountant before a specified date. Failure to comply with the latter provision attracts penalty equal to one-half per cent of the total sales, etc., subject to a a maximum of rupees one lakh.

Scope of audit

2.01.4 The object of the review was to assess the overall efficiency with which the Income-tax Department, in general, finalised assessments relating to income derived from lotteries, and to examine whether the Department was successful in taxing the entire income generated by various authorities and agencies in conducting lotteries, and also winnings from lotteries. The review also tried to examine to what extent the Department has been able to check avoidance of tax and conversion of black money into white, the twin objectives contemplated by Wanchoo Committee. In the process, an attempt was also made to identify the loopholes and lacunae existing in the system which if plugged, could mobilise additional revenue, apart from curtailing the scope for avoidance of tax.

Highlights

2.01.5 (i) A random check of assessments of persons carrying on lottery business in various capacities disclosed that though the profit margin returned was very low in most of the cases, and the expenses were not fully vouched, there was no detailed examination of the accounts of the assessees by the assessing officers so as to bring the actual income to tax. Nor was there any co-ordination of inter-related payments with the records of recipients or their secrutiny with reference to law and commercial practice, though there was scope for overstatement of expenses in this line of business. The expenses claimed and allowed also varied from assessee to assessee and from year to year, with no relation whatsoever to the turnover. The Central Board of Direct Taxes had also

not assessed the gross profit in this trade, even decades after the operation of the schemes in the States.

(ii) Flowing from the overall growth in the volume of lottery business all over the country, it was noticed during the review, that conscious and planned efforts were on the increase to avoid payment of tax by adoption of questionable modes. Despite this, the Department is yet to centralise the lottery cases, for possible co-ordination and detection of any suppression of income.

(iii) One of the objects of the legislation is to prevent conversion of black money into white money by purchase of prize winning tickets at a small premium. There is, at present, no safeguard in the scheme of lotteries to prevent a third person, other than the real buyer, from claiming the prize money. Also, there is enough scope for splitting of the prize money by putting forth joint claims so as to avoid tax liability.

(iv) The persons directly involved in the business' such as organisers, stockists and sub-agents are not many, but they receive substantial amounts as service charges, bonus and service charges on prize winning tickets. It is, therefore, essential that the State Governments have complete and reliable data of these persons for periodical exchange of information with tax department. There is, however, no effective co-ordination on data so as to widen the tax base and to curb tax evasion. According to the test check by audit, there are a number of stockists and sub-agents who are reportedly not borne on the books of the department.

(v) The Act provides for deduction of tax at source from lottery winnings as in the case of interest, dividends, contractor's payments, etc. There is no similar provision for deduction of tax at source from bonus and commission paid in substantial amounts in this business. Test check disclosed that while a number of stockists promotors and sub-agents had not filed the tax returns, quite a few others, had not returned the full incomes received by way of bonus, commission and service charges.

(vi) The Act requires furnishing of statements in respect of the tax deduction to the concerned Income-tax Officer every quarter. The test check brought to light instances of incomplete and delayed submission of the statements apart from deficiencies in the system which led to non-deducation of tax from prize winnings and agents' bonus, non-deduction of surcharge, etc.

(vii) The quarterly statements of tax deducted at source are meant to communicate the names of prize winners to the assessing officers, so as to ensure that all prize winners file their returns in time. The audit scrutiny however, disclosed that a large number of prize winners were not registered for assessment in the books of the department. Further, even those who had filed their income-tax returns were not assessed for wealth-tax.

(viii) Even such basic requirements provided for under the Act, such as compulsory maintenance of accounts by major assessees and tax audit, and payments in excess of Rs. 2,500 by crossed cheque/demand draft were not insisted upon in many cases.

(ix) According to the test check, there was under-assessment of tax of Rs. 6 crores approximately on various counts.

Detailed review

2.01.6 A review was conducted in audit during the year 1988-89 of the assessments of persons connected with lotteries, e.g., agencies organising lotteries, lottery agents and sub-agents and prize winners of lotteries, etc. The results of the review are summarised in the following paragraphs :

General observations on Assessment Procedure

2.01.7 By its very nature, lottery operations cover a number of agencies, millions of fortune-seekers, thousands of prize winners and a variety of transactions and offer scope for withholding certain transactions from books, in case one seeks to evade tax. It is, therefore, necessary that the assessing officers scrutinise the accounts of agents, stockists, etc., of lotteries critically in the process of assessment. However, it was noticed that out of 49 cases of stockists, sole selling agents, sub-agents and others dealing in lottery tickets spread over in ten State assessment circles, covering 116 assessment, 39 assessments were completed in summary manner, without requiring the presence of the assessee or the production by him of any evidence in support of the claims made in the accounts. Even in the remaining cases, barring a few where the assessments were completed as scrutiny assessments, only marginal additions were found to have been made with the incomes returned by the assessees having been accepted as such in most of the cases. Further, the expenses claimed were also generally allowed in all assessments, in toto. Test-audit indicated that the returns filed were not generally accompanied by details of income returned under various heads, and that the various expenses incurred were not fully vouched, nor were such details called for by the assessing officers during the course of assessments. Even in cases with high turnover, running into crores of rupees, the accounts were replete with claims for disproportionately heavy expenses, which reduced the profit margin to very low levels. The quantum of various expenses claimed also differed from assessee to assessee, making comparison for the purpose of better appreciation difficult.

Comparative study of accounts and income assessed

2.01.8 A selective test-check by audit of the particulars of turnover, income and expenses, etc., of representative assessees from different charges disclosed that there was no discernible pattern or relation between the profit margins (income) returned by the assessees and the gross turnover, for different lotteries, as also between different assessees from year to year. The variation ranged from anything less than one tenth per cent to as high as eighty per cent. The cases in Annexure illustrate the wide disparities in the income returned and assessed.

Non assessment of promotors, stockists/sub-agents

2.01.9 Where lotteries business is conducted through stockists and sub-agents, the payments include service charges on sales, bonus on prize winning tickets and service charges on prize winning tickets, for arranging sales of tickets. The scheme of the lotteries generally provide for deduction towards bonus, selling agents commission, etc., in respect of the prize winning tickets from the prize money and the amounts so deducted are made over to the stockists/sub-agents, who, should, naturally, include such receipts in their respective returns of income. However, audit review revealed that a number of them had omitted to return the relevant income. The assessing officers also did not call for the same, leading to possible escapement of substantial income from tax-bracket. A few such cases are mentioned below :

(*i*) (*a*) In Karnataka circle, out of 30 cases of sub-agents who had received bonus ranging from Rs. 30,000 to Rs. 1 lakh aggregating to Rs. 17.60 lakhs, without any deduction of tax at source during the assessment years 1986-87 to 1988-89, the returns of income were not seen filed by 14 sub-agents and no action was also initiated by the department to call for the returns. As no expenditure is generally incurred in earning the bonus income, the entire income of Rs. 8.20 lakhs involving tax effect of Rs. 1.98 lakhs is likely to have escaped assessment.

(*b*) In the same circle, an attempt by audit to verify the assessment records of another group of 2,150 sub-agents appointed by a sole selling agent was not fruitful as most of the sub-agents were not regular assessees.

(*c*) In the case of two other assessees dealing in a State local lottery, in the same circle, the bonus and commission returned by the agents for the assessment years 1986-87 and 1987-88 were less by Rs. 20,06,093 and Rs. 18,36,704 than that intimated by the sole selling agent, and involved a tax liability of Rs. 21,67,983. According to the information furnished by the department, three other agents, who were not listed as income-tax assessees, had received bonus and commission totalling to Rs. 3,53,008, Rs. 2,47,843 and Rs. 1,73,611 for the assessment years 1986-87 to 1988-89, which also escaped tax liability.

(*ii*) (*a*) In Madhya Pradesh circle, out of 5 stockists of State lotteries, one stockist had not declared any amount of such commission in his returns of income for the assessment years 1983-84 and 1986-87.

(*b*) In the same circle, 19 promotors of private lotteries were given licences for organising lottery draws during the calendar years 1984—87. Although, the promotors had organised lottery draws according to records available with State Government in no single case had the income-tax returns been filed nor was the reasons therefor available with the Income-tax Department. It is also not verifiable whether any or all of them were exempted from tax. A cross verification of the records maintained in the offices of the Directorate of State Lottery and Collectors concerned by audit, however, revealed that in 5cases *i.e*, a sports club, two branches of a welfare society, an educational institution and a trade fair, lottery tickets of more than Rs. 1 lakh each had been sold. In the absence of details, it was not possible to assess the extent of income which may have escaped assessment in all the cases put together.

(*iii*) In North Eastern circle, the organising agents/sole selling agents of a State lottery was not based in the Region of that State. The rules regulating the conduct of lottery also did not provide for the State Government being informed of the details of the persons engaged for running of lotteries by the organising agent/sole selling agent and no co-ordination was possible in audit.

(*iv*) In Orissa circle, two stockists of State Lotteries, one of whom had purchased at least tickets worth Rs. 9 lakhs and was a sales-tax assessee, were not income-tax assessees.

(*v*) In Kerala circle, in respect of a State lottery agent with very high turnover, the assessment for assessment years 1985-86 to 1987-88 were completed in a summary manner. It was noticed in audit that his returns did not contain any details regarding receipt of agent's price, incentives in kind, etc., and in their absence the assessing officer could not have satisfied himself of the fact of deduction of tax at source.

Non-enlistment of prize winners

2.01.10 The review disclosed large-scale omissions to bring the recipients of winning tickets to tax control registers for the purpose of regular income-tax and wealth-tax assessments :

A few instances are given below :—

State	Nature of mistake
Kerala	76 winners of prizes ranging from Rs. 5.95 lakhs to Rs. 25.50 lakhs not enlisted for wealth tax.
Punjab	89 out of 106 prize winners (all residents of Punjab) of Rs. 50,000 and above (38 of them being winners of another State lottery) not entered in the control registers, while in the remaining cases no returns filed.
Karnataka	During 1985-86 and 1986-87, 81 out of 113 winners of prizes ranging from 50,000 to Rs. 25,00,000 (six of them with prizes above Rs. 20 lakhs) filed no income-tax returns, possibly these assessees were also liable to wealth-tax. In one case tax was incorrectly assessed resulting in excess refund of Rs. 9,544 while in another case of an individual who had won the prize of Rs. 25 lakhs and an ambassador car was not assessed to income-tax or wealth-tax and the car value escaped tax liability.
	15 agents out of 19 selling tickets in Karnataka and Goa, not borne on the books of the department. No means to verify the fact of the filing of the return in any other State.
Uttar Pradesh	Out of 293 cases of prize winners only 51 were reportedly entered in the Control Registers, assessment records of the remaining winners were not produced to audit.

State	Nature of mistake
Assam and Meghalaya	Out of 112 prize winners with given addresses at Gauhati and Shillong in no single case the records were produced for audit for verification of the genuineness of the certificates issued for non/less deduction of tax at source, the distinct reference numbers, etc., notwithstanding. On the basis of prize money of Rs. 33.14 lakhs, a sum ot Rs. 9.63 lakhs was deductible at source but only a sum of Rs. 1.46 lakhs was actually deducted. In another 320 cases from outside the Region in respect of lotteries held during 1984-85 and 1985-86 involving payment of Rs. 290.10 lakhs, tax was deducted at Rs. 18.53 lakhs against Rs. 83.75 lakhs due.
Orissa	18 of the 37 winners had not filed returns nor the department had issued notices to this effect. Details of the winners were also not communicated to the concerned assessing officers on the basis of quarterly return of tax deducted at source.
Madhya Pradesh	3 winners residing in Madhya Pradesh were assessable to tax for profits of Rs. 7 lakhs and above, but no returns had been filed for income/wealth-tax purposes as per records. Income-tax involved Rs. 1,20,556.

Incorrect grant of exemption.

2.01.11 Certain cases of incorrect application of the provisons of the Act, suggesting undue tax benefits to certain individuals or association of persons, were noticed in the course of the review. The specific instances so noticed are given below:

Madhya Pradesh

(*i*) (*a*) Under the Income-tax Act, 1961, income received by any person, on behalf of institutions established for charitable purposes, is exempt for tax, provided they are notified by the Central Government in the official gazette having regard to the objects of the institutions and their importa nce throughout India, or throughout any other State or States.

A Children's Welfare Society, at Churhat which organised its lotteries through agents, by assigning the licence to them, claimed its guaranteed profit of Rs. one crore, received from the organising agent during the accounting year relevant to the assessment year 1985-86 as exempt from tax on the ground that the institution was established for charitable purposes. In the return of income for the assessment year 1985-86, filed in February 1988, the Society stated that an exemption order to this effect had been obtained by it from the Government of India, Ministry of Finance, *vide* notification dated 31 August 1984. Based on the above, the assessing officer, in the assessment made in March 1988, exempted the guaranteed profit of Rs. one crore from payment of tax. Subsequently, the Society obtained similar orders for exemption from tax, *vide* another notification dated 25 March 1986 for the assessment years 1986-87 to 1988-89. The orders granting exemption from tax in respect of the income of the Society were irregular for the following reasons :

1. According to the Society, the lotteries were organized by it under clause 7 of its Memorandum of Association which enabled it to do all lawful things as were conducive or incidental to the attainment of its other objects specified in its Memorandum of Association. However, Rule 7 of the State Lottery Scheme Rules (Niyantran Tatha Kar) of the State prohibited the assignment or transfer of lottery licences, and read with Section 23 of the Contract Act, the assignments and agreements entered into by the Society with its organizing agents for conducting the lotteries were, prima facie, void.

2. Moreover, in its application dated 2 July 1984 to the Government of India seeking exemption from income-tax as applicable to charitable institutions, the Society had declared that no portion of its income or property shall be paid or transferred directly or indirectly to any other person. By assigning the conduct of lottery draws to the organising agents, the Society had, however, shared its lottery business and income with the latter and had, in the process, violated its own declaration.

3. The State Government had, in its letter of 9 October 1984 to the District Collector clarified that the permission given to the Society was for one lottery draw but against it the society arranged 12 lottery draws during the period 14 July 1984 to 7 April 1985, which were later regularised expost-facto. According to the provisions of Section 6(1) of the State Lottery (Niyantran Tatha Kar) Act, 1973, all the 11 lottery draws (other than the draw organised on 14 July 1984) were, thus, not covered by the provisions of law at the relevant time. Besides, under Section 4 of the Indian Trust Act, the Society became null and void as and when it undertook the unlawful activity of conducting lotteries, without permission of the State Government.

4. Under the Income-tax Act, as applicable from 1 April 1985, the provisions relating to exemption, accumulation and exemption of trust income will not apply to any profits and gains of income, unless the related business is carried on by a trust wholly for public religious and charitable purposes.

As brought out in the Audit Report (Civil) of the Government of Madhya Pradesh for 1987-88, the way the Society organised the lottery draws was nothing but business, and the income derived therefrom was not exempt from payment of income-tax with effect from 1 April 1984. Thus, the lottery income of this Society did not qualify for exemption.

5. According to the instructions of Central Board of Direct Taxes issued in August 1984, before allowing exemptions to charitable institutions, a report from the Commissioner of Income-tax concerned, containing, *inter alia*, the details of the object of the institution, its activities and its importance (which should be at least of State level) was required to be furnished. While granting exemption to the Society for the assessment years 1984-85 and 1985-86, *vide* Notification dated 31 August 1984, the Board did not call for any report from the Commissioner of Income-tax as contemplated in its own instructions of 1984. Moreover, when it finally called for a report from the Commissioner of Income-tax on the Society's application dated 28 March 1985 for

renewal of the earlier exemption orders, the Commissioner of Income-tax had not favoured renewal and wanted to keep the case pending till receipt of full details of lottery from the Society. However, the Board granted renewal of exemption for the assessment years 1986-87 to 1988-89 on 25 March 1986 without waiting for the details and in disregard of the Commissioner of Income-tax's recommendations, reasons for which are not available. It is relevant to mention here that in view of the then obtaining unlawful nature of the activity, and having regard to the fact that the reported welfare activities of the Society were confined to a radius of 100 sq. kms. from its headquarters, the criteria of All India/State-level importance could hardly be said to have been fulfilled in this case, and the Commissioner of Income-tax's reluctance to recommend the case was fully justified.

6. The Supreme Court had held on 8 February 1973 (88 ITR 432) that where members of an association join voluntarily and without any compulsion to undertake any purpose, there was an 'association of persons'. It was clear that in the light of the above, the income from lottery draw by the Society was assessable in the hands of the Society and the organising agent, as an association of persons. Since this association of persons could not be registered as charitable institution, the income from lottery draws was obviously chargeable to tax. Further, the shares of the members of association of persons being indeterminate, the income-tax would be leviable in this case at the maximum marginal rate. In the absence of records or details of the assessed income from the lottery draws in the hands of the organising agents and considering only the guaranteed profit of Rs. one crore, revenue of Rs. 61,87,500 in the hands of the Society, thus, escaped assessment during the assessment year 1985-86.

(*b*) The wealth accumulated out of lottery draws in the hands of the Society and the organising agent would also be chargeable to wealth tax in the status of association of persons consisting of the Society and the organising agent.

(*c*) Apart from all the above, the Society and its organizing agents suppressed information regarding actual sales of tickets, with a view to avoid tax and to conceal its income. The extent of suppression, as extracted from records would at least, be Rs. 1,23,08,469 because against the sales of lottery tickets of Rs. 5,44,49,590 as per details furnished by the Society, the organising agents accounted for the sales of Rs. 4,21,41,121 only in its profit and loss account, for all the lottery draws put together. This resulted in escapement of revenue of Rs. 76,15,865 for the assessment year 1985-86.

(*d*) In respect of all the draws held by the organising agents, 226 lottery prizes worth Rs. 4,36,70,000 (for more than 1,000 in each case) were declared on unsold lottery tickets in contravention of the provisions of the State Lottery Act, 1973. This also resulted in depriving the exchequer of income-tax revenue of Rs. 1,35,92,288, which would have, otherwise been recoverable as income-tax and deducted at source, had lottery prizes been declared on sold lottery tickets only.

(*ii*) (*a*) Under the Income-tax Act, any income of a hospital or other institution dedicated for the reception and treatment of persons suffering from physical or mental illness, and existing solely for philanthropic purposes is not to be included in the computation of total income.

In the case of a branch of a Welfare Society guaranteed profits of Rs. 25,000 and Rs. 22 lakhs for two draws, received from the organising agents in return for assigning the conduct of two lottery licences during the accounting years relevant to the assessment years 1980-81 and 1985-86, were claimed as exempt in the returns of income filed on 18 June 1980 and 26 June 1985, on the ground that the institution existed solely for philanthropic purposes and not for the purposes of profit. The assessing officers accepted the plea and exempted the guaranteed profits of Rs. 25,000 and Rs. 22 lakhs from payment of tax.

In this case also, the agreement made by the Society with the organising agent on 19 June 1984 for organising the lottery draw held on 15 September 1984 was void in view of the provisions of the State Lottery (Niyantran Tatha Kar) Rules which prohibited the assignment of transfer of lottery licences. In view of the above, taking into account only the guaranteed profits of Rs. 25,000 and Rs. 22 lakhs (for both draws), revenue of Rs. 13.79 lakhs escaped assessment during the assessment year 1985-86. Further, since there were no records or details of the assessed income from the lottery draw in the hands of the organising agent, it is not known to what extent his share of income had actually suffered income-tax.

(*b*) The wealth accumulated out of lottery draws would also be chargeable to wealth tax in the status of an association of persons consisting of the society and the organising agent. The details of such accumulated wealth are yet to be worked out.

(*c*) Further, the sale of lottery tickets were suppressed by Rs. 68,43,365 in this case; as against the sales of lottery tickets for Rs. 3,46,98,980 as evidenced from the information supplied by the Collector, the organising agent in its profit and loss account for the lottery draw had accounted for the sale of only Rs. 2,78,55,615. This resulted in escapement of revenue of Rs. 42,34,330 during the assessment year 1985-86.

(*d*) Also, refund of prize money of Rs. 25 lakh against unclaimed and undisbursed lottery prizes by the Society to the organising agent was not accounted for by the origanising agent in the profit and loss account prepared for the lottery draw. This amount was assessable to tax in the hands of the association of persons, consisting of the Society and the organising agent, but had escaped assessment leading to loss of revenue of Rs. 15,46,875.

(*iii*) (*a*) The State Lottery (Niyantran Tatha Kar) Act, 1973 and Rules made thereunder permit conducting the private lottery draws only after issue of licences for them by the Collector of the Districts concerned.

A Sports Trust assessed in this circle organised two lottery draws without even obtaining necessary licences from the concerned authorities. It received guaranteed profits of Rs. 60 lakhs (accrued and partly received) from two organising agents from assigning the work of three lottery draws during the accounting year ending 31 March 1986 relevant to the assessment year

1986-87 but had not offered it for assessment in the returns of income filed on 1 September 1986, claiming that the Trust was a charitable trust. In the summary assessment made in December 1988, the guaranteed profit of Rs. 60 lakhs was exempted totally. As the trust had not obtained the necessary licences for the three draws organised by it in 1985/1986 the agreements made by it with the organising agents were, ab initio, void. Consequently, the guaranteed profits of Rs. 60 lakhs received by the trust for all the three draws escaped assessment during the assessment year 1986-87 with consequential loss of revenue of Rs. 30 lakhs. Since there were no records or details of assessees' income from lottery draws in the hands of the organising agents, their share of income also apparently were not brought to tax.

(*b*) The wealth accumulated out of lottery draws in the hands of the trust and the organising agents would also be chargeable to wealth tax in the status of an association of persons consisting of the trust and the organising agents. The details of such accumulated wealth are yet to be worked out by the department.

(*c*) The sale of lottery tickets for the first draw held on 12 July 1985 was suppressed to the extent of Rs. 1,13,96,340 because according to the books of accounts of the organising agents for this draw, 64,418 lottery tickets were sold for Rs. 38,09,260 whereas according to the information supplied by the Collector, 3,04,112 lottery tickets of Rs. 50 each amounting to Rs. 1,52,05,600 were sold. Thus, suppression of sales figures resulted in escapement of revenue of Rs. 47,12,254.

(*d*) 6,340 lottery prizes worth Rs. 15,67,75,000 (for more than Rs. 1,000 in each case) were declared on unsold lottery tickets in all the three draws, which was not permissible under the State Lottery Act. This also resulted in loss of income-tax revenue of Rs. 3,91,93,750 which was otherwise recoverable at source, had the lottery prizes been declared on sold lottery tickets only as per rules.

(*e*) 212 lottery prizes for Rs. 6,62,65,000 declared on sold tickets were paid, but the details of income-tax deducted at source out of prize money were not filed with the Income-tax Department. In the absence of such details it could not be verified in audit whether interest and penalty due for defaults in deduction of income-tax at source and remittance to Government account, if any, had been done properly.

(*iv*) In yet another case of a private lottery, organised by Freedom Fighter's Society and which had not also been issued licence by the District Collector, return of income for the assessment year 1985-86 offering the guaranteed profit of Rs. 75 lakhs for assigning the work of the lottery licence to the organising agent was not filed at all. This resulted in escapement of revenue of Rs. 46,40,625 during assessment year 1985-86 since the exemption granted in this case was also irregular. Since there were no records of details of assessed income from the lottery draw in the hands of the organising agent, the extent to which his share income escaped tax was not ascertainable.

The wealth accumulated out of lottery draw in the hands of the trust and the organising agent would be chargeable to wealth tax in the status of an association of persons. The amounts of such accumulated wealth are yet to be assessed by the department.

Incomes escaping assessment, bonus and agency commission, etc.

West Bengal

2.01.12(*i*) (*a*) An assessee, a registered firm, was engaged in lottery business conducted by various State Governments as well as by private organisations. The assessee was also sole selling agent/selling agents in respect of three State Government lotteries. In the assessment for the assessment year 1985-86 completed in March 1988 and for the assessment year 1986-87 completed in March 1987 under summary assessment scheme, the following omissions were noticed :

(1) The Directorate of State Lottery, Madhya Pradesh sold 18,00,000 lottery tickets to the assessee as its sole selling agent for a weekly draw held during the previous year relevant to the assessment year 1985-86. But as per details of purchases available in the assessment records, the assessee had shown the number of tickets purchased for the relevant draw as 12,84,000 only. By this means, the assessee suppressed a turnover of 5,16,000 tickets (each having a face value of Re. 1) from his assessment which led to an under assessment of income of Rs. 25,800.

(2) The same Directorate paid Rs. 82,50,000 and Rs. 1,87,72,500 respectively to the assessee on account of agent's commission and sole selling agents' commission during the previous year relevant to assessment year 1985-86 (draws 10 to 34) and assessment year 1986-87 (draws 35 to 86) respectively. But the assessee did not include the amounts in his profit and loss account for the respective assessment years, which resulted in under assessment of income of Rs. 82,50,000 and Rs. 1,87,72,500 for the assessment years 1985-86 and 1986-87 respectively.

(3) As per profit and loss account for the assessment year 1986-87, the same assessee debited a sum of Rs. 82,800 under expired stock. Since the value of expired stock was not credited in the trading account in the form of closing stock, debit of the same in the profit and loss account resulted in reduction of income by Rs. 82,800 involving under assessment of income of a similar amount.

The above mistakes involving under assessment of income of Rs. 2,71,31,100 for the assessment years 1985-86 and 1986-87 led to aggregate short levy of tax of Rs. 67,54,481.

(*b*) In the assessment of another assessee, an individual engaged in the business of purchase and sale of lottery tickets of different State Governments for the assessment years 1984-85, 1985-86 and 1986-87 completed between July 1987 and November 1988 in a summary manner, Rs. 50,108 and Rs. 3,687 only were shown as receipts by way of agency bonus/ sellers bonus received from the Directorate of the State Government, during the previous year relevant to assessment years 1984-85 and 1985-86 as against the correct sums of Rs. 1,29,143, Rs. 1,27,173 and Rs. 2,18,979 under these heads. This resulted in under assessment of income to the extent of Rs. 79,035, Rs. 1,23,506 and Rs. 2,18,979 with consequent undercharge

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of tax aggregating to Rs. 2,30,658. The department has justified the case under the summary assessment scheme.

(*c*) The assessment of a third assessee, an individual, for the previous year ending 31 December 1985 relevant to the assessment year 1986-87 was completed in March 1989 on a total income of Rs. 3,42,450 and a demand of Rs. 1,50,475 was raised. The scrutiny of the assessment records revealed that the assessee had received sums of Rs. 1,79,100 and Rs. 3,10,083 for monthly draws from 1 to 12 and weekly draws from 500 to 550 as stockist bonus and 'agency bonus' from the Directorate of State Lotteries of West Bengal State. Since the assessee maintained the accounts on mercantile system, the entire total receipt of Rs. 4,89,183 was required to be included in the income for the period ending 31 December 1985 as against the sums of Rs. 18,419 shown in the profit and loss account during this period. This resulted in under assessment of income of Rs. 4,70,764 leading to short levy of tax of Rs. 2,35,380.

(*d*) The assessment of another individual dealing in purchase and sale of lottery tickets of various State Governments for the assessment year 1986-87 was completed in July 1988 and for 1987-88 in March 1989 respectively, in a summary manner. A scrutiny of the assessment records revealed that sums of Rs. 5,46,644 and Rs. 3,52,471 were received by the assessee from the Director of State Lotteries of West Bengal State on account of stockist's bonus, agency bonus and sellers' bonus for the two assessment years, but only sums of Rs. 19,000 and Rs. 16,000 were shown as receipts under these heads. Thus, there was an under assessment of income of Rs. 5,27,644 and Rs. 3,36,471 for the two assessment years leading to aggregate undercharge of tax of Rs. 4,17,513.

(*e*) Yet another individual was a dealer for purchase and sale of lottery tickets for the various State Governments and private organisations. In the assessment for the assessment year 1985-86 completed in February 1988 in a summary manner on a total income of Rs. 25,020, it was noticed that deductions of Rs. 1,02,420 on account of invalid stock of a lottery and Rs. 4,69,549 on account of advertisement and publicity were allowed by the assessing officer, as returned by the assessee. It was, however, noticed that the assessee had debited the value of invalid stock of Rs. 1,02,420 in his trading account without taking the same on credit side in the form of closing stock which led to short credit in the trading account to that extent as the value was already included in the purchases. This, together with excess allowance of Rs. 73,910 (being 20 per cent of excess of Rs. 1,00,000 as admissible under the Act) on account of advertisement and publicity expenses resulted in under assessment of income of Rs. 1,76,330 involving a short levy of tax of Rs. 99,830.

(*f*) The agency bonus of Rs. 3,00,000 paid in November 1984 to a firm and a sum of Rs. 3.50 lakhs introduced as capital in October 1983 during the previous year relevant to the assessment year 1985-86 could not be traced in the records of the recipients.

Assam and Meghalaya

(*ii*) According to the agreement between the State Government and the organising agent in respect of State Lotteries (June 1982) valid up to June 1985, the prize money in respect of unclaimed prizes above Rs. 1,000 payable through the Government, if not claimed within 45 days of the date of publication of the results, lapsed to the organising agent. An amount of Rs. 38.07 lakhs due to the organising agent on this account adjusted by the state Government towards security deposit against guaranteed profits and prize money, would be liable to be taxed as business income involving a likely revenue of Rs. 25.69 lakhs. However, no action had been taken by the assessing officer.

Orissa

(*iii*) An individual won a prize of Rs. 15 lakhs in respect of a Bumper lottery of a non-Government institution of the State of Madhya Pradesh drawn in February 1986, but the assessee filed a return disclosing only a sum of Rs. 1 lakh as having been received in February 1987. The amount was shown in his capital account in his return for assessment year 1987-88. The institution had not deducted tax on the amount disbursed and had also not paid the tax deductible on undisbursed balance as the Act did not provide for any time limit for payment of prize money and prompt deduction of tax at source therefrom. There was non-deduction of Rs. 6 lakhs due to Government.

Uttar Pradesh

(*iv*) An assessee filed his income-tax return for the previous year relevant to the assessment year 1984-85 in July 1984 returning an income of Rs. 0.19 lakh as a partner having 29 per cent share in a registered firm dealing with rubber tubes. As per list of prize winners furnished by the Directorate of lotteries of the State, the assessee had won a prize of Rs.1 lakh. After deducting 11 per cent commission of the agent, the balance of Rs. 0.89 lakh formed part of assessee's total income which should have been included in the assessee's total income. This was not done, resulting in short computation of income by Rs. 0.89 lakh and consequent short levy of tax of Rs. 49,000.

Delhi

(*v*) In the assessment of an assessee, an individual for the assessment year 1986-87, the benefit of deduction allowable on winnings from lotteries was allowed to the extent of Rs. 46,49,400 which also included the seller's bonus of Rs. 2,21,400. As the seller's bonus does not qualify for deduction, the mistake resulted in under assessment of income of Rs, 1,10,700, being 50 per cen- of the amount of bonus (Rs. 2,21,400) with consequential tax effect of Rs. 80,235 including interest due for late filing of return and short payment of advance tax.

Tamil Nadu

(*vi*) (*a*) In the assessment of an assessee registered firm dealing in lottery tickets for the assessment year 1984-85 completed in a summary manner, a sum of Rs. 219.80 lakhs was shown in the trading account as purchases after deducting purchase returns of Rs. 10.82 lakhs from the gross purchases of Rs. 220.62 lakhs. The correct amount on this account would work out to Rs. 209.80 lakhs. This mistake resulted in short computation of income of Rs. 10 lakhs and short levy of tax of Rs. 6.52 lakhs in the hands of the firm and its partners.

(*b*) In the case of another assessee, an individual who won Rs. 1.80 lakhs in the Sikkim State Lottery during the assessment year 1987-88, the lottery agent failed to deduct tax at source. In the assessment completed under the summary assessment scheme, the assessee had shown the income from lottery only as Rs. 70,000 instead of the entire sum of Rs. 1.80 lakhs. This resulted in short demand of tax of Rs. 37,000.

(*c*) In the case of a specified H.U.F., the prize of Rs. 1 lakh of Royal Bhutan Lottery won during the assessment year 1984-85 was exhibited in the capital account without offering the same to tax. This, together with certain other mistakes, resulted in short levy of tax of Rs. 49,000.

Deduction of tax at source and deposit thereof to Government account

2.01.13 As mentioned in Para 2.01.3 above, the Act makes it obligatory for every person responsible for deduction of tax to furnish quarterly statements to the Income-tax Officer in the prescribed form (Form 26B). Some omissions in this regard are discussed below :

(*i*) In the West Bengal circle, it was noticed that the Director of State Lottery had not submitted the quarterly returns to the department in the prescribed form. The returns submitted on 12 May 1986, 14 May 1987, 1 December 1987 and 30 May 1989 did not contain the following columns :

(1) Date of payment of prize money to the prize winners;

(2) Date on which tax was deducted at source; and;

(3) Date on which tax deducted at source was paid to the credit of the Central Government.

(*ii*) (*a*) In Madhya Pradesh circle delays were noticed in sending 10 quarterly statements due for the period from April 1984 to September 1984 and January 1985 to December 1986. The Income-tax authority was responsible to verify the accuracy of the tax deducted at source from the details of the lottery prizes given in the statement and the remittances thereof to the Government account from the challans and bank scrolls received from the banks. He was also responsible to communicate the details of the prize moneys to the concerned assessing Income-tax Officers, who were to watch the same. None of these requirements were found complied with, and the remittances of Rs. 6,79,222 out of a total amount of Rs. 75,41,191 deducted at source in 69 lottery prizes were not traceable in the records of the department.

(*b*) In the same circle, in the case of 4 assessees, cooperative societies, conducting lottery business through private agents, quarterly statements for deduction of income-tax at source were not seen filed. In one case, the society subsequently obtained the details of lottery prizes paid to the prize winners by the organizing agents but theIncome-tax authority did not check the accuracy of income-tax deducted at source, verify fact of remittances of income-tax deducted at source to the Government account and intimate the details of the lottery prizes to the Income Tax Officers concerned. In another case, the required statements were not filed by the society giving details of the organising agents who were responsible to deduct income-tax at the time of payment of lottery prizes and its remittance to Government account.

(*iii*) In Uttar Pradesh, Kerala, Punjab and Rajasthan circles the quarterly statements for the years from 1983-84 to 1988-89 were either not sent on due dates or not sent at all to the concerned income-tax authority. In Kerala for the year 1987-88 only a single statement was sent, and in respect of payments to contractors no returns were sent; in Punjab first two quarterly statements for 1986-87 were submitted late. However, in Rajasthan circle delays ranging from 2 to 162 days were noticed in submission of 16 of the 20 quarterly statements. In Uttar Pradesh since October 1987, no such statement was furnished.

Non inclusion of value of prize paid partly in kind

2.01.14 As per the standing instructions of the Central Board of Direct Taxes issued in August 1985 where a prize is given partly in cash and partly in kind, source deduction of income-tax will be with reference to the aggregate amount of cash prize and the value of prize in kind. Although the practice in Kerala was to offer an Ambassador car along with the first prize in every monthly draw, it was noticed that the State Lotteries Directorate had not included the value of the car for deduction of tax at source. The statements of source deduction filed by the Directorate of Lotteries also did not contain particulars of the prizes in kind. Moreover, a number of prize winners had also not filed their income-tax returns for the relevant assessment years. Thus, in respect of 16 such cases checked by audit income representing the value of the cars had apparently escaped assessment, the approximate revenue effect being of the order of Rs. 6,10,000.

Non deduction of tax at source in respect of prize to agents

2.01.15 Under the terms of agency arrangement, in addition to twenty per cent sales commission and other incentives in respect of major prizes, the agents/sellers are also eligible for a specified percentage of the declared prize money of each draw on each prize winning ticket sold. The amount so received is winning from lotteries in the hands of the agent/seller in as much as the payment had nexus to the prize winning ticket and not to the business turnover, and is set apart from the declared prize as seller's prize as per the scheme of the lotteries. Such income would therefore, fall under 'winning from lotteries' liable to source deduction at source.

(*i*) (*a*) In Kerala circle, omission to deduct tax at source from such amounts, (five per cent of declared prize money) relating to the draws conducted from 1 April 1984, aggregated to Rs. 23.41 lakhs.

To what extent the income so realized by the agent/ seller had been brought to tax while assessing them for this business income was not ascertainable.

(*b*) In 2 cases in one income-tax ward in Kerala circle, in the assessments for the assessment year 1987-88 completed under the summary scheme, seller's prize was assessed as business income for taxation instead of winnings from lotteries (under charge Rs. 16,000).

(*ii*) In North Eastern circle, the balance ten/twenty per cent of the prize money is retained by the sole organising agent who received the same directly from the Directorate of Lotteries without giving any detailed information regarding distribution of the same amongst the sellers and stockists to the Government. In respect of the 314 draws held during 1987-88 and up to September 1988, the amount of the balance prize money paid to the sole organising agent towards sellers, stockists, etc., prize came to Rs. 134.00 lakhs, but the amount of tax deductible at source on this amounting to Rs. 53.60 lakhs, was not, however, levied and realised.

Non levy of surcharge on tax deducted at source

2.01.16 (*i*) As per the amendment to the Finance Act, 1987, which came into force in December 1987, source deduction of tax on winnings from lotteries was to be increased by a surcharge of five per cent. But this was not done till March 1988 by the State Lotteries Department in the Kerala circle, leading to non deduction of tax amounting to Rs. 2.97 lakhs in 18 cases alone. Surcharge due on payment of winnings from lotteries during the financial year 1987-88 (assessment year 1988-89) in 47 other cases in Kerala circle amounted to Rs. 7.89 lakhs.

The omission is significant in the context of the revised pattern of taxing lottery income at forty per cent flat rate, effective from 1 April 1987, since a large number of prize-winners of lotteries do not file income-tax returns on the plea that tax has already been deducted at source. Non-deduction of surcharge at source would, in such cases, result in direct loss of revenue.

(*ii*) In Rajasthan circle, surcharge totalling Rs. 2,10,560 was not deducted at source in 41 cases while distributing the prize money during the quarter January 1988 to March 1988.

Delay in depositing tax deducted at source

2.01.17 Under the Act, any person, not being an individual or Hindu undivided family, who is responsible for paying to a resident any income by way of interest other than income chargeable under the head 'interest on securities,' shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque, whichever is earlier, deduct income-tax thereon at the rates in force and deposit the same to the credit of the Central Government.

In West Bengal circle, a scrutiny of the statements of tax deducted at source of the Directorate of Lotteries revealed that in 186 cases there were delays ranging from 1 month to 4 months in crediting the amount of tax, deducted at source, to the Income-tax Department's account. Failure to observe the statutory provisions attracted levy of interest amounting to Rs. 1,20,183 in these cases, but no interest was found to have been levied by the department.

Incorrect credit for tax deduction at source

2.01.18 The following irregularities were noticed in this regard :

(*i*) In Uttar Pradesh circle an assessee's returned income included a sum of Rs. 41 lakhs from lottery, received by him as prize money from the Government of Sikkim. The assessee claimed credit for Rs. 3.68 lakhs deducted at source by the Government of Sikkim towards income-tax from the prize money of Rs. 41 lakhs paid to the assessee. In the original assessment completed in March 1987 the credit claimed was not allowed by the assessing officer on the ground that proof of deduction was not submitted by the assessee in original. On the assessee moving an application on 26 April 1987, for rectification of mistake apparent from records, enclosing the income-tax clearance certificate for sums issued by Government of Sikkim, the department revised the assessment in May 1987, allowing the credit claimed. It was pointed out in audit that the allowance was not correct because (*a*) the clearance certificate issued by the Sikkim Government did not constitute tax deduction at source for the purpose of the Indian Income-tax Act, 1961 and (*b*) the deduction was only a receipt of the State Government of Sikkim where the Indian Income-tax Act 1961, was not operative at the relevant time, and (*c*) the amount was credited to the State Revenues and not to the Revenues of the Government of India. The omission resulted in short levy of tax of Rs. 3.85 lakhs including interest for belated filing of return.

(*ii*) In Andhra Pradesh circle, the assessment of an individual for the assessment year 1984-85 was completed in August 1987 in a summary manner accepting the returned income of Rs. 52,230 plus Rs. 10,000 agricultural income. This included a sum of Rs. 15,840, authorised against the tax deduction at source of Rs. 33,750 from winnings from lotteries of Rs. 1 lakh. During investigation of the genuineness of the lottery prize and the cash credit of Rs. 2.5 lakhs introduced in assessment year 1983-84, the assessee offered Rs. 1 lakh as income from unexplained sources and Rs. 1.75 lakhs as income from undisclosed sources for the two years. In the re-assessments, though deduction towards winnings from lotteries was not allowed, the credit allowed towards tax deducted at source was not withdrawn as being not admissible against unexplained income. The department replied in February 1989 that the prize with amount of tax deducted at source was genuine, though not assessed to tax separately.

(*iii*) The correctness of the Tax Deduction Certificates issued by the Directorate of Lotteries (West Bengal circle) and those received from the circles of Madhya Pradesh, Punjab, Kerala, Orissa and Rajasthan could not be verified with the records of the recipients (except in one case) in the absence of the PA/GIR No. in the relevant (TDS) statements.

Other Irregularities

Incorrect allowance of deduction treating seller's bonus as winnings from lotteries

2.01.19. In the Uttar Pradesh circle, a registered firm carrying on lottery agency business received seller's bonus of Rs. 3 lakhs against a prize of Rs. 1 crore declared by the Indian Red Cross Society on a ticket sold by the firm. The bonus was returned for assessment for the assessment year 1986-87 and a deduction of Rs. 1.53 lakhs was claimed as admissible on lottery winnings. The department allowed the deduction in the assessment completed in February 1987. As the amount received was not winnings from lotteries, the irregular deduction allowed led to short levy of tax of Rs. 58,000.

Splitting of income/incorrect deduction from winnings

2.01.20. Under the provisions of the Act as applicable upto the assessment year 1986-87, where the gross total income of an assessee includes any income by way of winnings from any lottery, a deduction equal to five thousand rupees as increased by a sum equal to fifty per cent of the amount by which the winnings exceed five thousand rupees shall be allowed in computing the total income of the assessee. Under an amendment to the Act effective from 1 April 1981, the deduction is to be determined with reference to the net income and not on the gross income.

In Bombay circle, an individual claimed to have won a prize of Rs. 2.22 crores in a Raffle (draw held on 18 February 1984) against a ticket of Rs. 5, jointly with three other family members, viz., wife and two sons. In support, he furnished an affidavit filed in the Court on 26 March 1984 stating that the four family members had formed a syndicate, agreeing to share the prize amount equally. The assessing officers concerned with the assessments of the individual, his wife and one son accepted the affidavit and completed their assessments allowing the deduction available under the provisions of the Income-tax Act, 1961, for winnings from lottery at Rs. 28,83,750 in each case and taxing the balance at the appropriate rate. Returns were, accordingly, filed individually returning therein income from lottery winnings at Rs. 41,62,500 after deducting agent's commission of Rs. 13,87,500 from Rs. 55,50,000 (i.e. 1/4th share from gross winnings of Rs. 2.22 crores).

Audit scrutiny revealed that the affidavit, claiming the formation of the syndicate, was filed in the court after 38 days of the declaration of the results of the draw on 18 February 1984. As there was no evidence to show that the syndicate was actually formed before the declaration of the results of the draw, the acceptance of the assessee's statement without full investigation was not proper as it was prejudicial to the interests of revenue, apart from the fact that the claim could enable the assessee to launder his black money. It is relevant to mention that the assessing officer had not accepted the affidavit of one of the family members and held that the assessee had apparently purchased the winning ticket after the results were declared.

Incorrect assessment as winnings from lotteries

2.01.21. Any expenditure or trading liability incurred for the purpose of business carried on by the assessee is allowed as a deduction in the computation of his income. Where on subsequent date, the assessee obtains any benefit in respect of such expenditure or trading liability allowed earlier, by way of remission or cessation thereof, the benefit that accrues thereby, shall be deemed to be the profits and gains of business or profession to be charged to income-tax as income of the previous year in which such remission of cessation takes place.

(*i*) In a case in Delhi circle during the previous year relevant to the assessment year 1983-84, the total income of an individual, engaged in the business of lotteries as organising agent of certain State Government lotteries, as also stockists of various other State Government lotteries, was determined at Rs. 3,60,680 after allowing deduction of Rs. 19,45,837 as admissible under the Act. The assessee was to conduct certain number of draws and to pay the prescribed guaranteed profits to the State Governments. Besides, he was to reimburse to the State Governments, the prize money claimed over Rs. 1,000 by prize winning tickets holders, but the liability to pay such prize money below Rs.1,000, on which no tax at source was deductible, was on the assessee. As stipulated in the contract, the assessee was entitled to unclaimed prizes as also his share of prize on unsold prize winning tickets. The assessee debited to the trading account for 1982-83, a sum of Rs. 21,47,500 as guaranteed profit to the two State Governments, and Rs. 8,81,31,622 as provision for prize money. The assessee debited a sum of Rs. 64,06,134 on account of unsold stock of tickets and credited a sum of Rs. 38,86,674 comprising unclaimed prizes amounting to Rs. 32,62,674 and his share on prizes of unsold tickets amounting to Rs. 6,24,000 in the profit and loss account. The assessee was holding the tickets as his stock in trade. In view of the fact that the assessee had debited a sum of Rs. 8,81,31,622 as provision for prizes, any amount of prizes that remained unclaimed, constituted his business income under the Act which reduced his liability to that extent in respect of provision for prizes. Likewise, his share of prizes on unsold tickets received under the terms of the contract of business did not constitute winning from lotteries, but business income. The relief of Rs. 19,45,837 allowed to the assessee from his gross total income of Rs. 23,23,316 was thus erroneous which resulted in under assessment of income of Rs. 19,45,837 involving a short levy of tax of Rs. 12,99,921 including interest for late filing of the returns. The assessee was also allowed deduction of Rs.4,08,703 and Rs. 1,05,477 for the assessment years 1982-83 and 1981-82 respectively, resulting in an undercharge of tax, including interests amounting to Rs. 2,56,734 and Rs. 46,736.

The department justified the grant of relief relying on an appellate decision for the assessment year 1973-74 to 1978-79 by the Tribunal against which reference application was rejected by the Tribunal. The decision was not applicable for subsequent years as for the purposes of income-tax assessment each year was to be reckoned as self-contained and independent. The department had disallowed the claim for the assessment years 1984-85, 1985-86 and 1986-87. The disallowance for the assessment year 1984-85 had also been confirmed by the Commissioner of Income-tax (Appeals) but no information regarding this confirmation was available for assessment years 1985-86 and 1986-87.

(*ii*) In another case, in Delhi circle, of a registered firm engaged in the business of lottery, an organising agent of a State Government/Union Territory, lotteries, as also stockist of various other State Government lotteries income for the assessment year 1983-84 was determined at Rs. 'NIL' after allowing deduction of Rs. 5,58,147 towards winnings from lotteries under the Act. In the assessment made for the assessment year 1984-85, the assessing officer disallowed the similar deduction by holding that the amount of prize money being remission of trading liability allowed earlier, was business income and not 'winnings' from lottery to qualify for the said deduction. The Commissioner of Income-tax (Appeals) also upheld the disallowance, vide order dated 17 February 1988. However, no action was taken by the department to revise the assessment for the assessment year 1983-84 to withdraw the deduction allowed. The omission to do so resulted in under assessment of income of Rs. 5,58,147 with consequent short levy of tax of Rs. 3,16,635 in the hands of the firm and its partners. The department stated (July 1989) that no action for 1983-84 was possible due to time-bar.

Incorrect charge of income-tax due to incorrect consideration of assessment year

2.01.22. An individual assessee in Bombay circle filed return of income for the assessment year 1986-87 showing an income of Rs. 1,80,000 being winning s from lottery conducted by a Metropolitan Development Authority. The assessing officer completed the assessment in March 1987 raising a demand of Rs. 24,250 calculated at rates applicable for the assessment year 1986-87. Audit scrutiny in May 1988 revealed that the assessee had received the prize money in May 1986. Since she had no other source of income, her previous year was the financial year preceding the assessment year, and winnings from lottery received in May 1986 was, therefore, income pertaining to the previous year relevant to the assessment year 1987-88. The tax leviable on Rs. 1,80,000 for the assessment year 1987-88 worked out to Rs. 70,000 against Rs. 24,250 levied by the assessing officer. The incorrect consideration of the assessment year, thus, resulted in short levy of tax of Rs. 45,750.

Irregularities noticed in respect of lottery authorised by the State Government to be conducted by a non Government body (Society)

2.01.23. The Government of Kerala, authorised a Society 'A' a registered society in May 1976 to conduct a series of weekly lotteries, primarily to enable it to repay certain loans, for which the State Government had stood guarantee, and to augment the resources of the Society. Society 'A' entrusted the work of organising the lotteries to another Society 'B', registered under the Co-operative Societies Act, on agency basis and an agreement was entered into in December 1986, under which society 'B' was entitled to a service charge at one per cent of the face value of the total tickets for each draw and a loan of thirty per cent of the net proceeds of the lottery for a period of 21 years at one per cent interest.

The net profit derived from the lotteries conducted during the period from September 1986 to April 1987 by Society 'A' amounted to about Rs. 405.26 lakhs, out of which Rs. 121.57 lakhs was given as loan to Society 'B', who also received service charges at one per cent, namely, Rs. 22.9 lakhs. In February 1987, 'Society 'A' applied to the Commissioner of Income-tax for exemption of its lottery income under the provisions of the Act and the decision on the application is still awaited (March 1989). However, as Society 'A' had diverted part of its income from lotteries (Rs. 121.57 lakhs) for purposes other than the object for which it was established the Society is not eligible for the exemption sought for.

Pending the decision of the Commissioner of Income-tax the Society 'A' had not filed any income-tax returns for the assessment years 1987-88 and 1988-89. Further, Society 'B' had also not filed any income-tax return for assessment year 1988-89 (accounting year ended 30 June 1987), the department has also not initiated any proceedings to tax the income of over Rs. 400 lakhs derived by the Society from lotteries (March 1989). It was noticed in audit that the Society 'A' had not made any deduction of tax at source from the payment of service charges of Rs. 22.9 lakhs to Society 'B' under the agreement. The amount of tax omitted to be deducted at source at two per cent worked out to Rs. 45,800. On being pointed out by Audit in November 1988, the Department has enlisted the Society 'B' for income-tax assessment for the assessment year 1986-87 onwards. It is to be mentioned that in so far as Society'B' is concerned the difference between the market rate of borrowing and the rate levied by A, viz., one per cent, constituted receipt on account of service charges every year for 21 years from the previous year relevant to assessment year 1988-89 and would be liable to be taxed. The tax leviable on the Society on this account is yet to be ascertained.

Under the agency agreement between the Society 'B' and a bank, a sum of Rs. 11.45 lakhs was paid to the latter for its assistance in launching the scheme of lottery. But source deduction of Rs. 22,900 required to be made under the Act was not made. Similarly, source deduction of Rs. 36,000 (approximately) to be made from payments to three printing contractors was also not made by Society 'B'.

Failure to issue notice to file the return

2.01.24. In the case of any income of any person other than a company, where the assessing officer is satisfied that the total income of the recipient justifies the deduction of income-tax at lower rates or deduction of no income-tax at all, he shall, on an application made by the assessee in this behalf, give the assessee a certificate to that effect. The department should, however, follow up such cases to ensure that income covered by such certificates are actually brought to tax at the appropriate rates. Omission to do so, in respect of winnings from lotteries, was noticed during the review, as pointed out below :

In Uttar Pradesh circle an individual filed an Affidavit on 28 January 1986 showing an income of Rs. 1.71 lakhs, including income of Rs. 1.51 lakhs from lottery. After deducting agent's commission amounting to Rs. 0.17

lakh and exemption of Rs. 0.70 lakh as admissible under the Act, the assessee affirmed in an affidavit that he would invest Rs. 0.40 lakh in the National Savings Certificates and accordingly, claimed a further deduction of Rs. 0.20 lakh on this account. On the basis of the assessee's affidavit for the balance income of Rs. 64,500, the concerned assessing officer issued him a certificate for deduction of tax at source at lower rates. The Director of State Lottery, relying on the above certificates, deducted income tax at source at the lower rate. The assessee did not, however, file any income-tax return. The department also did not take any follow up action to call for the return of the prize winner (March 1989), so much so, there was no evidence as to whether the individual actually purchased the certificate, etc., as proposed by him.

Non-completion of assessment

2.01.25. In Delhi circle, an assessee firm was engaged by a Sports Trust as lottery organisers for conducting three draws of lottery, sanctioned by the Government of Madhya Pradesh. As per the agreement, the organisers were to pay a minimum guaranteed profit of Rs. 10 lakhs to the promotors for each draw, before putting the tickets on sale. The organising agent furnished a bank guarantee of Rs. 35 lakhs to the Trust, providing, inter alia that the guarantee would stand forfeited to the Trust in the event of breach of any of the terms and conditions of the contract by the organising agent. The District Collector informed that the organising agent had sold 3,04,112 tickets of Rs. 50 denomination out of a total of Rs. 16,97,000 tickets printed and collected an amount of Rs. 1,52,05,600 against the scheme of prizes of Rs. 15 crores declared. First draw was held on 12 July 1985 but no prize was paid to the winners. The organisers issued cheques for Rs. 9 lakhs as guaranteed profit to the Trust, which were dishonoured by the Bank. The Bank also found that the Bank guarantee given by the organisers was fraudulent. The Sports Trust lodged an FIR with police authorities against the organisers, but they had reportedly left India. The department has not taken any action so far (January 1989) to complete the assessment of the assessee firm (July 1989) as ex-parte and to recover the tax by attachment of the assets of the assessee.

Non-levy of penalty for failure to furnish audited accounts—Lottery agents/prize winners

2.01.26. Under the provisions of the Income -tax Act, 1961, as applicable from assessment year 1985-86 onwards, every person carrying on any business and whose sales turnover or gross receipts exceed Rs. 40 lakhs, in the relevant previous year, will have his accounts audited before the specified date of filing the return of income, by an accountant and obtain before that date, the report of such audit in the prescribed form to be attached to the return of income. For failure to comply with these provisions without reasonable cause, an assessee will be liable to pay penalty at the rate equal to one half per cent of sales turnover or gross receipts, subject to a maximum of rupees one lakh. The Central Board of Direct Taxes have, in their circular issued in June 1985, clarified that no penalty proceedings would be initiated for the assessment year 1985-86 in cases where the prescribed audit report had been obtained by 30 September 1985 and self assessment tax paid within the prescribed period for filing of return of income. The Board have also issued instructions in July 1964 and again in September 1975 that where the assessing officer does not initiate penalty proceedings in any case he should record the reasons for not doing so.

(*i*) In Kerala circle, in the case of an assessee, a major agent for various State lotteries, assessments for assessment years 1985-86 and 1986-87 were completed accepting the income returned on estimate basis at Rs. 1.25 lakhs and Rs. 2 lakhs respectively. The assessee had not furnished profit and loss accounts and balance sheets along with returns, even though his turnover of the Kerala State Lottery tickets alone for the assessment years 1985-86 and 1986-87, was of the order of Rs. 150 lakhs and Rs. 290 lakhs respectively. There was no indication in the assessment records that the assessee had prepared even final accounts.

A penalty of upto Rs. one lakh was leviable for each year in this case, but this was not imposed, nor were any proceedings initiated for the purpose. Further, in the absence of details it could not be ensured in audit that five per cent agent's prize and incentives in kind, for which no source deduction was made, were considered in computing the taxable income.

(*ii*) In West Bengal circle, the total sales/turnover gross receipts of 2 assessee registered firms and 2 individuals for the assessment years 1985-86, 1986-87 and 1987-88 assessed between July 1986 and July 1988 exceeded Rs. 40 lakhs in each case. As such, the firms were required to get the accounts audited by accountants and to furnish the report of such audit alongwith the return of income; but no such report was attached to the returns nor was insisted upon by the assessing officer. For failure to observe the statutory provisions, the assessees would be liable to an overall penalty at Rs. 5,16,146 which was not levied.

(*iii*) In Madhya Pradesh circle, a welfare society received a guaranteed profit of rupees one crore from the organising agent during the year relevant to the assessment year 1985-86, but the annual accounts were not got audited by the specified date *i.e.*, by 31 July 1985, nor were any such proceedings initiated by the assessing officer. For failure to observe the statutory provisions a penalty of Rs. 50,000 was leviable, but was not levied by the department.

(*iv*) In Delhi circle, in ten cases, though the sales, turnover or gross receipts for the assessment years 1985-86 and 1986-87 exceeded Rs. 40 lakhs in each case, the prescribed audit reports were filed beyond the specified date or not filed at all before finalising the assessments. For failure to follow the statutory provisions, penalty to the tune of Rs. 11,00,000 was leviable, but no such action was initiated by the assessing officers.

In four cases, the department was stated to have allowed the assessees' extension of time for furnishing the returns of income and hence the specified date for filing the audit report got automatically extended. However, the assessees were statutorily required to get the accounts audited by the specified date notwithstanding the extension granted for filing of the returns, and liable for penalty.

Non-disallowance of expenditure in excess of Rs. 2500 paid otherwise than by crossed cheque/draft

2.01.27. The Income-tax Act, 1961, provides for disallowance of expenditure incurred in business or profession, subject to certain exemption, for which, payment is made for any amount exceeding Rs. 2,500 otherwise than by crossed cheque or a crossed bank draft. This provision was designed to act as a check against evasion of tax through claims for expenditure, shown to have been incurred in cash, but would frustrate proper investigation by the department as to the identity of the payee and the reasonableness of the amount. A residuary provision made in this regard states that exemption can be allowed where the assessee satisfies the Income-tax Officer not only about the genuineness of the payment and identity of the payee, but also on the fact that the payment could not be made by a crossed cheque/bank draft due to exceptional or unavoidable circumstances or due to the impracticability of payment or to avoid causing genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof.

It has been judicially held (167 ITR 139) that to claim the benefit of the provision of this Rule, it is not sufficient to establish the genuineness of purchases and identity of the payee, but the assessee should also be further required to prove that the circumstances mentioned in the rule existed, and the required conditions were satisfied and in the absence of such evidence, such payments are not deductible in the computation of income.

In West Bengal circle, in the assessment of an assessee registered firm and an individual engaged in the business of lottery for the assessment year 1985-86 completed between July 1986 and July 1988, payments in each case exceeding Rs. 2,500 made otherwise than by crossed cheque/bank draft to the extent of Rs. 5,40,606, were listed out in the assessment records without indicating the exceptional and unavoidable circumstances as provided under the rules. There was nothing on record to indicate that the assessing officer was satisfied with these payments The expenditure of Rs 5,40 606 was, therefore, not allowable to the assessee and consequently resulted in aggregate undercharge of tax of Rs. 1,49,096.

The review was forwarded to the Ministry of Finance for comments in September 1989; the reply from the Government has not so far been received (October 1989)

ANNEXURE

(Amount in lakhs)

Name of the A.G./ D.A.	Assessee	Assessment year	Total sales/ turnover/ receipts including commission on sales of price winning tickets	Expenses		Income returned by the assessee	Income assessed	Percentage of profit over receipts
				Claimed	Allowed			
Tamil Nadu	A	1984-85	570.08	562.69	555.18	12.63	20.14	3.53
		1985-86	986.78	986.11	982.38	16.56	20.29	2.05
		1986-87	1031.99	1018.35	1016.30	13.67	15.71	1.52
		1987-88	1038.81	1062.77	1060.67	(—)23.86	(—)21.76	
	B	1984-85	82.98	92.46	91.99	(—)7.81	(—)7.34	—
		1985-86	954.42	984.06	983.61	(—)28.43	(—)27.98	—
		1986-87	231.85	221.06	220.87	12.36	12.55	5.41
		1987-88	2.53	0.38	0.18	2.15	2.35	
	C	1984-85	1132.71	1125.86	1113.56	12.35	52.50	4.63
		1985-86	2315.32	2343.41	2331.31	(—)13.08	(—)7.99	—
		1986-87	2162.33	2238.78	2232.57	(—)76.45	(—)70.24	—
		1987-88	1364.35	1312.48	1307.51	51.90	58.88	4.31
	D	1984-85	945.13	937.36	924.08	11.67	14.95	1.58
		1985-86	1406.88	1404.61	1379.[illegible]0	16.10	40.91	2.90
		1986-87	1077.74	1084.78	1079.38	(—)6.96	(—)1.67	—
		1987-88	1426.42	1443.78	1437.82	(—)12.96	(—)6.98	—
	E	1984-85	1040.24	1038.29	1033.17	7.84	12.96	1.24
		1985-86	851.84	847.72	856.99	6.41	11.94	0.83
		1986-87	583.62	594.57	591.96	(—)10.91	(—)8.29	—
		1987-88	146.03	148.39	147.27	(—)2.04	(—)0.92	—
Calcutta	F	1984-85	1127.05	1106.80	1106.79	—	—	0.07
		1985-86	1489.90	1461.94	1461.01	(—)33.81	2.03	0.02
		1986-87	2226.47	2218.19	2218.19	0.46	0.46	0.02
	G	1984-85	225.93	223.69	223.21	1.86	3.23	0.99
		1985-86	154.08	152.60	152.60	0.25	0.25	0.23
	H	1984-85	19.05	18.70	18.70	0.50	0.50	2.95
		1985-86	35.47	33.81	33.81	0.80	0.80	4.84
	I	1984-85	426.96	421.68	421.68	—	—	0.74
		1985-86	194.78	183.66	183.86	—	—	0.63
	J	1984-85	148.10	149.63	149.63	0.46	0.46	0.47
	K	1985-86	2.37	2.05	2.05	0.32	0.32	13.33
		1986-87	16.98	16.57	16.57	0.41	0.41	2.40
	L	1984-85	155.06	152.72	152.71	0.28	0.29	0.24
		1985-86	84.00	83.17	83.17	0.43	0.43	0.85
		1986-87	122.47	121.19	121.19	0.36	0.36	0.40
		1987-88	84.30	83.18	83.11	0.30	0.41	0.7)

	M	1984-85	109.26	108.85	108.83	0.20	0.18	0.18
		1985-86	56.96	56.47	56.47	0.37	0.33	0.66
		1986-87	149.89	146.22	143.58	1.06	3.42	2.36
Kerala	N	1985-86	186.46	7.09	7.09	1.32	1.32	0.70
		1986-87	195.82	6.06	6.06	1.01	1.61	0.82
		1987-88	104.99	3.53	3.53	(—)0.02	(—)0.02	Nil
	O	1985-86	5.22	5.08	5.08	00.14	00.14	2.6
		1986-87	1.90	1.80	1.80	00.11	00.11	5.6
Andhra Pradesh	P	1984-85	0.73	00.21	00.20	00.83	00.83	113.69
		1985-86	1.35	00.68	00.69	1.09	1.09	80.74
		1986-87	3.65	00.91	00.91	2.96	2.96	81.09
		1987-88	2.34	0.83	0.83	1.77	1.77	75.64
Karnataka	Q	1985-86	39.26	1.83	1.83	0.75	0.75	1.9
		1986-87	31.73	1.46	1.46	0.95	0.95	3.00
		1987-88	16.52	1.37	1.37	N.A.	N.A.	1.7
	R	1986-87	139.86	0.64	0.64	0.73	0.73	0.52
		1987-88	167.69	2.32	2.32	0.97	0.97	0.58
	S	1985-86	2.62	2.02	2.02	0.71	0.71	27
Bihar	T	1985-86	65.99	65.01	65.01	0.99	0.99	1.50
		1986-87	87.85	86.88	86.88	0.97	0.97	1.10
		1987-88	134.51	133.57	133.57	0.95	0.95	0.70
	U	1986-87	137.16	136.23	136.23	0.92	0.92	0.67
		1987-88	388.52	387.54	387.54	0.98	0.98	0.25
	V	1985-86	2.85	2.00	2.00	0.85	0.85	29.81
		1986-87	3.02	2.05	2.05	0.98	0.98	32.28
		1987-88	3.17	2.26	2.26	0.91	0.91	28.59
Gujarat	W	1984-85	19.15	1.08	1.03	1.00	1.87	9.5
		1985-86	42.80	1.14	1.04	0.93	1.31	3
		1986-87	174.67	2.78	2.68	1.05	2.36	1.5
	X	1984-85	13.98	1.12	1.07	0.63	1.93	14
		1985-86	40.88	1.68	1.56	1.42	1.86	4.5
		1986-87	45.66	1.19	1.08	1.14	1.36	3
	Y	1984-85	5.27	0.53	0.53	0.90	0.90	17
		1985-86	4.81	0.29	0.29	0.48	0.48	9
		1986-87	3.03	0.32	0.32	0.33	0.33	11
	Z	1984-85	5.43	0.47	0.47	1.06	1.06	19
		1985-86	7.82	0.31	0.31	0.69	0.69	9
		1986-87	4.94	0.37	0.37	0.43	0.43	8
	AA	1984-85	14.54	0.27	0.27	0.22	0.22	1.5
		1985-86	12.11	0.16	0.16	0.17	0.17	1.5
	BB	1987-88	94.57	1.99	1.99	0.28	0.28	3
Uttar Pradesh	CC	1984-85	0.40	0.22	0.22	0.18	0.18	45.14
		1985-86	0.69	0.47	0.47	0.22	0.22	31.7
		1986-87	1.57	1.21	1.21	0.30	0.30	19.2
	DD	1984-85	187.38	186.53	186.49	0.91	0.95	0.51
	EE	1986-87	5.13	3.56	3.56	1.58	1.58	30.72

	FF	1986-87	1.09	0.67	0.67	0.14	0.14	12.72
	GG	1985-86	15.22	7.78	7.75	7.91	7.93	52.11
		1986-87	18.28	7.85	7.80	10.45	10.50	57.40
	HH	1986-87	0.08	7.86	7.86	0.22	0.22	2.77
New Delhi	II	1986-87	189.45	195.66	195.66	0.17	0.57	0.29
	JJ	1985-86	263.81	257.44	257.44	1.40	1.40	0.53
		1986-87	986.19	997.59	997.59	3.63	3.63	0.37
	KK	1984-85	658.45	661.49	660.26	2.86	7.82	1.2
		1985-86	1270.94	1255.46	—	3.07	8.00	0.6
		1986-87	1230.51	1240.40	1239.78	5.08	5.89	0.46
	LL	1984-85	6.37	4.47	3.29	2.39	3.09	48.4
		1985-86	54.82	306.72	304.68	(—)14.44	(—)12.40	Loss
		1986-87	473.73	654.35	643.55	(—)36.29	(—)25.48	Loss
	MM	1986-87	304.23	305.47	305.38	1.24	2.09	0.7
	NN	1986-87	71.77	84.69	73.53	(—)7.11	(—)6.01	Loss
	OO	1984-85	2718.63	3770.88	3746.10	—	91.34	3.3
		1985-86	3501.73	3737.21	3713.63	30.73	203.84	5.8
		1986-87	4483.51	4172.88	4171.74	365.51	505.21	11.3
	PP	1984-85	238.08	220.08	211.03	25.63	26.55	11.2
		1985-86	935.81	946.20	935.61	(—)2.07	00.21	0.02
		1986-87	3397.00	3381.15	3374.90	21.33	22.10	0.65
	QQ	1984-85	1107.52	1123.02	1117.07	99.37	124.08	11.2
		1985-86	2601.63	2307.60	2297.50	113.30	285.03	10.9
		1986-87	3536.68	3073.35	3063.13	327.72	479.49	13.5
	RR	1986-87	64.99	89.05	88.90	(—)2.29	(—)2.15	Loss
	SS	1984-85	3325.68	3321.07	3303.09	19.97	22.59	0.7
		1985-86	4332.22	4323.68	4297.12	8.54	12.43	0.3
	TT	1985-86	3.16	5.78	5.78	0.15	0.15	4.6
		1986-87	33.16	35.47	35.47	0.67	0.67	2
	UU	1986-87	304.23	305.47	305.38	1.24	2.10	7
	VV	1985-86	1627.41	1626.80	1626.80	0.61	0.61	0.04
Madhya Pradesh	WW	1984-85	14.65	14.46	14.46	0.24	0.24	1.6
		1985-86	14.91	14.81	14.81	0.18	0.18	1.2
		1986-87	16.36	16.01	16.01	0.28	0.28	1.7

2.02 Deduction of tax at source

Introductory

2.02.1 The Income-tax Act, 1961, and Income-tax Rules, 1962, prescribe the broad provisions for the deduction of tax at source. These provisions are supplemented by executive instructions issued from time to time, detailing the procedure for the proper administration of these provisions. The provisons for source-deduction of tax ensure that annual tax revenue is collected during a year side by side with the earning of the income by the tax payer, without waiting for the completion of formal assessments. For the system to function effectively, it is essential that the persons responsible for deducting tax at source and the income-tax authorities, both discharge their complementary functions properly and efficiently.

The importance of the system of tax deduction at source, in the scheme of direct taxes administration, is largely indent from the following figures :

Sr. No.	Year	Total collection	Tax deducted at source	Percentage of T.D.S. to total Collection
		In crores of rupees		
(i)	(ii)	(iii)	(iv)	(v)
1	1982-83	4138.23	970.60	23.45
2	1983-84	4498.38	1053.70	23.42
3	1984-85	4797.33	1100.26	22.93
4	1985-86	5621.83	898.30	15.98
5	1986-87	6236.46	1496.10	23.99
6	1987-88	6757.18	2276.93	33.69
7	1988-89*	8,828.68	1862.79	21.10

*Figures furnished by the Ministry of Finance. are provisional

Objectives of the system

2.02.2 The objectives of deduction of tax at source are two fold :

(i) Collection of tax revenue while the income is being earned; and

(ii) Safeguard against possible escapement/concealment of taxable income by tax payers by not returning/disclosing their true income.

The Scheme

2.02.3 The Income-tax Act lays down the law relating to the deduction of tax at source, which covers sources of income including salaries, interest on securities, dividends, interest other than interest on securities, winnings from lotteries, cross-word puzzles, horse races, contract amounts payable to contractors and sub-contractors, insurance commission and other sums. Persons responsible for making such payments are required under the Act, to deduct tax at source at the time of payment/credit to the accounts of recipients, at the prescribed rates, and to deposit the same to Government account in the prescribed manner and within prescribed time. They are also required-to maintain and furnish periodical returns of such deductions to the income-tax authorities and issue certificates of deduction of tax to the persons from whom tax is deducted. The income-tax authorities on their part are required to ensure that the statutory responsibility of the persons making deduction of tax at source are properly discharged and credit is given in assessments for the correct amounts. For this purpose, they are required to maintain prescribed registers and records, check the various returns received. for any shortfall/lapse in deductions, initiate penal actions against defaulters, wherever necessary, and to ensure co-ordination between the annual returns and the tax deduction certificates.

Public Accounts Committee Recommendations

2.02.4 The Public Accounts Committee in their 78th Report (Sixth Lok Sabha) (1977-78) had noted with grave concern certain lapses and shortcomings reported by audit in the working of the Salary circles. The Committee observed that the proper maintenance of employers' register, tax deduction certificates, the annual/monthly returns furnished by the employers etc., which can serve as important tools in the hands of the income-tax authorities were not receiving adequate attention. The employers' registers were generally incomplete and the timely receipt of the returns from the employers was not being closely watched. The Committee were distressed that there were cases where either tax was not deducted at source at all or the tax deducted was not credited to Government account in time and cases of incorrect computation/assessment of the perquisites and other amenities provided by the employers. The Committee had recommended effective steps to guard against the recurrence of such lapses.

Scope of Audit/Review

2.02.5 The efficiency and effectiveness of the scheme of tax deduction at source was reviewed in audit during January—May 1989, by a selective test-check of 736 wards spread out in 73 circles, all over India. The study covered approximately 19 per cent of the total number of wards (3,831) operating the scheme. The objective of the review was to evaluate the working of the scheme *vis-a-vis* the legislation encompassing the scheme, the mode of implementation, efficiency of the system of monitoring and control, as also to verify whether there was any escapement of tax due to the Government at any of the stages of implementation of the scheme.

2.02.6 Particulars of tax deducted at source :

(In crores of rupees)

Year	Total Collection	Total T.D.S.	Percentage
1984-85	2,799.35	428.41	15.30
1985-86	3,128.23	703.49	22.49
1986-87	3,966.12	792.26	19.97
1987-88	3,820.86	880.37	23.04
1988-89	Complete information not available with the department.		

COLLECTION OF TAX (Rs. in crores)

S. No.	State	Total No. of Cs.I.T's (for which details are included)	1984-85 Advance Tax	1984-85 Source	1984-85 Total Collection	1985-86 Advance tax	1985-86 At Source	1985-86 Total Collection
1	West Bengal	13	313.79	30.48	439.80	324.63	52.89	474.37
2	Tamil Nadu	10	165.07	68.07	331.64	174.74	89.04	375.53
3	Delhi	6	30.43	1.69	42.54	43.85	2.75	63.65
4	Uttar Pradesh	6	937.19	49.44	1012.46	672.38	188.30	945.55
5	Madhya Pradesh	2	30.25	16.47	63.53	36.31	36.68	89.97
6	Gujarat	7	130.16	56.20	197.14	188.14	59.09	286.70
7	Karnataka	4	134.06	15.32	149.38	131.01	50.59	181.60
8	Rajasthan	2	18.84	20.61	41.67	22.34	26.56	53.14
9	Bihar	2	15.06	21.26	57.42	13.46	30.62	61.49
10	Andhra Pradesh	4	48.30	35.16	114.90	54.40	41.66	174.74
					5.24			15.09
11	Kerala	2	40.10	22.37	72.16	40.60	23.40	83.82
12	Haryana	1	14.21	10.78	28.39	17.76	14.07	34.56
13	Punjab	4	58.89	22.42	138.83	83.00	38.87	149.12
14	J & K	1				4.32	1.87	8.28
15	H. P.				Included against Punjab by A. G. Punjab.			
16	(U.T.) Chandigarh							
17	Orissa	1	6.98	14.75	23.67	9.77	22.05	33.43
18	Bombay	6	12.56	3.87	29.76	16.72	4.63	26.92
19	Assam	1	24.20	19.32	50.82	29.85	20.44	70.27
	Total		1,978.09	428.41	2,799.35	1,843.18	703.49	3,128.23

S. No.	State	1986-87 Advance Tax	1986-87 At Source	1986-87 Total Collection	1987-88 Advance tax	1987-88 At Source	1987-88 Total Collection	1988-89
1	West Bengal	274.83	80.70	493.74	278.42	53.42	493.85	
2	Tamil Nadu	186.52	102.12	419.26	235.38	126.82	472.74	
3	Delhi	200.54	9.73	263.75	256.25	0.67	332.13	
4	Uttar Pradesh	752.45	114.20	953.89	626.93	142.95	845.49	
5	Madhya Pradesh	33.34	41.48	97.57	37.39	49.01	109.79	
6	Gujarat	216.22	80.59	335.84	202.35	101.22	317.13	Complete information not available
7	Karnataka	163.92	51.07	214.99	167.00	46.43	213.43	
8	Rajasthan	25.49	29.59	65.36	31.24	34.75	64.68	
9	Bihar	14.50	36.91	90.07	19.99	41.43	81.97	
10	Andhra Pradesh	64.36	54.44	170.57	66.75	63.21	177.39	
				12.77			13.52	
11	Kerala	44.51	26.54	95.83	52.18	27.33	92.90	
12	Haryana	20.56	14.92	40.97	23.60	15.06	48.07	
13	Punjab	91.00	40.97	180.06	112.74	50.15	213.17	
14	J & K	3.32	2.27	7.10	2.98	2.22	6.40	
15	H. P.				Included against Punjab by A. G. Punjab.			
16	(U.T.) Chandigarh							
17	Orissa	4.56	21.43	36.26	8.09	27.69	45.19	
18	Bombay	112.96	66.75	213.79	133.78	64.65	227.47	
19	Assam	20.83	18.55	74.30	23.92	33.36	65.54	
	Total	2,229.91	792.26	3,966.12	2,278.99	880.37	3,820.86	

HIGHLIGHTS

2.02.7 The test-check revealed the following deficiencies :

(1) Several instances of non-deduction of tax at source and incorrect deduction of tax at source as also delays/omissions in remittance of the tax deducted at source to the Government, and in their accounting. The total amount of tax deducted short aggregated to Rs. 1,701.10 lakhs while interest/penalty leviable for all the defaults noticed in audit worked out to Rs. 748.85 lakhs approximately.

(2) Large-scale failures by employers, etc., to furnish the periodical returns prescribed for regulating the deduction of tax at source and their prompt credit to the Central Government and omission on the part of the Administration to monitor the requirement. The penalty leviable on the omissions pointed out by audit was of the order of Rs. 389.68 lakhs.

(3) General non-compliance by field offices with the instructions of the Board regarding maintenance of control registers to watch the receipt of the periodical returns of tax deductions at source as also of the non-reconciliation of the deductions at source annualy, as required.

(4) Non-reconciliation of the tax deduction at source with the challans received from the banks, on regular basis, as directed by the Board.

(5) In their report submitted in May 1975, the Committee of Experts on Accounting and Collection Procedure, had recommended the appointment of seperate Income-tax Officer (Tax Deduction Section) with exclusive jurisdiction on the work relating to deduction of tax at source for effective co-ordination, control and prompt action. Despite the creation of separate wards in important places, there was no visible improvement in the administration of tax deduction at source.

(6) There is no machinery to satisfy about the genuineness of tax deduction certificates or for cross verification of outstation tax deduction certificates in general or otherwise. Co-ordination between the department and other Government agencies regarding deduction at source is generally absent.

(7) The progress in allotment of tax deduction account number has been slow due to the non-availability of a ready reckoner of persons to whom such number is to be allotted.

(8) The internal audit and the inspection by the Inspecting Assistant Commissioner (now Deputy Commissioner) in charge of tax deduction sections were not carried out in any of the wards test-checked.

Incorrect deduction of tax at source from salaries

2.02.8 According to the instructions issued by the Central Board of Direct Taxes regarding deduction of tax at source from income chargeable under the head 'salaries', the employers are required to compute the correct taxable income of assessees by applying the provisions of the Income-tax Act and Rules, including valuation of perquisites, etc. Omission to do so were, however, common.

As a result of non-inclusion of taxable perquisites and allowances or grant of excess allowances/deductions in the computation of income from salaries (as evidenced from the annual return of salaries filed by the employers), there was short deduction of tax aggregating to Rs. 318.10 lakhs. The omission also attracted levy of interest and penalty of Rs. 89.05 lakhs, which was not imposed. Commissioners-wise details are given below :

Andhra Pradesh

Due to incorrect computation of income in the annual returns filed by employers, there was shortfall of Rs. 1.98 lakhs in tax deducted at source. The omissions related to allowing incorrect standard deduction, incorrect exemption of housing loans, excess relief in house rent allowance, etc. No action was taken by the department to levy any interest/penalty in such cases.

Tamil Nadu

The following omissions were noticed :

Excess allowance of standard deduction

(i) According to the Income-tax Act, 1961, read with the Income-tax Rules 1962, where one or more motor cars are owned or hired by the employer for the assessee and the assessee is allowed the use of such motor car, otherwise than wholly and exclusively in the performance of his duties, the standard deduction shall not exceed Rs. 1,000. On a test-check of the annual returns, it was seen that 3 employers in 2 wards did not restrict the standard deduction to Rs. 1,000 in such cases, in respect of 13 employees, during the financial year 1986-87. This resulted in a short deduction of tax of Rs. 39,622 involving interest liability of Rs. 7,545.

Inadmissible allowance of expenses from commission

(ii) One assessee, engaged in the business of running chit funds, paid to 8 out of 11 of his employees (in addition to salary and house rent allowance) commission for canvassing chits (salamy). But while computing the salary income for purpose of deduction of tax at source, the assessee allowed a deduction of 50 per cent of the commission paid to them towards estimated expenses for earning the commission. As salamy includes commission in lieu of or in addition to any salary or wages, and as expenses incurred for earning salary are not deductible, this resulted in a short deduction of tax of Rs. 31,183 for the financial year 1986-87 attracting levy of interest amounting to Rs. 9,330.

Inadmissible exemption of compensation paid on voluntary retirement

(iii) Under the Income-tax Act, 1961, any compensation received by a workman under the Industrial Dispute Act or under any other Act or rules, order or notification issued thereunder or under any standing order, under any award, contract of service or otherwise at the time of the retrenchment, will not be included in the total income of the employee, subject to a ceiling provided therein. This does not, however, cover compensation paid on voluntary retirement.

In one ward, 2 employer companies allowed the amount paid to 5 employees as compensation on their voluntary retirement as exempt under this section. The inadmissible exemption during the financial year 1986-87 resulted in a short deduction of tax at source amounting to Rs. 35,816.

Mistake in calculation

(iv) A test-check of the annual returns in 2 wards revealed short deduction of tax amounting to Rs. 92,309 in the case of 5 employers due to mistakes in calculation. No action was taken by the department to demand these short deductions. The interest leviable in these cases amounting to Rs. 24,254 (upto March 1988) was not also levied.

Non inclusion of the value of perquisite in computing salary

(v) In one case, the value of perquisites provided to the employees as per the annexure to the annual return was omitted to be carried over to the relevant column of the prescribed form, resulting in short computation of salaries paid to the employees and consequent short deduction of tax amounting to Rs. 24,160. The interest leviable on this upto March 1989 worked out to Rs. 7,230.

Punjab

In 123 cases subjected to audit, tax was found to have been deducted short at source during the period 1986-87/1987-88, to the extent of Rs. 1.86 lakhs. The interest and penalty leviable for the omission were also not levied.

Gujarat

A test-check of returns revealed that generally, in respect of bank employees, the city compensatory allowance paid during the financial year 1987-88 was not included as income from salary, for the purpose of deduction of tax at source, relying upon a judgment of the Calcutta High Court, which had no jurisdiction over Gujarat. For exclusion of the compensatory allowance from taxable income of these employees, which resulted in non-deduction of tax at source, the employers were liable to pay interest and face penal consequences. It would be relevant to state here that the Calcutta High Court judgment was stayed by the Supreme Court on 6 May 1988 while admitting a special leave petition of the department, but so far no action has been taken by the employers to pay the difference of tax due to wrong allowances and nor has any action been initiated against the employers for the short deduction of Rs. 11,88,181 in respect of 2,747 employees stationed at Ahmedabad, Baroda and Surat, apart from levy of interest of Rs. 1,72,514 and penalty of Rs. 11,88,181.

Uttar Pradesh

(i) In 2 Commissioners' charges, in 3,344 cases of employees under 50 employers additional demand of Rs. 41.26 lakhs and penalty of Rs. 7.24 lakhs were demanded for assessment year 1988-89 for short assessment of income detected by the department which indicated large-scale omissions to deduct tax at source. Yet in two other charges, no such checking was made. Audit scrutiny brought to notice non-inclusion of perquisites relating to reimbursement of medical expenses, in excess of the permissible limits in one Commissioners' charge by 18 employers involving 2,872 assessees. The detection of this case resulted in raising of demand of Rs. 35,14,765 on which penal interest of Rs. 7,23,303 was also imposed. The additional demand raised was partly recovered alongwith penal interest.

(ii) In another Commissioners' charge wrong working of tax deduction at source was detected against 32 employers involving 472 tax payers owing to wrong allowances made by them, on which aggregate additional demand of tax of Rs. 6,12,219 was raised which was also recovered partially.

(iii) A company had paid fixed conveyance allowance to its officers at stipulated rate without imposing any condition regarding actual maintenance of any conveyance or effective use of the amount for any other mode of transportation. The allowance was not also in the nature of reimbursement of actual expenses incurred in the performance of duties, but was essentially in the nature of addition to salary and was chargeable to tax. The aggregate of such allowances amounting to Rs. 1,81,129 paid to 61 officers during financial year 1987-88 was not, however, included in the taxable income of the concerned officers. Similarly, reimbursement of expenses incurred on chowkidars' and gardners' pay amounting to Rs. 88,300 was not included in taxable income of the officers for whom the former rendered service, although part of it was to be included in this income being taxable perquisites, according to orders of the Board. Wrong working of tax deducted at source amounted to roughly Rs. 80,830 (at the average rate of tax of 30 per cent).

(iv) In another Commissioner's charge, short working of tax deducted at source owing to excess deductions (not admissible under law) was detected against 5 employers during the year 1987-88 to the tune of Rs. 91,641, in respect of their 27 employees, in which Rs 51,376 was against a single employer involving 13 employees.

(v) An employer of another Commissioner's charge had excluded medical allowance paid at fixed rates to its officers from computation of taxable income, treating it as compensation for medical treatment although the amount was not eligible for exclusion. This resulted in the short working of tax deducted at source by Rs. 9,000 or total medical allowance of Rs. 30,000 not being included in individual's taxable income.

(vi) Under the charge of another Commissioner, an employer had granted maximum deduction in respect of interest on bank deposit/certain securities/dividends, etc., out of the salary income of 39 persons without inclusion of any receipts in this behalf. This resulted in short deduction of tax at source by Rs. 45,047 in financial year 1987-88.

(vii) In one Commissioner's charge the tax deductible by 4 employers (57 employees) during financial year 1987-88 worked out to Rs. 2,41,782 but the disbursing officers had deducted only Rs. 1,26,077 resulting in total short deduction of Rs. 1,15,705 of which, short deduction of Rs. 73,329 pertained to one employer with 49 employees. The mistake was not detected by the department nor was any penal action taken against defaulters even after the omission was brought to notice.

Madhya Pradesh

(i) A company, in addition to salary, had paid total commission of Rs. 1,45,835 to its two directors for sale of newspapers and for advertisement work. Income-tax was not deducted at source out of such commission amounts, and for the defaults interest of Rs. 98,415 (upto 30 June 1989) and a maximum penalty of Rs. 1,45,835 were leviable, but neither any interest was levied nor any penalty proceedings initiated.

(ii) In fourteen cases the income-tax at source was short deducted due to wrong application of the provisions of the Income-tax Act. The total amount of short recovery was Rs. 8,33,641 and in 8 cases total amount of income-tax of Rs. 27,408 was short deducted at source due to calculation mistake.

Rajasthan

(i) In case of an employer, interim relief and dearness allowances allowed to 469 employees were deducted from the total income of the employees for deduction of tax at source resulting in short deduction of tax amounting to Rs. 6,34,197.

(ii) In another charge a test check revealed that 18 employers in 50 cases did not deduct the amount of tax deductible at source resulting in undercharge of tax (1.66 lakhs), interest (3.14 lakhs) and penalty (0.90 lakh) aggregating to Rs. 5.70 lakhs.

Some of the cases are detailed below

(A) The assessment of income under the head 'salary' for the assessment year 1987-88 in respect of three German nationals employed with a public sector company were completed on 31 January 1985, but the employer did not deduct tax at source as required under the Act and the assessing officer also failed to initiate any action to levy interest and penalty. On the omission being pointed out by audit, the department while accepting the mistake, raised a demand of Rs. 4,14,899 (Rs. 3,24,519 interest and Rs. 90,380 penalty) and realised the entire amount in February 1989.

(B) Another employer did not deduct tax at source, in respect of salary paid to four of its employees. On the omission being pointed out (September 1987), the department raised an additional demand of Rs. 23,970 (March 1989).

(C) An employee retired from service on 29 September 1987, and a salary of Rs. 51,184 was paid to him without deducting tax at source. The tax not deducted amounted to Rs. 10,217.

(D) In the case of 3 employees of a Government corporation tax was deducted at source less by Rs. 41,152.

Kerala

In six income-tax wards, short deduction of tax was noticed in 21 returns involving 57 employees, shortage being to the tune of Rs. 56,668, for assessment years 1986-87 and 1987-88. Four cases of non-inclusion of perquisites, value of amenities or benefits provided by employers in the total income, were also noticed, involving short deduction of tax of Rs. 11,232 for assessment years 1986-87 and 1987-88.

Karnataka

(i) Omission to include unexempted portion of house rent allowance in the taxable salary of 24 employees, by 2 persons responsible for deduction of tax at source led to non-deduction of tax of Rs. 12,169 in assessment year 1985-86 and Rs. 16,005 in assessment year 1987-88. In both the cases no action was taken to levy interest and penalty due.

(ii) One employer in the same charge did not deduct tax from 12 of his employees for the financial year 1986-87 and particulars of salary were also not given in annual return filed, on the ground that the employees were filing their returns of income. Annual returns for financial years 1984-85 and 1985-86 were also not furnished by the employer. Verification in audit, from the annual return for the financial year 1987-88, revealed that all these employees had taxable income for that year, nine of them had gross salary income exceeding Rs. 50,000 and two of them gross salary income between Rs. 30,000 and Rs. 50,000 and that an amount of Rs. 43,965 was deducted towards income-tax from the salaries of these employees during that financial year. Prima facie, these employees had taxable income during the financial year 1986-87 also, but the employer failed to deduct tax from their salaries. No penal action was initiated against the employer for failure to deduct tax.

(iii) In another case an employer deducted Rs. 12,600 from the salary of his employee during the financial year 1986-87 and furnished a certificate of tax deduction at source and enclosed a salary statement to the certificate. As per the salary statement, the gross salary of Rs. 1,43,760 included additional conveyance of Rs. 25,907 The employer deducted from the gross salary income a sum of Rs. 90,133 comprising standard deduction (Rs. 10,000), conveyance allowance (Rs. 30,000), additional conveyance allowance (Rs. 23,316), recovery of additional conveyance allowance (Rs. 17,910) and deduction under Section 80C (Rs. 8,907). The assessee (employee) filed his return of income for assessment year 1987-88 on this basis and claimed a refund of Rs. 1,898. On being questioned as to why standard deduction of Rs. 10,000 and deduction towards conveyance allowance of Rs. 71,226 were not shown in Tax Deduction at Source Certificate (Form No. 16) the employer merely affirmed that the salary certificate issued was correct. Thereupon, the Income-tax Officer asked the assessee to file a revised return, pointed out that the claim for deduction of conveyance allowance to the extent of Rs. 71,226 was not in order, as the actual conveyance allowance received was only Rs. 25,907. The assessee replied that his return was based on the salary statement furnished by his employer and the Income-tax Officer then concluded the assessment under Section 143(1), accepting the income returned. Apparently, the employer had wrongly deducted Rs. 71,226 from the gross salary of the employee against Rs. 25,907 actually paid to the employee as conveyance allowance and this had resulted in short deduction of tax at source by Rs. 16,230. Penalty and interest leviable for the default would be Rs. 3,449 and Rs. 16,230 respectively. No action was initiated to recover the amount of tax short deducted and to levy interest and penalty, either on scrutiny of annual return furnished by the employer or even after short deduction came to notice through the assessee's return of income.

Delhi

In 2 cases short deduction of tax at source to the extent of Rs. 21,018 was noticed in audit. No action was taken by the department to levy penal interest and penalty for the default.

Bombay

(i) In two Commissioners' charges, inadmissible deduction of various allowances while arriving at taxable income resulted in wrong working of the tax deduction at source by Rs. 1090.79 lakhs in respect of 2156 cases.

(ii) In the same charges, an assessee had not included the amount of city compensatory allowance in the taxable salary income of their employees for calculation of tax deductible at source, in the assessment years 1987-88 and 1988-89 and the department stated that the tax was not deducted in view of a stay order given by the Calcutta High Court. The amount of tax deductible involved was approximately rupees 14 lakhs. As mentioned in Para 6(d) supra, the Calcutta High Court decision was not binding on the authorities at Bombay and besides, Supreme Court had stayed the Calcutta High Court judgement in May 1988. In another similar case, the employer did not include the amount of city compensatory allowance paid to their employees in the taxable salary income during the year 1988-89. The amount of tax deductible involved is approximately Rs. 6.21 lakhs.

Deduction of tax on average rate basis

2.02.9. As per provisions of the Act, any person responsible for paying any income chargeable under the head 'Salaries' shall, at the time of payment, deduct income-tax on the amount payable, at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made, on the estimated income of the assessee for that year, subject to adjustment. Failure to deduct tax attracts interest provisions of the Act.

Omission noticed to follow the above rule are enumerated below, charge-wise :

Punjab

Test-check of the records of units disclosed that tax was not being regularly deducted at source by employers, at the average rate. Generally the tendency was to deduct most of the tax due during the last two months of the financial year. Interest foregone in 47 such cases pointed out by audit, amounted to Rs. 1.48 lakhs.

Delhi

In one Government salary circle in 15 cases, tax was not deducted at source, on monthly average rate basis, during the previous years relevant to the assessment years 1987-88 and 1988-89. The interest leviable in these cases on the shortfall of tax deducted, amounting to Rs. 2.62 lakhs was not levied.

Delay/omission in crediting tax deducted at source

2.02.10 Under the Income-tax Rules, 1962, all sums deducted at source in accordance with the various provisions of the Income-tax Act shall be paid to the credit of the Central Government (a) in the case of deduction by or on behalf of the Government on the same day, (b) in all other cases within one week from the last day of the month in which the deduction is made. Delay in depositing or failure to deposit the same attracts interest, penalty and prosecution. Large-scale omissions were noticed in many circles to comply with the rule, instances of which, representative in nature, are given below :

Andhra Pradesh

(i) In respect of two employers under one Commissioner for assessment year 1988-89 for delays in remittances of tax deducted from salaries, ranging from one month to 3 months, interest amounting to Rs. 2.25 lakhs was leviable, but not levied.

(ii) In a salary ward in another charge, the annual returns indicated that there were delays amounting to three months in the remittance of tax deduction at source (Rs. 2.22 lakhs) by a private limited company into Government account. The interest leviable worked out to Rs. 8,322.

(iii) In respect of a ward in another Commissioner's charge, in 24 out of 32 cases where the tax deducted of Rs. 2.57 lakhs was not paid in time, the department had not initiated any action to levy interest.

Tamil Nadu

A test-check of 18 disbursing officers under 3 State Government undertakings, over a period of 3 years, revealed that out of Rs. 64.44 lakhs tax deducted at source from payments made to contractors under the Act, only 10 per cent (Rs. 6.45 lakhs) was remitted within the stipulated time (i.e., before the 7th of the succeeding month), 13.45 per cent (Rs. 8.67 lakhs) with a delay of 1 to 7 days, 20.11 per cent (Rs. 12.96 lakhs) with a delay of 8 to 15 days, 28 per cent (Rs. 18.05 lakhs) towards the end of the succeeding month (i.e., with a delay of 16 to 23 days) and 28.40 per cent (Rs. 18.31 lakhs) with a delay extending over 1 to 5 months. No action was taken in the cases of delay exceeding one month to levy interest which amounted to Rs. 61,000 and to levy penalty.

In respect of other belated remittances not exceeding one month, though interest could not be charged thereon under the rules, it could be seen that considerable amount of tax deducted (61.60 per cent) was kept outside the Central Government accounts.

It was also seen that only 3 out of these 18 disbursing officers filed quarterly returns of tax deducted (in Form 26 C). Under the Act failure to file the returns would attract levy of penalty which may extend to Rs. 10 for every day during which the failure countinues. But no penal action was initiated against the defaulters. Besides, failure to watch the receipt of the returns resulted in the department not being aware of the continued delayed remittance by these undertakings.

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Bombay

During the audit of assessments completed by the department in the year 1987-88, 29 cases where taxes deducted at source for assessment years 1984-85 to 1987-88 aggregating to Rs. 9.13 lakhs but not remitted to Government, were pointed out.

A Dock Labour Board deducted income-tax at source to the extent of Rs. 23 lakhs approximately from the monthly pay bills of the employees of their stevedore scheme during the year 1986-87. The amounts were paid to Government in instalments, on 24 March 1987 (Rs. 18,00,000) on 8 April 1987 (Rs. 2,03,972) and on 8 April 1987 (Rs. 2,78,234). Under the Income-tax Act, 1961, the Board had to be deemed to be a defaulter and was liable for interest for the period of default and penalty.

Further verification of the case in the concerned income-tax ward revealed that the Board had not filed annual return for assessment year 1987-88 for 3 sections of their workers/staff which included stevedore section for which tax deduction at source amount of Rs. 22,82,246 was paid late as mentioned above. On this being pointed out, the department issued notice on 16 March 1989 for the filing of returns and the Board filed the return for the year ended 31 March 1987 on 10 April 1989.

Uttar Pradesh

In two charges in 31 and 8 cases, amount of tax deducted at source from salaries pertaining to the financial years 1986-87 and 1987-88 was credited to Government account late by 15 to 22 days but no penal interest as stipulated was levied. In the remaining two charges, no records about delays in crediting the tax to Government accounts was available.

Scrutiny of Form 24 in 3 cases disclosed delay in crediting the tax deducted at source. However, no action for levy of interest as prescribed was taken.

In one case, an employer was found to have kept income-tax deducted from salaries of various employees and deposited it after a month of its deduction during 1987-88, but no interest was levied on him by the department.

In yet another case, in a different charge tax amounting to Rs. 21,770 pertaining to the year 1987-88 was paid on 30 April 1988 on the date of filing of Form 24 by the employer, although tax was to have been deducted from monthly payments. It could not be verified whether tax was regularly deducted from salary every month as no monthly return was posted either in the register of the employers or in register for tax deduction at source on salaries.

Rajasthan

Test-check revealed the following irregularities :

(i) In one case, the tax deducted at source from salaries was deposited quarterly instead of monthly and in the case of another, the tax deducted from December 1987 to March 1988 was deposited only on 26 April 1988. Delay in depositing tax attracted interest of Rs. 3,410 besides penalty, which were not levied.

(*ii*) In another case, tax deducted at source from salaries (1987-88) amounted to Rs. 17,412 against which a sum of Rs. 14,763 was deposited (Rs. 2,649 deposited short) and in another case, tax deduction at source amounting to Rs. 24,825 was deducted in 1987-88, but Rs. 19,825 only was credited to Government account (Rs. 5,000 deposited short).

Madhya Pradesh

In 22 cases, the income-tax deducted at source out of salary payments was either not credited to the Central Government account or was short credited. For such defaults total amount of interest of Rs. 69,205 and maximum penalty of Rs. 2,72,776 were leviable. In none of the cases, however, the interest was charged and penalty proceedings were initiated.

Gujarat

A test-check of the returns in 84 wards in seven Commissioners charges revealed that interest amounting to Rs. 1,86,203 had not been levied for delays in crediting the tax deducted at source in 534 cases.

A test-check of the returns of tax deducted at source in 84 wards in seven Commissioner's charges, it was also seen that :

(*i*) Penalty aggregating to Rs. 24.74 lakhs was not levied for failure to furnish returns of tax deducted at source from salary in 678 cases.

(*ii*) Interest aggregating to Rs. 51,987 was not levied in 5 cases for failure to deduct tax at source for payment of interest other than interest on securities.

(*iii*) Penalty aggregating to Rs. 1,17,800 was not levied in respect of 298 returns of tax deduction at source from salaries which were submitted after delays ranging from 15 to 515 days.

(*iv*) Penalty of Rs. 1.89 lakhs was not levied for delay in furnishing the prescribed return from a State Financial Corporation.

Delhi

A company which had deducted tax of Rs. 1,69,800 during the previous year relevant to the assessment year 1986-87 remitted the amount to Government account after delay of 214 days.

Bihar

Delays ranging from 37 days to 89 days in crediting tax amounting to Rs. 7,94,387 deducted at source to Government account were noticed. The interest leviable in those cases amounting to Rs. 18,999 was not levied. Maximum penalty leviable would be equal to the amount of the tax i.e. Rs. 7,94,387.

Calcutta

An examination of the entries in the Annual Return with the entries in the Employers Register disclosed that in many cases tax deducted were not fully deposited to the credit of the Government. In the course of test audit it was noticed that in 107 cases, the short deposit of taxes worked out to Rs. 19,54,936 in the year 1986-87.

Interest leviable for these short deposits worked out to Rs. 5,83,400 upto 31 Marh 1989. There was nothing on record to indicate whether this short remittances of tax deduction at source had actually been deposited to the Government account along with penal interest even after 31 March 1989.

Gujarat

A test-check of returns in 84 wards in seven Commissioner's charges revealed that in two cases the amount of tax deducted at source was not paid to Government as on 31 March 1989. In addition to the tax in arrears of Rs. 51,458, the assessee was liable to pay interest of Rs. 10,217 and penalty not exceeding Rs. 51,458. Prosecution proceedings for not paying the tax after its deductions were also required to be launched. However, no action had been initiated in these cases.

Uttar Pradesh

(*i*) 5 employers in one Commissioner's charge and 1 employer in another Commissioner's charge were found to have not paid to the Government account the entire tax deduction at source (Rs. 45,819) in financial year 1987-88, but no penal action against the defaulter was taken.

(*ii*) In one of the Commissioner's charge 3 employers who had deducted tax of Rs. 2,64,617, Rs. 10,245 and Rs. 8,733 respectively in financial year 1987-88 did not furnish particulars of payments of tax. In the absence of any maintenance of prescribed register and complete posting of monthly returns therein, it was not verifiable whether tax deduction at source was credited to Government account or not. No action to obtain particulars or for initiation of penalty proceedings was taken.

(*iii*) An employer of another Commissioner's charge had shown deduction of tax at source from employees during financial year 1987-88 at Rs. 2,35,946 but he claimed a total payment of Rs. 2,53,734 in 12 monthly instalments. The means/source from which surplus payments towards tax became possible was not explained. In the absence of proper maintenance of records the variation was also not verifiable. No action was taken to reconcile the discrepancy.

(*iv*) An employer had withheld tax deducted at source of Rs. 8,591 attributable to city compensatory allowance with him after deducting the same from his employees. No action was taken by the department to get the sum deposited to Government account and no penal action was initiated against the employer for the irregular withholding of tax deducted by it.

Assam

Interest amounting to Rs. 43,104 leviable for delay in crediting tax deducted at source was not levied in respect of :—

(*i*) 74 cases noticed during test-check of 2 wards where an amount of Rs. 13.99 lakhs was retained in hand beyond the admissible period by private/quasi-Government/Government employers.

(ii) One University deposited the tax amounting to Rs. 3.28 lakhs deducted during 1988-89 after delay of 1 to 6 months.

(iii) A tea corporation limited retained the amount of tax deducted at source of Rs.2.52 lakhs during 1986-87 and 1987-88 for 1 to 7 months before crediting to Government.

(iv) An autonomous body submitted annual return for the financial year 1987-88 on 16 June 1988 and the tax deducted at source amounting to Rs. 1.95 lakhs was deposited to bank by cheque on 18 June 1988. The delay attracted interest at 15 per cent per annum from 8 April 1988 to 17 June 1988.

Tax deduction at source on accumulated balances of recognised provident fund/approved superannuation fund

2.02.11 Under the provisions of Fourth Schedule of Income-tax Act, 1961, the trustees of a recognised provident fund are required to deduct tax at source at the time of payment of accumulated balances due to an employee like deduction of tax on salaries, if the employee had not rendered continuous service with his employer for a period of not less than 5 years, or in circumstances other than specified in other rules. Similarly where any contribution made by an employer including interest on contribution to an approved superannuation fund are paid to an employee prematuraly during his life time in circumstances other than those specified in the Act the payer is required to deduct tax at specified rates and credit it to Government Account.

Under the provisions of Income-tax Rules, 1962, such payers are required to furnish a return (Form 22) to the Income-tax Officer within whose jurisdiction the office of the persons responsible for paying the salaries is situated.

(a) The test-check in Uttar Pradesh charges revealed that none of the wards had ever received any such return from any of the recognised trusts nor any of them irrespective of the Commissioners' charges maintained any list of such recognised trusts/funds to exercise any control over them in calling for the stipulated return although all Commissioners have been according recognition to a large number of trusts/funds each year. While one Commissioner had accorded recognition to 7 Superannuation Funds and 26 Provident Funds upto March 1989 another Commissioner has accorded recognition to 3 such provident funds in his jurisdiction upto March 1989.

(b) In Tamil Nadu circle also no such returns were being received in Tax Deduction at Source wards dealing with salaries. When this was pointed out one Income-tax Officer replied that these returns were not received and will be insisted in future.

Trustees of the funds file returns for purpose of getting refund of the tax deducted at source from income received by them as their income is exempt under the Act. Alongwith the return. they file only copy of income ad expenditure account and balance sheet for the respective years. It was suggested that at the time of completing their assessments they could be asked to file details of payments made out of these funds, to ensure that tax due was deducted in all cases without omission. Report on action taken has not been received.

Non/incomplete maintenance of prescribed register and failure to furnish statutory returns

2.02.12 Every employer is required to file with the Income-tax Officer on or before April 30 of every year in respect of deductions made during the immediately preceding financial year, Annual Returns of Salaries (in Form 24) giving details of all amounts chargeable under the head 'Salaries' paid to the employees and the amount of tax deducted and credited to the Central Government. This statement provides specific columns not only for various items of income assessable under salaries, such as wages, annuity, pension, gratuity, commossion, bonus, fees or profits in lieu or in addition to salary, but also perquisites such as residential accommodation provided free of rent or at concessional rent, household furniture provided by the employer, remuneration paid by the employer for domostic and personal services provided to the employee free or concessional passage on home leave or other travelling facilities provided by the employers, contribution to recognised provident fund in excess of 10 per cent of the employees salary or interest on the provident fund balances credited at rates higher than those fixed by the Government or any other amenity provided by the employer free of cost or at concessional rate.

The non-Government employers in addition to the annual return are also required to file with the Income-tax Officer a monthly return giving details of the amount of 'Salaries' paid to each employee, the amount of tax deducted and the date of payment thereof to the credit of Government account. The Commissioners of Income-tax are empowered to waive the requirement and allow submission instead of a monthly certificate of tax deducted from salaries and paid to the credit of Government.

The Income-tax Officer is required to maintain a 'Register of tax on salaries' giving details of salary and the amount of tax deducted at source in respect of each employee (in Form Income-tax Non-statutory Form Series 22). In the register each employee is to be allotted a page and entries are to be made on the basis of monthly returns. This register helps in checking whether adequate deduction is being made from the salary of the employee, every month.

In addition, an alphabatical Register of Employers (Income-tax Non-statutory Form Series 118) is also required to be maintained in each salary Tax Deduction at Source ward, in this register, each employer should be allotted a page and entries are to be made on the basis of the monthly returns indicating date of receipt of the monthly returns, tax deducted at source, tax actually deposited to Government account, date of payment and daily collection register number, short payment and action taken in respect of short payment and to be reconciled with reference to annual returns. The reconciliation is to be recorded at the foot note of the alphabatical Register of Employers. The annual returns submitted by employers in Form 24 should be scrutinised with a view to see whether the tax has been correctly deducted and deposited in time.

In the event of failure to deduct tax or after deducting, failure to deposit it into the Government Treasury as required by or under the Act, the employer would have to pay simple interest at the rate of 15 per cent per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid. The employer would also be treated as an assessee in default and thereby become liable to the penalties under section 221 and prosecution proceedings under section 276B of the Act.

Ommission to maintain the prescribed register and to take follow up action regarding proper deduction/ remittance of tax were noticed in the following cases.

West Bengal

During 1984-85, 1985-86 and 1986-87, 2,058 employers had not furnished annual returns and the amount of penalty leviable at the maximum prescribed rate upto 31 March 1989 worked out to Rs. 2.31 crores. In 848 cases, notices calling for returns were not issued. In addition for delayed submission of these returns during the three years as aforesaid penalty leviable upto 31 March 1989 worked out to Rs. 12.73 lakhs but no steps had been taken to levy and collect penalty in any case.

Kerala

In one of the major wards in Kerala circle, tax deducted at source collection during 1987-88 and 1988-89 amounted to Rs. 93.12 lakhs and Rs. 102.85 lakhs respectively but the concerned Income-tax Officer neither maintained any records to watch the receipt of return nor exercised any control over persons responsible for making deductions. Maximum penalty leviable in four income-tax wards including two wards in a salary circle for non/late filing of returns for 1987-88 and 1988-89 amounted to Rs. 55.12 lakhs approximately. But no penalty was levied in any case.

Andhra Pradesh

Percentage of non-receipt of return ranged from 14 per cent to 70.58 per cent during 1985-86 to 1987-88. There was an upward increase from year to year, which showed lack of control by the department.

Punjab

Returns in 192 cases were received late, the delay ranged from 4 days to 741 days, but no penal proceedings were initiated. There was also omission to watch the receipt of the annual returns regularly.

Tamil Nadu

In one ward in Tamil Nadu, delay in submission of returns ranging from 6 months to 13 months were noticed in 55 cases The penalty leviable on these cases would amount to Rs. 1,30,880 but no action was initiated in this regard till it was brought to the notice of the department by Audit.

Andhra Pradesh

The total amount of penalty leviable in 3 wards alone during 1987-88 came to Rs. 2,26,200.

Uttar Pradesh

Two Commissioners charges accounted for 171 cases of delay during the years 1986-87 and 1987-88 involving a leviable penalty of Rs. 0.79 lakhs. In another Commissioner's charge, no penalty was imposed in 11 cases of delayed submission of annual returns during 1987-88 and 1988-89.

Rajasthan

In one charge of Commissioner, the amount of penalty leviable in respect of 1987-88 alone for delayed submission worked out to Rs. 1.84 lakhs. For 1985-86 and 1986-87 relevant details were not noted in the Employers' Register and returns were also not made available to Audit. Similarly in another Commissioner's charge, penalty leviable amounted to Rs. 0.86 lakhs for the year 1987-88 alone and no action was taken for the period 1985-86 and 1986-87.

Madhya Pradesh

Entries of receipt of annual returns were not made in the Employers Register and by actual count Audit noticed 806 cases of delayed submission of annual returns (out of 1506 received in 7 wards test-checked) for which penalty leviable worked out to Rs. 6.28 lakhs. But no penalty action was initiated.

Gujarat

A review of 8 salary wards in 3 Commissioners' charges revealed delayed submissions of 298 salary returns amounting to Rs. 1.18 lakhs but no action to initiate penalty proceedings was initiated. Similarly, delayed submission of 678 cases of annual returns accounted for Rs. 24.74 lakhs without any action being initiated by department.

Bihar

In 123 cases in the charge of one Commissioner and in 32 cases in another, the belated receipts of annual returns entailed penalty of a total sum not exceeding Rs. 0.85 lakh. No penalty proceedings were, however, initiated.

Delhi

In Delhi circle, maximum fine imposable in 108 cases in 3 wards, for non-filing of statutory returns (Form 51) by the companies for the years 1985-86 to 1986-87 amounted to Rs. 7.92 lakhs. Maximum fine leviable in 30 cases in 4 wards for non-filing of statutory returns (Form 52) by the contractors for the years 1978-79 and 1981-82 to 1986-87 amounted to Rs. 25.45 lakhs. Maximum fine leviable from 34 employers in two wards for late filing of returns relating to the financial years 1985-86 to 1987-88 amounted to Rs. 0.30 lakh. Penal interest leviable in one case for delayed remittance of tax of Rs. 1,69,800 by the company for the previous year relevant to the assessment year 1986-87 worked out to Rs. 12,735. Penal interest leviable in 83 cases for delayed remittance of tax of Rs. 1.52 lakhs by the Race Club for the previous years relevant to the assessment years 1985-86 to 1987-88 worked out to Rs. 3,768.

Assam

A test-check of 3 Income-tax Officers' charges revealed that the prescribed register was either not maintained or wherever maintained, it was not in the prescribed proforma or was incomplete.

The register of employees was incomplete and not uptodate and hence the number of monthly returns due could not be ascertained. The monthly returns received were also not processed and noted in the prescribed registers. Percentage of non-receipt of annual returns ranged from 30 per cent to 89 per cent in these wards test-checked. There was also no reconciliation of the monthly returns with the annual returns.

(i) An assessee company did not furnish the annual returns since 1981-82 onwards. The department in their letter dated 19 July 1982 took up the matter with the company but did not pursue the case further. As a result the company was liable to pay penalty of Rs. 1,29,320 due to non-submission of returns till 30 June 1989, pertaining to the financial years 1981-82 to 1988-89.

(ii) In 1,108 cases of default during the period 1986-87 to 1988-89, the penalty which worked out to Rs. 37,10,350 in the aggregate was not imposed. Reasons for non-imposition of penalty was not on record.

Checking of annual returns

2.02.13 A test-check of the Annual returns received revealed the following positions.

Tamil Nadu

The Annual returns received were not checked by the dealing officer with the challans to ensure correctness of the remittances. Out of 161 cases produced to audit in 3 wards in Tamil Nadu, challans were not available with the returns in 130 cases. In 2 wards, in the case of 9 employers, the total deduction as per returns was Rs. 13,97,362 but the amount remitted as per the remittances particulars noted therein totalled to Rs. 13,46,702 only resulting in short remittance of Rs. 50,660.

Kerala

In many cases, the details of remittances of tax deduction at source amounts mentioned in the annual returns were not seen verified either with challans (if available) or with reference to the entries in the Daily Collection Register. In the annual returns of one employer the amount of tax deduction at source of Rs. 3,89,198 shown to have been remitted to Government account from May 1987 to April 1988 could not be traced in the Daily Collection Register for tax deduction at source produced for audit. In another case, there was a discrepancy (deficiency) of Rs. 1,23,926 between the amount shown to have been remitted to Government account and that in the Daily Collection Register.

Instances of wrong postings and delay of two to seven months in postings were also noticed in several cases. The amount remitted on 23 October 1987 as per Central Daily Collection Register of Local Treasury Units in one ward was Rs. 15 lakhs, but the amount posted in the Collection Register in January 1988 was Rs. 1.5 lakhs only, thereby exhibiting short collection from tax deduction at source for 1987-88 accounted by the ward, by Rs. 13.5 lakhs.

West Bengal

In the Annual returns of 88 employers there was short deduction of tax at source amounting to Rs. 6.97 lakhs and interest payable therein was Rs. 2.29 lakhs. No action to recover the amount of tax and interest had been taken till 31 March 1989.

Uttar Pradesh

A scrutiny of Register of Form 24 maintained under a Commissioner's charge disclosed that out of 425 employers who had submitted Form 24 during financial year 1986-87, checking was made only in 6 cases. Remaining returns were not checked even after two years. As a result, no action if any, could be taken against defaulters.

Owing to non-checking of returns, excess allowance on account of house rent allowance, granted under provisions of Income-tax Act read with Income-tax Rules, 1962, by an employer in 9 cases, which was even more than the amount of house rent allowance received by the employees, remained undetected.

Proof of payment of tax deducted at source was also not made available. The payments, if any, were not susceptible of verification owing to non-maintenance of records of payment i.e. Register of Tax Deduction at Source in Income-tax Non-statutory Form Series No. 22. By its non-maintenance/non-posting of monthly returns, the verification of accuracy of total of Annual returns and also payments of tax shown therein was not possible. The requirement of checking monthly total every month, from the treasury challans received in subsequent months, was not also being attended to and consequently, the agreement of totals of collection, according to Income-tax Non-statutory Form Series 135, with the annual returns could not be verified and checked.

Andhra Pradesh

(i) In one ward, the figure of tax deduction at source noted in the Register (Income-tax Non-statutory Form Series 118) was Rs. 25,850 ,whereas in the annual returns in Form No. 24; the figure was Rs. 24,668. There was difference between the amount of tax deduction at source shown as per Annual returns and the total as per monthly returns. Evidently no reconciliation was being done between monthly and annual returns.

(ii) In two wards, details of tax payments were not furnished in the annual returns submitted by 20 employers.

(iii) 5 employers in a salary ward at Hyderabad did not furnish the annual returns in the prescribed proforma.

During the audit of salary ward under one Commissioner's charge, it was noticed from annual returns filed that seven employers covering 44 employees, had short deducted the tax at source to an extent of Rs. 54,141. The department did not demand the amount of shortfall and also interest due under Section 201(1A).

Rajasthan

Treasury challans were not received by the Income-tax Officers (Tax Deducted at Source from Salary) and monthly totals were not checked with the treasury challans. The totals of collections according to annual returns were also not tallied with the total of collection in Income-tax Non-staturory Form Series 135.

Test-check revealed that as per annual returns filed by an employer for 1987-88, tax aggregating to Rs. 10,29,946 was deducted at source against which Rs. 9,19,053 was credited to Government accounts. The difference of Rs. 1,10,893 was stated to be on account of tax deducted at source from employees who had either proceeded on transfer or joined on transfer. But details of the difference and particulars of deposit were not available. No action was taken to reconcile discrepancy.

Bihar

The Annual returns received were not checked to verify short deduction of tax at source. A review of the statements disclosed short deduction of tax in 6 cases for which interest/penalty was chargeable aggregating to Rs. 1,08,573 for 1986-87 and 1987-88.

Haryana

In 15 cases for the year 1986-87 and 5 cases for the year 1987-88, the total amount of tax paid as per challans attached with the annual returns fell short of the total amount shown in the said returns by Rs. 1,86,775 and Rs. 44,579 respectively. No action had been taken to reconcile the discrepancy.

It was observed from the Annual returns in Form 24 that the percentage of cases in which returns were not so received varied from 49 for 1986-87, 62 for 1987-88 and 29 for 1988-89. In 303 cases for the year 1986-87, in 401 cases for the year 1987-88 and in 334 cases for the year 1988-89, late receipt worked out to 15 years 8 months, 19 years 6 months and 8 years 7 months involving penalty of Rs. 56,970, Rs. 71,520 and Rs. 31,200 respectively.

In one of the above cases where the Annual return in Form 24 for the years 1986-87 and 1987-88 due on 30 April 1987 and 30 April 1988 respectively was received on 3 March 1989, no penal action for late submission of these returns as stipulated in section 272-A of the Income Tax Act was initiated (March 1989).

Income other than Salaries

Prescribed procedure

2.02.14 Every person responsible for paying any income chargeable under the following heads, is required at the time of payment to deduct income-tax thereon at the rate prescribed by the relevant Finance Act.

(i) Interest on securities [Section 193(ii)].

(ii) Dividends (Section 194).

(iii) Interest other than interest on securities (other than individual or Hindu Undivided Family) (Section 194A).

(iv) Winnings from lottery or crossword puzzle (Section 194 B).

(v) Winnings from horse race (Section 194BB).

(vi) Payments to contractors and sub-contractors (Section 194C).

(vii) Insurance commission (Section 194D); and

(viii) Other sums (Section 195).

The amount so deducted should be remitted to Government account on the same day in respect of deductions made by or on behalf of the Government and in other cases, the remittance should be made within the time limits under the Income-tax Rules. The Income-tax Act also requires every person, deducting tax at source, to file with the Income-tax Officer periodical returns in the form prescribed in Income-tax Rules, giving details of deduction of tax and remittance. If a person deducting tax at source fails to furnish the returns he shall be liable for penalty which may extend to Rs. 10 for every day during which the failure continues.

The Income-tax Officer has to watch the receipt of the periodical statements and ensure whether the tax has been deducted as per the rates in force and remitted within the time limit. For this purpose, he has to maintain a register containing the names of all persons who deduct tax at source, types of payments, periodicity of statements, due date, and date of receipt, so that action could be taken against defaulters. The Manual of Office Procedure issued by the Board provides that the Income-tax Officer should maintain a register of dividends allotting one page to each company for tax deducted at source from dividend income, and update the list of disbursing officers in the private sector, public sector and Government departments in respect of contract payments, on the basis of the returns received in the preceding year and other relevant information.

(i) Interest on Securities

(a) Statutory Returns and Registers

Uttar Pradesh	A test check revealed that the work of maintenance and follow up of the registers which was to be looked after by different wards before centralisation of the work was not attended to by any one in all the four charges obtaining at that time. Even after centralisation of the entire work of tax deduction of source, no such return was received nor checked, nor called for by any of the officers to whom such work was assigned. Even the Income-tax Officer (T.D.S.) who had been exclusively assigned the work of receiving/watching of various returns of tax deducted at source and checking did not know the person who deposited tax deduction at Source under this head.
Gujarat	Test check revealed that a State financial Corporation which was regularly making payment of interest on securities and was deducting tax therefrom had failed to furnish returns in Form 25. The delay as on 31 March 1989 ranged between 30 days to 3 years. Penalty leviable for failure to furnish the return amounted to Rs. 1.89 lakhs.
West Bengal	None of the 29 assessing officers whose records were reviewed, maintained a control register to watch the receipt of Form 25. Other register, viz., Register of Daily collection of penal action was also not maintained.
Tamil Nadu	No registers were maintained indicating therein the name of all persons from whom the periodical statements were due, periodicity of the statements, due date and date of receipt and action in the Tax Deducted at Source wards was confined to the returns received only.

(b) Non deduction of income-tax and surcharge from interest on securities

Bihar

The amount of income-tax computed for deduction of tax at source was required to be increased by a surcharge for purposes of the Union calculated at the rate of five per cent of the tax in respect of payments made after 16 December 1987. The levy of surcharge at the rate of five per cent continued in the following year 1988-89 also.

An assessee company paid interest on securities to banks and other financial institutions during 1988-89 and deducted income tax at source therefrom to the tune of Rs. 14,09,28,122 at the rate of 21.5 per cent. Surcharge leviable thereon at the rate of 5 per cent was, however, not deducted at source. The total amount of surcharge deductible but not deducted at source worked out to Rs. 70,46,406. In addition, interest and maximum penalty chargeable for the default upto 31 March 1989 alone worked out to Rs. 2,43,383 and Rs. 70,46,406 respectively. No action was, however, taken by the department for non-levy of surcharge and no penal action was taken for the default.

Large sums were debited to the profit and loss account for the year 1985-86, 1986-87 and 1987-88 of an assessee company on account of interest on bonds, deposits and borrowings. The assessee did not furnish returns in Form No. 25 or 26(A) showing deduction of tax at source from interest payments to the assessing officer. In the Annual account of the company for 1987-88, it was stated that the issue and repayments of bond and interest thereon were managed by State Bank of India, Calcutta and as such, details relating to those were not in possession of the assessee company. The tax deductible at source from interest payments would work out to not less than Rs. 6,43,60,374.

There was no information available from the assesss ment records whether tax was deducted at source from interest payments and deposited to Government accounts as per provisions of the Act and relevant rules.

(ii) Dividends

Statutory returns and Registers

Uttar Pradesh — A test check of the wards revealed that neither any register was maintained nor any statement in Form 26 were received nor the return in prescribed Income Tax Non-statutory Form Series 54 was received or called for by officers concerned. A list of companies which are required to furnish aforesaid returns was also not maintained.

Punjab — No Register was maintained in any of the units test checked.

Calcutta — None of the 35 assessing officers could furnish particulars regarding returns in Form 26 or Income Tax Non-Statutory Form Series 54. No control Register was also maintained by any of them.

Delhi — In 3 Range officers under 3 Commissioners' charges, statutory returns (Form 51) were not furnished by the companies in 108 cases relating to the years 1985-86 to 1987-88.

Assam — No register of deduction of tax at source from dividends was maintained in one office, while a register not in prescribed proforma was introduced by another from 1987-88.

(iii) Interest other than interest on securities

Non deduction of tax at source

Uttar Pradesh — Test check of records of Income Tax Offices prior to centralisation at 4 stations revealed that list of persons responsible for deduction of tax was not available with them nor was any control register maintained by them. Form 26A/27A was also not received nor was separately checked except at the time of assessment. The dealing officer also could not give the number of persons responsible for deduction of tax, submission of returns, number of returns received and number not received, and no penalty was levied in this regard for default of the assessee. Even after centralisation of tax deduction at source work, no such information was available except in one place where the number given was 61 for 1987-88 and was 65 for 1988-89. These figures were obviously incomplete since the applications for allotment of T.A.N. (Tax Account Number) for the respective years was 225 and 354.

Kerala — Quarterly returns due were not being furnished in several cases and instances of non-deduction of tax at source were also found. In one of the wards, returns were due from 126 persons but were not received from any.

Karnataka — Quarterly returns were not watched in eight wards test checked. Particulars of total number of returns due, number actually received and number received late were not available.

Andhra Pradesh — In 7 wards under 3 Commissioners charges, no separate records were maintained to watch the receipt of the returns due from the persons responsible for tax deduction at source giving details of deduction of tax at source and its remittances.

Rajasthan — Eleven persons in the two Commissioner's charges responsible to deduct tax for the years 1986-87 and 1987-88 did not file 58 quarterly returns. No penal action was taken against the defaulters.

In 3 cases, 5 quarterly returns (Form 26A) were submitted late (18 to 320 days) in one charge while in the other charge, submission of 4 quarterly returns were delayed by 41 to 315 days.

Punjab — No records were kept to watch receipt of the prescribed return in all the cases. The declarations (Form 15H) were also not being cross checked with a view to detecting false statements made by the declarants, if any.

Madhya Pradesh — (i) Quarterly statements were not filed by any persons responsible for deducting tax from interest (Other than securities).

(ii) Annual returns were also not filed in any case.

Gujarat — A test check of returns received in 6 wards in three Commissioners charges revealed that tax amounting to Rs. 3.55 lakhs deductible from payments was not deducted in 6 cases. In one case, interest of Rs. 0.79 lakhs was levied. Interest amounting to Rs. 0.52 lakhs was not levied in the remaining five cases.

General observation.

During the test check in 84 wards in 7 Commissioners' charges it was observed that adequate control was lacking to ensure that all persons within the respective jurisdiction of the assessing officers were regularly filing the statutory returns of all income other than salaries.

Calcutta — None of the 81 assessing officers could furnish any evidence to establish that adequate control or check was being exercised in the matter of remittance of taxes deducted at source to the credit of Government or in initiating any penal measure against the defaulter. No registers were maintained for the purpose of determination of actual collection of tax deduction at source in a year. None of the 81 assessing officers maintained any control register to ensure regular submission of quarterly returns in Form 26A and Form 27A.

Delhi — Out of 4,842 companies in the jurisdiction of 5 Ranges under 3 Commissioner's charges during the years 1985-86 to 1987-88, quarterly returns (Form 26A) in respect of first 13 companies could be produced to audit. The department had no information regarding the number of campanies who are required to furnish these returns and number of companies who had not furnished them.

Assam — A test check of the records/documents maintained in 2 (two) Income-tax Offices revealed as below :

(a) No records/registers were maintained showing the number of returns to be received, actually received, not received, for taking suitable action against defaulters.

(b) 25 returns relating to the years 1986-87 to 1988-89 produced for scrutiny in audit, revealed that there was delay in the submission of returns which ranged between 14 days and 1487 days.

(c) In 19 cases there was delay in the remittance of tax deducted at source which ranged between 25 days to 10 months attracting interest of Rs. 31,428 leviable under the provisions of the Income-tax Act, 1961, which was not charged.

(iv) Representative cases noticed in audit

Non deduction of tax at source

West Bengal

In the course of audit conducted in 4 Commissioners' charges it was noticed that although interest amounting to Rs. 1,72,12,464 was paid to different payees, no tax was deducted at source from such payments which worked out to Rs. 34,59,963. The amount of interest leviable in this case for non deduction of tax at source but not levied was to the extent of Rs. 21,82,505.

Uttar Pradesh

During test check a case was found in a Commissioners' charge 'A' wherein it was noticed that an assessee, a Registered firm, had paid interest of Rs. 1,10,290 and Rs. 1,28,322 during previous years relevant to assessment years 1986-87 and 1987-88 to 14 and 12 persons respectively each in excess of Rs. 1,000 but no tax was deducted therefrom. The assessee did not furnish any return in Form 26-A or Form 27-A nor any statement/declaration in Form 15A/15H in support of non deduction of tax. The amount of tax deductible at the rate of 10 per cent comes to Rs. 11,029 and Rs. 12,832 respectively. Penal interest at the rate of 15 per cent on Rs. 11,029 from 13 October 1985 and on Rs. 12,832 from 2 November 1986 till the date of actual deposit was required to be levied alongwith penalty but no such action was taken. The assessee was also liable to penalty for not filing the annual returns required under Section 285. The amount of penalty works out to Rs. 10,200 for assessment year 1986-87 @ Rs. 10 per day from 16-6-86 to 31-3-89.

Kerala

(i) During the course of regular audit of an Income-tax Ward in July 1987, it was found that though a registered firm had made interest payments amounting to Rs. 8,48,913 during accounting years relevant to assessment years 1983-84 to 1985-86 and was prima facie, liable to deduct tax at source amounting to Rs. 84,891 it had made no source deduction. In October 1988, the Department replied that the interest payment on which tax was deductible was Rs. 6,51,709, tax deducted was Rs. 65,271, tax credited to Government account in time was Rs. 4,985 and the balance amount was remitted in August 1987 only. During the review in April 1989, it was seen that the same firm had made interest payments of Rs. 6,22,255 for the previous years relevant to assessment years 1986-87 and 1988-89, making source deduction of Rs. 16,716 only (for assessment year 1988-89), leaving a deficiency in source deduction of Rs. 45,510.

(ii) In eight other similar cases in five income tax wards tax deductible amounting to Rs. 0.87 lakhs from payment of interest of Rs. 8.73 lakhs was not deducted.

(iii) Penal interest for failure to deduct/pay tax by nine persons leviable worked out to Rs. 0.51 lakhs. In one other case penal interest of Rs. 0.27 lakh was levied after the lapse was pointed out by audit.

Karnataka

In nine cases under two Commissioners' charges the persons who paid interest in excess of Rs. 1,000 in each case to persons other than banks, failed to deduct the tax at source aggregating to Rs. 2,90,907. No action was taken to levy interest and to initiate proceedings (Rs. 72,666 and Rs. 2,90,904).

Rajasthan

In one case under a Commissioner's charge tax at source amounting to Rs. 8,529 was not deducted during the financial year 1986-87. Interest chargeable thereon worked out to Rs. 3,934.

Four persons under Jaipur charge responsible for deducting tax Rs. 47,389 at source from 16 tax payers during the financial year 1986-87 to 1988-89 failed to deduct the same. Interest chargeable thereon amounted to Rs. 13,478. No action was taken in these cases except in one case in which prosecution proceedings were intiated but not yet been finalised.

Madhya Pradesh

In cases where income tax was not deducted at source out of interest payments exceeding Rs. 1,000 (Rs. 2,500 w.e.f. 1 June 1987) for such default, interest of Rs. 1,70,164 and maximum penalty of Rs. 4,30,576 were leviable. It was noticed that in none of these cases interest was charged and penalty proceedings were initiated.

Bihar

In course of test check it was seen that in one case, an assessee for assessment year 1987-88 paid interest totalling to Rs. 72,996 to 9 persons between 27 March 1987 and 31 March 1987. Tax was, however, not deducted at source under Section 194(A) of the Act.

Neither statement in Form 26A or 27A was furnished by the assessee nor penal proceedings were initiated by the Department.

(v) Winnings from lottery or cross word puzzles

Statutory returns and Registers

(a) Non submission of Returns due

Uttar Pradesh	The Director of State Lotteries who is responsible for payment of income by way of winnings from lottery and making deductions therefrom had not furnished the statement to any of the wards covered by test check. The department had also not called for the same.
Kerala	The department of lotteries had not also sent the quarterly statements of tax deduction from winnings from lotteries for the period upto 31 March 1987 and for the year 1987-88.
Rajasthan	9 quarterly returns, submitted late by the Director of lotteries (ranging upto 82 days) were lying unchecked in survey and investigation branch of the department.

Madhya Pradesh	10 quarterly statements for the period from April 1984 to September 1984 and January 1985 to December 1986 were filed late by the Directorate, upto 197 days and in the case of 4 promotors of private lotteries, these statements were not filed at all.
Calcutta	Quarterly returns giving details in Form 26B were not submitted by the Director of Lotteries regularly to the Income-tax Department. Even on the defective statements (not in prescribed form) received on 12 May 1986, 14 May 1987, 1 December 1987 and 30 May 1989, the department had not taken any action nor was the Director of Lotteries asked to submit quarterly statements in the prescribed form and by the prescribed dates.
Delhi	One ward could produce only 6 quarterly returns out of which 4 were received after delays ranging from 25 to 116 days. An autonomous body which had been conducting lotteries regularly did not send quarterly returns (Form 26B) for the period upto 30 June 1987.

(*b*) *Representative cases of default noticed in audit*

Rajasthan

Test check of the return for the quarter ending March 1988 filed by one Director of State Lotteries, revealed that surcharge leviable with effect from 16 December 1987 at 5 per cent of Income-tax was not deducted at source. Non levy in this case amounted to Rs. 2,10,560 for the period from January 1988 to March 1988, besides interest amounting to Rs. 31,575 for the period from April 1988 to March 1989.

On the omission being pointed out (May 1989), the department stated (May 1989) that the returns were received in survey and investigation branch for investigation/intelligence purposes and no tax calculation was checked. The fact, however, remains that the returns were not sent to the assessing officer concerned.

Assam

Rate of deduction of tax at source under section 194B during the year 1986-87 is 40 per cent on the gross winnings in the case of persons other than company.

The quarterly returns submitted by the Directorate of State Lotteries, Assam, Guwahati, revealed that in 18 cases relating to 1st, 2nd, 3rd and 4th quarter of the year 1986-87, the correct rate of tax deduction at 40 per cent of the gross winnings was not applied. This resulted in short levy of tax of Rs. 81,600.

(*c*) *Tax deductible but not deducted*

Uttar Pradesh

An assessee had received prize money of Rs. 89,000 (after deducting Rs. 11,000 being agents commission) in financial year 1985-86. In accordance with the income-tax rates in force for the Financial year 1985-86 (Assessment Year 1986-87) tax deductible at source at the rate of 25 per cent on Rs. 89,000 worked out to Rs. 22,250. Against this sum only a sum of Rs. 575 was deducted at source resulting in short deduction of Rs. 21,675.

(*d*) *Bogus tax deduction certificates*

Under the provisions of Income-tax Act, 1961, read with the Income tax Rules, 1962, a person deducting tax at source from the winnings of lotteries and crossward puzzles should furnish to the person from whom tax was deducted at source a certificate in form 19-B.

On test check of assessment case of an individual assessee for assessment year 1986-87 it was noticed that the assessee had claimed to have received prize money of Rs. 90,000 run by an other State Government. A sum of Rs. 22,500 was stated to have been deducted at source from the aforesaid sum towards income tax. The certificate of Tax Deducted at Source submitted was issued by the lottery agent instead of by the Director of State lottery of the concerned State on whom the responsibility for tax deduction at source devolved. The lottery agent was not the authorised person to issue such certificate of tax deduction at source and if one was issued by him, it should have been treated as nonest. The department erred in accepting the certificate and in issuing refund order without reference to competent authority for verification of facts of deduction.

(*e*) *Delay in credit of tax deducted at source*

West Bengal

The Directorate of State lottery, Government of West Bengal deducted tax at source from prize money of Rs. 1,000 and above and deposited such amounts to the credit of the Central Government. Scrutiny of the statements of tax deduction at source available in the office of the Director of Lotteries revealed that in 186 cases, there were delays ranging between 1 month to 3 months and 23 days in depositing the tax to the credit of the Central Government. The amounts involved in these cases came to Rs. 37,71,837 and the delay in depositing it to the Government account invited levy of interest to the extent of Rs. 1,20,183. The Income-tax Department, however, did not have the above information.

(vi) Winnings from Horse Races

West Bengal

No Control register was being maintained by the department to ensure regular submission of quarterly statements indicating details of deduction of tax at source and remittance to Government accounts by the assessees. No register was also being maintained by the office to record the statements received by them. In the Daily Collection Register, no entry in respect of tax deducted at source and remitted to the credit of Government was made.

Owing to non-maintenance of records, the yearwise breakup of the tax deducted at source could not be furnished. The quarterly statements (in Form 26BB) in respect of one of the two race clubs in the State was not also made available to audit.

The quarterly statements furnished by one of the assessees for the quarter ending June 1988 to March 1989 disclosed belated submission of the statements by 7 to 14 days.

Further, the challan number and date of deposit of the tax deducted at source to the treasury was not mentioned in the return. The original copy of the relevant challans were also not kept on record, nor was any entry thereof found in the Daily Collection Register, though there were specific columns in the said register for the purpose.

Delhi

Delhi Race Club which deducted tax of Rs. 3.76 lakhs in 208 cases during the previous years relevant to the assessment years 1985-86 to 1988-89 remitted the amount to Government account after delays ranging upto 154 days.

(vii) Payments to contractors and sub-contractors

(*a*) *Statutory returns and register*

Uttar Pradesh

A test check in 4 Commissioners' charges revealed that no Central register to post the returns received, if any, was maintained in any of the wards test-checked. The tax officers had also not maintained any list of the disbursing officers who are required to submit statutory returns etc. Consequently, the department did not have details of the number of persons responsible for deducting tax and there was no means of watching compliance of the provisions of the Act by the disbursing officers. Further, there was no mechanism to ensure that contractors were furnishing the periodical returns prescribed for them. Non/delayed submission of statutory returns (Form No. 52) by Five contractors in 3 Commissioners' charges was noticed during the test check. The maximum penalty leviable in these cases amounted to Rs. 13.03 lakhs.

Karnataka

It was noticed that 47 contractors under the jurisdiction of three Commissioners charges who had secured contracts of the value exceeding Rs. 50,000 in each case during the years 1984-85 to 1987-88 had not filed the particulars of contract within the prescribed date. Maximum penalty leviable for the default was Rs. 57.39 lakhs.

Andhra Pradesh

The penalty leviable in 4 cases of failure to file the particulars of contract worked out to Rs. 6.61 lakhs.

Rajasthan

In 14 cases under one Commissioner's charge, 56 quarterly returns were not filed for the period 1986-87 to 1988-89. No penal action was taken against defaulters.

In one Commissioner's charge, persons who deducted tax at source from contract payments filed returns late by 16 to 107 days.

Punjab

No records were maintained in the units test checked to watch the prescribed return in all the cases. On cross verification done in audit (March 1989) it was found that Tax Deducted at Source was deducted from 11 assessees (contractors) during 1985-86 to 1987-88 but the State Public Works Department had not sent the prescribed returns. The Department did not initiate any action to call for the returns upto March 1989.

Madhya Pradesh

Quarterly statements had not been filed in 36 cases. Contractors either did not comply with the provisions or failed or delayed to furnish particulars in Form 52. No action was taken to levy fine in these cases which resulted in foregoing of revenue of Rs. 32.51 lakhs (at maximum rates) in the two Commissioner's charges. The list of the disbursing officers in the private sector, public sector and Government department were not maintained in the wards test checked.

West Bengal

None of the 36 assessing officers maintained control registers to watch the regular submission of quarterly returns (From 26C). A few quarterly returns were received by some assessing officers, but no action was taken on them.

In 13 cases noticed in test check no fine was imposed on contractors and sub-contractors for non furnishing of statement (Form 52) and particulars of contracts under the Act. The fine leviable amounted to Rs. 45.40 lakhs in these 13 cases.

Delhi

In 4 wards of a Commissioner's charge it was noticed that in 30 cases relating to the years 1978-79 and 1981-82 to 1986-87, the statutory statements (in Form 52) were not filed by the contractors upto 30 April 1989.

In 5 other cases the assessee contractors, had returned contract receipts of Rs. 3.35 crores during the assessment years 1985-86 to 1988-89 (as per Form 19-C certificate of tax deduction at source) but the prescribed schedule containing particulars of contract was either not attached or not filled in. As such, the department was not aware under which contract the payments were received and as to whether particulars in Form 52 were furnished by the Contractors.

In other 5 cases, the assessee contractors had deducted tax at source to the extent of Rs. 1,24,801 from payments made to the sub-contractors during the years 1984-85, 1986-87 and 1987-88 but the quarterly returns (Form 26-C) were not filed.

Kerala

Penal interest leviable but not levied in four cases of payments to contractors where there was omission to deduct tax amounted to Rs. 2.97 lakhs.

(b) Case Studies

(*1*) *Non-deduction of surcharge on income-tax at source from payments to contractors and sub-contractors.*

Bihar

The amount of income-tax deductible at source under section 194-C was required to be increased by a surcharge for the purposes of the Union at the rate of 5 per cent of the tax in respect of payments made during 1987-88 after 16 December 1987. The surcharge at the rate of 5 per cent was also leviable in respect of payments made during 1988-89.

In a number of cases, it was noticed that surcharge on income-tax in respect of payments made after 16 December 1987 was not deducted at source. The surcharge leviable but not deducted at source by 19 assessees was Rs. 3,19,689. Interest and penalty leviable for the aforesaid default were Rs. 3,43,569 for assessment years 1987-88 and 1988-89, which was not, however, levied. Quarterly returns and statements showing details of tax deducted at source during 1987-88 (after 16 December 1987) by a number of persons who had failed to deduct surcharge on tax even during 1988-89 were not made available to audit.

(2) *Non deduction/short deduction of tax at source.*

Uttar Pradesh

During the test check conducted in three Commissioners charges, disbursing officers had not deducted tax at all or deducted it short by Rs. 31,565.

The assessing officers in these cases were required to take penal action to levy interest, penalty/or launch prosecution etc., but no action was taken.

Rajasthan

(*i*) Two persons responsible for deducting tax at source did not deduct the same from the sub-contractors at one per cent of the amount paid to them, which worked out to Rs. 28,641, besides interest of Rs. 5,494.

(*ii*) Six persons responsible for making payments and deduction of tax at source failed to deduct tax at source amounting to Rs. 67,355 including surcharge of Rs. 3,993. Interest chargeable thereon amounted to Rs. 2,550. No action was taken by the department.

Kerala

From the assessment records of a registered firm for assessment year 1987-88 completed in February 1989, it was seen that the assessee had received a sum of Rs. 65.12 lakhs being text-book printing charges in pursuance of a contract entered into with a State Government department for undertaking printing work of text books, but tax deductible at source at two per cent amounting to Rs. 1,30,240 was not deducted. Payment from the same source received for assessment year 1988-89 of Rs. 95.23 lakhs was also not subjected to source deduction (tax deductible Rs. 1,90,460). Total non-deduction of tax at source for the two assessment years came to Rs. 3,20,700.

Further, during the course of audit of the accounts of the State Government office which was responsible for deducting tax at source mentioned above it was noticed that during the period from 1985-86 to 1987-88 it failed to deduct tax at source amounting to Rs. 8.39 lakhs from payments to five contractors including a registered firm.

In another case, a contractor, an individual assessee, produced for the previous year relevant to assessment year 1987-88 tax deduction certificate for Rs. 37,705 from a private company and was allowed refund of the entire amount as his returned income for the year was below taxable limit (Rs. 4,500). The amount deducted represented source deduction of tax made from contract amount on account of the construction of a building, paid by a private company during the previous years relevant to assessment years 1981-82 to 1986-87 and it was remitted to Government account on 19 September 1986 only though the payments were actually made to the assessee long time back. There was failure to deduct tax at source during the periods relevant to assessment years 1981-82 to 1986-87. Further, the assessee was assessed to tax on a total receipt of Rs. 15,66,500 only for assessment years 1981-82 to 1986-87, though the contracts receipts as per the belated certificate was Rs. 18,18,115. The Department replied that the case was completed under summary assessment scheme.

In three other cases of contractors in two Income-tax wards, tax of Rs. 0.88 lakh (approximately) deductible from contract payments of Rs. 43.9 lakhs was not seen deducted.

Madhya Pradesh

According to provisions of the Income-tax Act, 1961, the Forest department as seller of timber is liable to deduct income tax at source from the buyers of timber, either through lease or depot auction, and credit into the treasury within 7 days failing which simple interest at two per cent per month on the amount of sale from the date on which income-tax was creditable to the date of actual credit into the treasury.

On test check of cases of auction of timber/fuel stock by the Forest department, it was observed that income-tax and surcharge at the rate of 10 per cent and 0.5 per cent and 15.75 per cent and 0.5 per cent for fuel wood was not recovered from the 37 buyers which led to short recovery of T.D.S. of Rs. 2,31,595.

It was observed in audit that the Income-tax Officer issued exemption certificates on 9th, 19th and 28th July 1988 in favour of timber merchants. The income-tax Officer subsequently had withdrawn the exemption certificates on 16 August 1988. The Forest Officer did not recover income-tax from the timber merchants on the strength of the exemption certificates which were withdrawn subsequently, which led to non-recovery of T.D.S. of Rs. 1,31,058.

The concerned Forest Officer replied that the amount of income-tax will be recovered from the buyers after consulting the Income-tax Officer concerned.

In one case tax of Rs. 37,023 was to be deducted out of payment made to the contractor against which tax of Rs. 3,889 was deducted. This resulted in short deduction of tax of Rs. 33,134 at source.

(vii) (a) Non-deposit of tax deducted from contractors/ sub-contractors

Bihar

From the Statement of tax deducted at source pertaining to the assessment year 1985-86, received by a Deputy Commissioner of Income-tax, Special Range of a State Construction Corporation, it came to notice that a total sum of Rs. 69,323 deducted at source by two units of the corporation was not deposited to Government account till 31 March 1989.

The practice of withholding the tax deducted at source by the units of the corporation since 1984-85 could not be verified since the quarterly return in Form 26-C or the detailed statement relating to the subsequent periods had not been submitted to the assessing officer.

The default in not making payment of the tax deducted at source also attracted levy of interest and penalty which for the default up to 31 March 1989 alone in the cases cited worked out to Rs. 55,235 and Rs. 69,323 (Maximum penalty) respectively. In addition, such defaults, are also liable to prosecution under section 276-B.

(b) *Non-deduction/non-deposit of tax deductible at source from sub contractors*

Bihar

Under the provisions of sub-section (2) of Section 194-C tax deducted at source at the rate of one per cent of the payments made to a sub-contractor by a contractor has to be paid to the credit of the Central Government within one week from the last day of the month in which the deduction is made.

A registered firm got substantial portion of contract works done through sub-contractors. The assessee firm neither filed quarterly returns in Form 26-C nor furnished challans in support of payments of tax deducted at source from sub contractors. The audit certificates (in Form 3-CD) furnished did not give any information about deduction/deposit of such tax. Total value of work done through sub-contractors during 1985-86 and 1986-87 was Rs. 2.5 crores and the tax required to be deducted at source was Rs. 2.5 lakhs. The department has not called for the information regarding deduction at source of the tax and payment thereof with a view to initiating penal proceedings. In the absence of relevant particulars, interest leviable under section 201(1A) for the default for even 12 months would work out to Rs. 37,500.

Uttar Pradesh

In a Commissioner's charge, a contractor company who had undertaken contract work of a public undertaking reported that from total net payment made to it during 1986-87 and 1987-88 income-tax at the rate of 2 per cent was deducted but no T.D.S. certificate was issued by the disbursing officer.

The scrutiny of records revealed that no return of the disbursing officer was filed with the concerned officer. Proper action to investigate the matter and to initiate penal action against the defaulter, if the default was established, was not also taken by the concerned officer.

Bihar

The review, in selected wards, revealed cases in which remittance to Government account of a total amount of tax deducted at source of Rs. 52,47,034 was delayed. Apart from not resorting to prescribed penal and prosecution measures the department did not even levy simple interest amounting to Rs. 2,53,074.

Madhya Pradesh

In 15 cases, income-tax deducted at source out of payments to the contracts was remitted late to the Central Government account and for such delay, interest of Rs. 3,929 and maximum penalty of Rs. 62,373 of the Income-tax Act, 1961, were leviable. It was noticed that in these cases neither any interest was charged nor any penalty proceeding was initiated.

Uttar Pradesh

During test checking the case of a Government corporation relating to financial year 1988-89 it was noticed that income-tax deducted at source from various contractors was deposited in Government account late by 1 to 5 months. On the sums not deposited in time interest leviable worked out to Rs. 4,289 but no interest was levied an collected.

Similarly, in another Commissioner's charge income-tax deducted by a contractor during 1987-88 from the payment made to a sub-contractor was paid into Government accounts late for periods ranging from 1 to 154 days but no interest on such delayed payment of tax was charged.

Andhra Pradesh

In 15 cases of assessments checked during the audit cycle of 1988-89 there was delay in remittance of T.D.S. into Government account for which interest under section 201 (1A) was leviable. Total amount of interest leviable worked out to Rs. 1,20,613 in respect of all the 15 cases.

Rajasthan

In one case tax deducted at source of Rs. 47,948 due to be credited by 7 January 1989 was deposited on 25 April 1989 interest amounting to Rs. 2,180 was not charged.

Assam

Administration of tax deducted at source under section 194C was centralised in the Income-tax Office, Ward (1)4 Guwahati in respect of 14 Income-tax Offices located in Guwahati having jurisdiction over Guwahati. Test check of the records/documents maintained in the above Income-tax office revealed as below :

(c) *Omission to file quarterly returns of tax deducted at source and belated filing of the returns*

In a number of cases delay in submission of returns was more than six months but no action was taken by the department against the-defaulters who did not submit the returns. A few instances are cited below :

(*i*) The Commissoner, Guwahati Municipal Corporation Limited filed returns amounting to Rs. 4,89,502 pertaining to the year 1986-87 and 1987-88 partly in December 1988 anc partly in March 1989 i.e. after a lapse of 1 to 2 years.

It was observed that the I.T.O. had issued reminder for submission of the returns for the said period in September 1988.

The returns were not submitted in prescribed proforma and showed only lump sum tax deducted during the years. The names of the contractors to whom payments were made and the amount paid to each contractor were not mentioned in the returns. Quartarly returns pertaining to the year 1988-89 were not filed till the date of audit (July 1989) and thus causing delay from 3 months to 1 year. No action was taken by the I.T.O. to call for the returns in prescribed proforma.

(ii) The Project Manager. KLHE Project, ASEB, filed quarterly returns amounting to Rs. 31,89,758 for the years 1986-87 to 1988-89 involving delay over 3 to 9 months in majority of the cases.

(iii) In 18 instances there was delay in submission of the returns of six months or more. Except for issuing occasional reminders, the I.T.O. did not pursue the matter to ensure the receipt of the returns on due dates. No penal measure was initiated against the defaulters.

(d) Delay in remittance of tax deducted at source

Andit scrutiny of quarterly returns filed by 54 disbursing officers in the office of the ITO ward I(4) Guwahati, during 1986-87 to 1988-89 revealed that the officers responsible for deducting tax at source did not deposit the same to Government account within the prescribed time limit and retained the sum so deducted in hand for 1 month to 2 years.

During 1986-87 to 1988-89 a sum of Rs. 68,74,381 was retained in hand by 18 disbursing officers for a period which ranged between 1 and 21 months (Statement 5) attracting interst amounting to Rs. 2,86,957 which was not levied by the department. In 2 cases alone the penal interest worked out to Rs 1,63,394.

(e) Non levy of surcharge

Test check revealed that the surcharge as per the Finance (Amendment) Act, 1987 was not levied on tax deducted from payments made during January 1988 to March 1989. During the said period 19 disbursing officers deducted tax of Rs.37,98,840 at the rate of 2 per cent of gross payments made to the contractors without levying surchagrge at the rate of 5 per cent thereon. Consequently there was short deduction of tax at source amounting to Rs. 1,89,942 and non-levy of interest amounting to Rs.14,246 (Statement 6).

(f) Short deduction of tax at source

Under Section 194C of the Income-tax Act, 1961 the I.T.O. may issue approriate certfiicate where the total income of the conctractor or sub-contractor justifies deduction of income-tax at any lower rate or non-deduction of income-tax, as the case may be. Audit observed that tax was deducted by disbursing officers at lower rate but the necessary records against whom the cerificate was issued by the I.T.O. concerned authorising deduction of tax at such rate was not made available to audit. A few instances are cited below :

(*i*) The Project Manager, KLHEP, ASEM deducted tax at the rate of 1/2 per cent from the payment of Rs. 4,05,07,577 made to a company druing 1986-87 to 1988-89 instead of the prescribed rate of 2 per cent of the gross amount paid. This resulted in short deduction of tax of Rs. 6,07,745 (Rs. 8,10,350 minus Rs. 2,02,605). By virtue of the provisions of Income-tax Act, 1961, the paying officers was liable to penalty to the extent of short realisation which was not invoked. Further, the Government sustained loss of revenue in the form of interest amounting to Rs. 50,496 calculated at the rate of 15 per cent per annum on the amount of the tax not decducted up to the end of respective years.

(ii) In 9 cases deduction of tax at lower rate without obtaining the necessary certificate from the concerned I.T.O. resulted in short deduction of tax of Rs. 63,290.

(g) Omission to deduct tax

A test check of payment vouchers of P.W.D. (Meghalaya revealed that 3 (three) disbursing officers (Executive Engineers) did not deduct income-tax and surcharge amounting to Rs. 12,224 from a total payment of Rs. 5,81,940 made to contractors in 5 cases during March 1988 and August 1988 to October 1988.

(viii) Insurance Commission

(a) Statutory returns and Registers

Uttar Pradesh

No control register was maintained in any of the wards test checked by audit in all the four Commissioners charges. No penal action was also initiated anywhere. for non submission and delayed submission of returns.

Rajasthan

In one Commissioner's charge, there were 3 cases where quarterly certificate (Form 26D) were received late (9 days to 89 days). Statements in Form 26 E and F were not received in any case, The extent of delay in furnishing returns (Section 195) ranged from 5 days to 50 days.

Punjab

No mechanism existed in the units test checked in keeping watch of the receipt of returns where due and verification of payments shown made to Government account.

West Bengal

All the disbursing officers were not furnishing the statements in Form 26D ad 26E. No control register was maintained to keep a watch over regular submission to these statements. No list of disbursing officers is being maintained. The Daily Collection Register was not made available to Audit rendering the extracting of year wise berakup of the total amount of T.D.S. for the years 1985-86, 1986-87 and 1987-88 impossible.

Assam

Audit observed that in one ward at Guwahati, no records/documents weie maintained showing the names of such persons, the returns to be received from them, the returns actually received from them and the returns outstanding on the due dates as above, for taking action against the defaulters. The records of T.D.S. for payment of Insurance Commission in respect of 5 (five) persons (Companies) only were produced to audit. A test check in the above cases revealed as below :

(1) The Statement of deduction of tax in Form No, 26E and 26F made during the immediate preceding financial year relevant to the year 1986-87 in one case, 1987-88 in one case, 1988-89 in one case and 1986-87 to 1988-89 in one case were not received till the date of audit (July 1989).

No action was taken (July 1989) by the I.T.O. Ward No.1 (4) to call for the returns from the defaulters.

(2) Out of 60 quarterly returns to be received during the years 1986-87 to 1988-89 27 quarterly returns were not received. The delay in the receipt of returns ranged between 4 days and 302 days. No action was taken (July 1989) by the I.T.O. Ward I (4) to call for the returns from the defaulters.

(3) The tax deducted at source is required to be credited to Government accounts within one week from the last date of the month in which the deduction is made. A test check of the payment of tax with reference to the challans submitted alongwith Form 26B by 3 (three) companies/corporations revealed that there was delay in depositing the tax which ranged between 7 days and 66 days The verification of the payment of tax as shown in the Form No, 26D with reference to the challan was not found to have been done.

(b) *Representative cases noticed in audit*

Uttar Pradesh

On checking of an annual Statement furnished by a branch for financial year 1987-88 a short deduction of tax of Rs.1,41,813 was noticed against 99 receipients who received payments more than Rs. 5,000 each. There was no indication of issue of certificate for non-deduction by the I.T.O. in any case. No action to levy penalty against defaulting person for short/ non deduction was taken.

Rajasthan

In 3 cases of payments of insurace commission to 50 agents under one Commissioner, tax amounting to Rs. 59,218 was not deducted at source. Interest chargeable theroen worked out to Rs. 9,870.

Uttar Pradesh

In two offices in two different C.I.T's charges test check showed that at each station tax deducted was deposited late by 38 days in one and 67 days in the other Commissioner's charge during financial year 1987-88 but action to charge interst for belated payments in accordance with law was not taken in any of the two offices.

Delhi

Test check of assessment records of an insurance company for the assessment years 1985-86 to 1988-89 revealed delayed remittance of tax deducted from insurance commisssion up to 365 days in 1671 cases and over a year in 3 cases. It was further noticed that the company which had deducted tax of Rs. 60,908, Rs.39,243, Rs, 82,384 and Rs. 35,069 during the previous years relevant to the assessment years 1985-86 1986-87, 1887-88 and 1988-89 had not remitted the amount to Government account up to December 1984, December 1985, December 1986 and December 1987 respectively.

Assam

(c) Short levy of tax and surcharge under section 194 D

In the case of persons, other than a company, rates of Income-tax and surcharge from payment of income by way of insurance commission under Section 194D of the Income-tax Act, 1961, is 10 per cent during the financial year 1988-89. The amount of the tax deducted shall be increased by a surcharge for the purpose of the Union at the rate of 5 per cent of such income-tax. No such deduction shall be made under this section in a case where the amount of such income during the financial year does not exceed Rs. 5,000.

It was noticed that due to incorrect application of the rate of tax and non levy of surcharge there was short levy of tax of Rs. 11,963 in 26 cases.

(d) Bogus tax deduction certificate

Uttar Pradesh

At one station erroneous refunds of Rs. 1,01,933 in 13 cases were detected in 3 different wards on the basis of bogus tax deduction certificates claimed to have been issued by the person responsible for deduction of tax at source from insurance commission. Before authorising refunds in these cases, genuineness of the certificates filed in Form 19D should have been verified from the annual quarterly returns furnished by the person deducting tax in Form 26E/26D by proper maintenance of the records of these returns which omission led to the erroneous refund.

2.02.15 Delay in remittance of T.D.S. amount to Government Account

West Bengal

In two Commissioners' charges it was noticed that althouh tax was deducted at souce from payment of interest other than interest on securities for Rs. 8,32,125 the amount was not deposited to Government account in time. Interest leviable for belated deposit worked out to Rs. 3,43,544.

Karnataka

In 10 cases, the persons deducting T.D.S. from interest payments remitted the T.D.S. amount of Rs. 3,69,977 to Government account after the prescribed due dates with delays ranging from one to 25 months. No action was taken to levy interest of Rs. 33,920 and initiate penal action (penalty leviable Rs. 3,69,977).

Madhya Pradesh

In one case income-tax of Rs. 35,151 deducted at source out of interest payment which was required to be credited to the Central Government by 31 July 1984 was credited on 9 September 1985 and for such delay, interest of Rs. 4,857 and maximum penalty of Rs. 35,151 were leviable. It was noticed that neither any interest was levied nor any penal proceedings were initiated.

Rajasthan

In one case, a company entered into an agreement for drilling operations with an India based foreign company and made payments during the period 16 May 1988 to 10 December 1988 amounting to Rs. 1,10,39,276 in rupees and in U.S. Dollars 17,83,539. Tax of Rs. 23,21,635 was deducted at source but Rs. 12,50,163 only was credited to Government account. The remaining sum of Rs. 10,71,472 was not credited on the ground that the entire amount of T.D.S. was likely to be waived by the Central Board of Direct Taxes. Although the request of the asseessee for non payment of T.D.S. was rejected by the Board, yet the remaining amount of Rs. 10,71,472 was not deposited to the Government account. Interest amounting to Rs. 1,16,946 was also recoverable besides penal action. No action was taken by the department.

2.02.16 Accounting of tax deducted at source—monthly/ yearly reconciliation etc.

Tax deducted at source is required to be paid to the credit of the Central Government through the appropriate challans. The fourth counterfoil is meant to be attached by the tax payer with the statement certificate of the tax deducted at source. The work of accounting of revenue receipts is done by the departmental Officers challans for the remittance are received by the Income Tax Officers from the treasury units and they should enter the same in their Daily Collection Register. In respect of tax deduction from salaries, the monthly returns (in Form 21) should be checked every month with the challans received from the disbursing officers. The monthly returns are later to be reconciled with reference to Annual returns (in Form 24) and the fact of reconcilation should be recorded at the foot note of the Alphabetical Register of employers (in Form ITNS 118).

The circle wise position in this regard noticed during the review is given below:

Tamil Nadu

It was noticed that the monthly and annual reconcilisation prescribed were not done in any of the wards

Kerala

Reconciliation of monthly returns with annual returns. challans etc. was not being done in six wards.

Gujarat

On test check of the records of four salary wards, where the work was centralised it was noticed that the monthly deductions of tax were not checked with challans received in the subsequent month and the tax deductions as per monthly returns were not tallied with the annual returns. Monthly/yearly reconcilation of the collections of tax at source as per returns was not made with the corresponding figures appearing in the local treasury unit, wherever tax deductions were appearing in the Daily Collection Register but no return was received in suppport thereof. No action was taken to call for the wanting returns.

Similarly in respect of tax deductions from sources other than salary, no reconcilation was effected between the figures as per returns and the accounted figures as per challans received from banks.

West Bengal

It was ascertained that no systematic procedure was followed for transmission of the challans in respect of T.D.S. received by the Budget and Statistics section from the Reserve Bank of India and the different nationalised banks to the different Income-tax Officers having jurisdiction over the assessees deducting tax at source. As regards accounting procedure and reconciliation of figures no information was made availabe to audlit.

All challans in respect of the payment of tax deducted at source whether paid at the Reserve Bank of India or at the branches of different nationalised banks received by the Budget and Statistics Section of the Department are posted in the Daily Collection Registers for T.D.S. from salaries (I.T.N.S. 192). The challans pertaining to the salaries are not sent to the Annual Return wards. It was noticed that no entries of these challans were made by the Annual Retuins wards either in the Daily Collection Register in I.T.N.S 123 (I.T.135) or in the Employers Registers. Owing to non maintenance of Daily Collection Register by the Wards no reconcilation between the payments as disclosed in the Monthly/Annual Returns and monthly/annual collection as accounted for in treasury challans could be made and the authenticity of the quantum of collection was not susceptible of verification in audit.

Under the Income-tax Rules, 1962, the employers other than Government are required to deposit tax deducted at source within seven days of deduction of taxes, unless permitted otherwise by an order of the Income-tax Officer to deposit taxes quarterly. It was noticed that although none of the employers has been permitted to pay taxes quarterly. There was no machinery in the ward to watch the compliance of the deposit of taxes by the non government employer within the prescribed period of seven days from the date of deduction of tax. Many employers delayed the deposit of taxes (the delay ranging between 8 days and 122 days) but no penal action had been initiated against them.

2.02.17 Cross verification of tax deduction certificates and co-ordination between Government agencies

Tamil Nadu

In the assessments made under the Act for the assessment year for which such income is assessable credit is generally given for the amount of tax deducted on the basis of the deduction certificate furnished under the Act. But the tax deduction certificates are not verified by the department independently with the returns of tax deducted at source.

A cross verification was conducted in audit in Tamil Nadu charges in respect of 12 out station tax deduction certificates issued in 4 States when it was noticed that in one station in 3 out of 5 cases the persons in whose name the ceritficates were given had not actually furnished any returns under section 205 and in the remaining 2 cases the deduction was not traceable in the statement produced by the department to audit. Information is not available in respect of other 7 cases in 3 States.

In big cities where separate tax deduction at source (T.D.S.) wards exist for collection and processing of the return of tax at source, it was noticed in audit that in respect of cases of omission apparent from the returns, statements etc. filed by the assessees, the assessing Income-tax officers did not generally take action as prescribed in the Act/Rules against the defaulters assessees or intimate such cases to the respective T. D.S.I.T.O'S for initiating action. It was reported in one T.D.S. ward that only 8 cases of default were intimated to them by the assessing ITOs over a period of 4 years. Information was not available in other wards. It was seen in audit that in 5 cases alone interest under section 201 (1A) omitted to be levied by the assessing ITO's amounted to Rs. 2,46,483.

Kerala

In Kerala, the department had not undertaken cross verification of outstation T.D.S. Certificates with the connected returns, challans, etc. in any of the cases checked in audit, involving an amount of Rs. 7.77 lakhs in three Income-tax Wards.

In the case of direct refunds to non-regular assessees (with below taxable income) tax deducted at source certificate are virtually converted as refund vouchers, as refunds are made without any verification, especially in the context of summary assessment scheme. At presentno attempt is made to ensure the genuinenss and correctness of such certificates. To audit queries, it was replied that it was not practicable to ascertain amount of source deduction, date of payment, etc. In the circumstances, it can not be ensured that the credits/ refunds are afforded for correct amount and possibility of even bogus certificates cannot be ruled out.

Direct refunds issued from one income-tax ward for 1987-88 and 1988-89 were 447 involving Rs. 5.86 lakhs.

Gujarat

On a test check of the records of 84 wards in seven Commissioners charges, it was found that no verification was being conducted in respect of the outstation certificates filed with the Income-tax returns by the assessees. It was also found that no verification was being conducted in respect of income from interest (other than interest on securities) exceeding the minimum amount liable to income-tax paid without deduction of tax at source on the basis of declaration in prescribed form. For instance, in respect of two deposits of Rs.15,00,000 each made in a fertillzer company by two registered firms falling within the jurisdiction of an Income-tax officer, interest of Rs. 2,10,000 was paid in each case during 1986-87 without deduction of tax at source on the basis of declarations furnished in Form 15 by the depositors.

The records maintained in the wards did not disclose any effort on the part of the departmental officers to undertake co-ordination with other counterparts etc. as also other Government agencies in respect of tax deduction at source.

West Bengal

The department did not maintain any uptodate list of disbursing officers and approved contractors (in private/public and Government departments) in cases of tax deducted at source under section 194C. The Government departments and local authorities also did not furnish the quarterly statements in Form 26C prescribed under Rule 37 (2c) of the Income-tax Rules. The department also did not have any machinery to pursue the submission of such documents.

2.02.18 Genuineness of tax deduction certificate

West Bengal

In the course of audit of 16 Income-tax officers charges under 5 Commissioners of Income-tax in West Bengal charges it was noticed that assesssments for the assessment years 1982-83 to 1986-87 were completed in a summary manner on the basis of tax deduction certificates filed by 266 assessees. Credit for tax deduction contained in these T.D.S. certificates was allowed in the assessments and excess tax deducted was refunded to the assessees. On cross checking and verification the following irregularities were noticed :

(i) Out of these 266 cases in 173 cases taxes were shown to have been deducted from interest (other than interest on securities) and commission payments. The names and permanent account numbers as noted in the T.D.S. certificates were scrutinised with a view to ascertaining the genuineness of the person issuing the T.D.S. certificates, but their genuineness could not be established.

(ii) In respect of 93 remaining cases where tax was shown to have been deducted from salaries, examination of the relevant annual returns filed by the respective employers revealed that the names of the assessees in question did not appear in such annual returns. In these cases also, the genuineness of the persons issuing the T.D.S. certificates was not free from doubt.

In the 266 cases, the total amount of tax deducted at source worked upto Rs. 25,21,433 and tax credit allowed in assessments was for Rs.1,58,763 and the balance of Rs. 23,60,512 (there being a short refund of of Rs. 2158) was refunded to the assessee. Irregular acceptance of these tax deduction certificates involved total revenue of Rs.25,19,275 (Rs.23,60,512 Plus Rs. 1,58,763).

Tamil Nadu

The person who deducts tax at source should send the prescribed return to the ITO. T.D.S. furnishing full details of deductions made alongwith the challns in which the tax deducted was credited to Government account. Credit for tax deducted at source is given to the person from whose income the deduction was made, on the basis of the certificate issued by the person who deducted tax and refund ordered, wherever due. In order to verify the actual credit given to the assessee based on the certificates isued by the person deducting tax, with the tax deducted and remitted to Government account and to check the correctness of the cerificates, the connected returns together with the challans for remittances were called for in 185 cases in 3 T.D.S. wards in Tamil Nadu charges. In 2 wards the returns (116 Nos) and challans were not produced since they were not available and in the third ward only 36 out of 69 returns called for were produced.

Bihar

In Bihar charges according to the department some suspected cases of false tax deduction certificates were under investigation.

2.02.19 Incorrect application of rate of exchange in conversion of foreign currency

Gujarat

For the purpose of deduction of tax at source on any income payable in foreign currency the rate of exchange for the calculation of the value in rupees of such income payable to an assessee outside India shall be the telegraphic transfer buying rate of such currency as on the date on which the tax was required to be deducted at source by the person responsible for paying such income (Rule 26 of Income-tax Rules 1962).

On test check of the statements in Form 27 submitted by an Indian company manufacturing fertilizers and petrochemicals in respect of payment of fees for technical services rendered by foreign companies the rate of exchange prevailing on the last day of the previous year was applied instead of the rate of exchange prevailing on the date on which tax was required to be deducted at source. When this omission was pointed out to the Department it was stated that in respect of income chargeable under the head 'Profits and gains of business or profession' the rate of exchange prevailing on the last day of the previous years of the assessee was applied as laid down in Explanation 2(c) below Rule 115 of Income-tax Rules, 1962. As rates of exchange under Section 115 are applicable for assessment of any income accruing to the assessee and not in respect of deduction of tax at source on sums payable to non-residents, the rate of exchange correctly applicable would be the rate on the date of deduction and not the last day of the previous year.

No attempt was made to ascertain the rate of exchange prevailing on the date of payment to the non-resident. In the absence of the data regarding the actual rates prevailing on the relevant dates, short recovery of tax, if any, on the payment relating to one commissioner could not be worked out.

Kerala

In Kerala charges the number of assessees who had returned income in foreign currency could not be ascertained as no register was maintained in the income-tax wards reviewed.

2.02.20 Other cases

Some interesting cases noticed in audit are:

Andhara Pardesh

(i) In his revised returns filed under amnesty scheme, an assessee, a registered firm, returned an income of Rs.3.7 lakhs. This was not accepted by assessing authority, since the expenditure was not fully supported by vouchers and the accounts were not properly maintained. The income was therefore estimated at 13.5 per cent of net receipts of Rs.27,43,784 which consisted of net profits of Rs.26,27,261 and T.D.S. of Rs.1,16,523. But as seen from T.D.S. certificates enclosed to the return the net bill worked out to Rs.31,34,489 against Rs.26,27,261. Thus there was an under—assessment of income of Rs,68,476 (13.5 per cent of difference between Rs.31,34,489 and 26,27,261) which resulted in short demand of Rs.16,43 4.

(ii) An assessee, a public limited company, during the previous year relevant to assessment year 1985-86, the assessment of which was completed in October 1987, debited a sum of Rs. 1,32,12,231 to profit and loss account towards payment to sub-contractors. But no tax was deducted at source on payment to sub-contractors. The assessee was liable to pay T.D.S. of Rs.1,32,122 plus interest under section 201 (1A) of Rs. 74,295 for the period 1 April 1985 to 31 December 1988 (date of audit).

(iii) On the strength of certificate issued by State Bank of India, an assessee was given credit of Rs. 14,500 (which was credited on 6.3.1986) during assessment year 1986-87. However it was seen from Demand and Collection Register 1985-86 that the credit was adjusted against the arrear demand for assessment year 1983-84. The assessee had not furnished the original challans in both the assessment years. The credit was given twice.

(iv) As per the T.D.S. certificate work done by an assessee firm was for Rs.14,05,855 whereas Rs. 12,70,129 only was brought to profit and loss account. The difference of Rs.1,35,726 escaped assessment. The assessee firm also received commission from the sub-contractors, which was credited to profit and loss account. But 2 per cent tax deducted at source recovered by the department in the name of the main contractor in respect of the work allotted to the sub-contractors was not offered to tax. The T.D.S. of Rs.14,170 was an income in the hands of main contractor which is to be added back. Tax implication on both the items would be Rs.33,799.

(iv) In the assessment files of eight assessees, verified during 1988-89 in six wards under 3 Commissioners charges tax deducted at source was given credit in the assessment orders based on duplicate xerox copy of the certificate. Indemnity bonds were also not obtained and placed on record. The total amount of tax deduction allowed in this regard was Rs.1,94,532.

(iv) In respect of 15 assessments checked during the year 1988-89 there was short computation of income due to the difference between the amount shown as per T.D.S. certificates and the amount accounted for in the profit and loss account. The total short demand in 15 cases worked out to Rs.1,07,760.

Tamil Nadu

(i) In two wards credit was given in 3 cases towards tax deducted at source for Rs. 2,57,102 (Rs. 54,150 in one case and Rs. 2,399 in the second case and Rs. 220,553 in the third case) without production of certificate of tax deduction in the first two cases. In one ward the Income-tax Officer agreed to call for the certificate from the assessee. In the third case the Income-tax officer replied that the T.D.S. certificates were not readily available and the general practice was to keep the certificate separately from the miscellaneous record during the subsequent audit of the ward also the T.D.S. certificate were not produced.

(*ii*) In the audit of one ward it was seen that an assessee firm paid interest on the funds advance by some creditors calculated at a percentage of the net profit of the business during the assessment years 1985-86, 1986-87 and 1987-88 and debited the amount paid under the head 'Interest paid' in the profit and loss account of the respective years.

But the assessee firm did not deduct the income-tax at source as required under section 194A. The non-deduction of tax for 3 assessment years amounted to Rs. 1,15,119. The interest and penalty to be levied thereon amounted to Rs.47,320 and Rs. 1,15,119 (maximum) respectively upto 31 December 1988.

(*iii*) In one case, an assessee engaged in the business of financing, obtained a refund based on a tax deduction certificate but failed to return the income of Rs. 1,11,700 received by him and covered by the T.D.S. Certificate. Thus, giving credit of tax deduction without assessment of the corresponding income resulted in short demand of tax of Rs. 26,808. The Income-tax Officer replied that the assessment was completed under Section 143(1)and hence no remedial action was possible.

(*iv*) In the audit of 2 wards. it was seen in 4 cases that while giving credit for T.D. S. certificates and granting refund to contractors the non disclosure of the correct income (covered by the T.D.S. certificates) was not checked by the department (the assessee returned only lesser amounts as their income). These cases were pointed out in audit with tax effect of Rs. 1,00,232. The Income-tax Officer replied that the assessments were completed in a summary manner.

(*v*) The Act provides that where the Income-tax Officer is satisfied that the total income of a contractor justifies deduction of income-tax at any lower rate or no deduction of income-tax, as the case may be, he shall give a certificate accordingly, and the person responsible for paying the sum shall deduct tax at the rate specified in such certificates till the certificate is cancelled by the Income-tax Officer.

During scrutiny of the assessment of a registered firm engaged in the business of labour contract for assessment year 1985-86 completed in March 1988 on a total income of Rs. 1,46,41,550 it was seen in audit that during the previous year tax was deducted at source at the lower rate of 1 per cent as against 2 per cent provided in the Act, as authorised by the Income-tax Officer under the above mentioned provisions of the Act. As the assessment resulted in a net tax demand of Rs. 37,53,949 the ITO's order to deduct tax at lower rate of 1 per cent resulted in a collection of tax at source of Rs. 3,54,649 only as against Rs. 7,09,298 and consequent postponement in revenue collection of Rs. 3,54,649 by over 40 months.

Assam

The Income-tax Act, 1961, provides that if any person, principal officer or company does not deduct or after deducting tax at source fails to pay the tax as required by or under this Act, he or it shall be liable to pay simple interest at the rate of 12 per cent per annum (15 per cent from 1 October 1984) on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid.

The assessee, a registered firm, filed return for assessment years 1984-85 to 1986-87 (March 1987) under amnesty scheme. Out of these returns, assessment of income for assessment year 1984-85 was completed in summary manner (November 1987). Assessment of subsequent two years could not be completed due to non-submission of tax deduction certificate by the assessee as evidenced from the assessing officers letter to the assessee. In all the above three years the assessee showed huge outstanding (tax deducted at source) liabilities in the balance sheet. Audit observed (February 1988) that the assessee realised tax of Rs. 5,855, Rs. 42,711. Rs. 39,653, Rs. 74,218 and Rs. 61,282 in assessment years 1980-81, 1981-82, 1982-83, 1983-84 and 1984-85 respectively. Out of the above realisation Rs. 4,233, Rs. 1,007 and Rs. 7,698 pertaining to assessment year 1980-81 were remitted in April 1981, March 1982 and April 1984 respectively. The assessee also remitted Rs. 1,833 pertaining to assessment year 1981-82 in April 1983, Rs. 88.26 and Rs. 6,000 for assessment year 1982-83 in April 1983 and May 1984 and Rs. 26,500 and Rs. 18,350 also in May 1984 relating to assessment year 1983-84 and 1984-85 respectively. Thus out of the total realisation of Rs. 2,33,819 only Rs. 74,447 had been remitted to Government accounts during the above period leaving a balance of Rs. 1,59,372 to roll in his business. Interest for such non payment of tax was not, however, levied in the assessments upto assessment year 1984-85. Interest realisable from the assessee on outstanding balance at the prevailing rates (from April 1980 to March 1988) worked out in audit at Rs. 1,26,090. The omission resulted in non levy of interest of Rs. 1,26,090 upto March 1988.

The case was reported to the Department in May 1988; their reply has not been received (May 1989).

2.02.21 Irregular adjustment of tax deducted from salaries in the following financial year

Bihar

Under the provisions of sub section (3) of section 192 of the Income-tax Act, 1961. the person responsible for making payment of salaries may, at the time of making any deduction of tax at source, increase or reduce the amount to be deducted under section 192 for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct during the financial year. Thus, the disbursing officer is authorised to adjust any excess or deficiency pertaining to and during the same financial year only and not after the close of the financial year. An assessee company filed statement for the years 1986-87 and 1987-88 showing total amount of tax required to be deducted as per annual returns under section 206 of the Income-tax Act, 1961, total amount of tax actually credited to the Central Government during the year and adjustment of the tax credited to Government in excess.

Under the Income-tax Act, 1961, every contractor, who enters into a contract exceedng Rs. 50,000 is required to furnish within one month a statement (in Form No. 52) giving particulars of the contract to the assessing officer. In case of failure to comply with the provisions, the Commissioner of Income-tax may impose a fine upto fifty rupees per day but not exceeding 25 per cent of the value of the contract. It was noticed during test check that the provisions were not complied with and no action was taken by the department for the breach in such cases though fine leviable in those cases amounted to Rs. 80,100.

2.02.22. Irregular refund of tax deducted at source

West Bengal

The test check conducted by audit in two income-tax wards under a general district revealed that in the regular assessments of income in respect of forty assessees for the assessment years 1983-84 to 1986-87 completed in a summary manner between April 1987 and October 1987, a total demand of Rs. 6,556 was raised against the tax deducted at source amounting to Rs. 3,42,374 and the difference of Rs. 3,35,818 was refunded. Verification in audit of the correctness of tax deduction certificates filed by the assessee revealed that the persons who had issued the tax deduction certificates were not borne in the books of the department and were not being assessed. In the circumstances, the genuineness of the T.D.S. certificates issued could not be established and the correctness of the refunds of Rs. 3,35,818 could not be verified.

The test check conducted in two other income-tax wards under a refund circle also revealed that in the regular assessment of income in respect of 10 assessees for the assessment years 1984-85 to 1986-87 completed in a summary manner between July 1987 and March 1988, nil demand was raised against the tax deducted at source amounting to Rs. 57,530 and the entire amount of Rs. 57,530 was refunded. Verification in audit of the correctness of the two deduction certificates filed by the assessees revealed that in this case also, the persons who had issued the tax deduction certificates were not borne on the books of the department and were not being assessed. In the circumstances the genuineness of the T.D.S certificates issued could not be established and the correctness of the refunds of Rs. 57,530 on the basis of the certificates could not be verified.

2.02.23. Working of Tax Deduction Account Number

For better monitoring of deduction of tax at source and its deposit into the Government account the Finance Act, 1987, inserted, with effect from 1 June 1987, a new section 203A in the Income-tax Act. Every person deducting tax at source in respect of any payment made by him and who has not been allotted a Tax Deduction Account Number (TAN) should apply (Form No. 49B) within one month from the end of the month in which tax was deducted to the Income-tax authority for the allotment of TAN. The TAN so allotted shall be quoted in all challans for payment of any tax deducted at source, in all certificates for tax deducted and in all the prescribed returns filed by persons deducting tax at source. Failure, within reasonable time to do so will attract the penal provisions of the Act, extending upto Rs. 5000.

A review of allotment of tax deduction Account number revealed the following :

Tamil Nadu

In 5 T.D.S. wards in Tamil Nadu charges, out of 13,253 applications received for allotment of TAN upon 31 March 1989 the number was allotted in 12,618 cases and in respect of the remaining 635 cases the allotment was stated to be in progress. No case of penal action taken for non-compliance of provision of section 203A was noticed in any of the wards. Information regarding the number of persons responsible for T.D.S. was not available in any of the wards.

Uttar Pradesh

The position of allotment of Tax Deduction Account Number relating to salaries by the four Commissioners checked by Audit in Uttar Pradesh was as under :

Year	Total No. of persons responsible for T.D.S. from salaries	No. of applications received for allotment of T.D. A/c No.	No. of persons to whom T.D. A/c No allotted.	No. of applications pending	Broad reasons for pendency
1987-88	733	247	247	Nil	Applications are under process
1988-89	Not known to the I.T. Department	690	490	200	

2.02.24. Non levy of penalty for non-submission of application for tax Deduction Account Number (TAN)

(*i*) Of the 2104 persons who had furnished the Annual return in Form 24 during the Financial year 1986-87 only 937 persons submitted applications for allotment of TAN for 1987-88 till 31 March 1989 although the due date was 30 September 1987. The remaining 1167 persons who had become defaulters, were liable for penal action but no action was taken by the department in this regard. The aggregate amount of penalty leviable in such cases worked out to Rs. 58.35 lakhs.

Dividends

For allotment of Tax Deduction Account Number relating to dividends in accordance with the provisions of the Income-tax Act, 1961, only 7 companies during financial year 1987-88 and 5 companies during financial year 1988-89 had applied till 31 March 1989 to whom such number was duly allotted. No application was pending as at present (April 1989). No action to impose penalty against defaulters for non-submission of application was initiated so far although number of companies that are required to apply for allotment of TAN could easily be collected from the wards where companies are assessed.

Interest on securities

(*ii*) No person had applied for allotment of tax deduction account number under the head 'Interest on securities' at the offices test checked in audit.

Interest other than interest on securities

(*iii*) The position of allotment of Tax Deduction Account Number relating to interest (other than interest on securities) is as under :

Year	Total No. of persons responsible for T.D.S.	No. of applications received for allotment of T.D. A/c No.	No. of persons to whom T.D. A/c No. was allotted	No. of applications pending	Broad reasons for pendency
1987-88	610	935	935	Nil	..
1988-89	215	1010	1000	10	No reasons given
TOTAL	825	1945	1935	10	

Winnings from lottery or crossword puzzle

(*iv*) A test check disclosed that the person responsible for deduction of tax from winnings from lottery had not submitted any such application for allotment of Tax Deduction Account Number till 31 March 1989. No action to initiate any penalty was also taken. The penalty leviable in this case was Rs. 5,000.

Payments to contractors and sub-contractors

(*v*) The position of allotment of Tax Deduction Account Number in the case of contractors and subcontractors is as under :

Year	Total No. of persons responsible for T.D.S.	No. of applications received for allotment of T.D. A/c No.	No. of persons to whom T.D. A/c No. allotted	No. of applications pending	Broad reasons for pendency
1987-88	25	5	5	Nil	..
1988-89	Nil	132	132	Nil	..
TOTAL	25	137	137	Nil	..

Insurance commission

(*vi*) The number of persons responsible for deduction of tax at source from insurance commission for the financial year 1987-88 was 22 against which only 6 persons had submitted applications for TAN upto 31 March 1989 while the remaining 16 persons had become defaulters liable to penalty for not complying the provisions of the Act. No. action regarding imposition of penalty against defaulters was initiated by the department. The aggregate amount of penalty leviable worked out to Rs. 80,000.

Kerala

For want of details, it could not be assessed in audit to what extent the procedure envisaged in the new provision is being followed. One of the two Commissioners of Income-tax could not furnish even the total number of Tax Deduction Account Numbers allotted during 1987-88 and the section wise details for 1988-89.

Karnataka

The total number of persons responsible for T.D.S. was available only in respect of Section 192 of the Act, which came to 4,123. As against these 4,123 employers (as on 31-3-1988) only 892 had applied for allotment of T.D. Number. No penalty proceedings were initiated in respect of employers who did not apply for allotment of T.D.S. Nos.

Andhra Pradesh

The following are the details of non allotment of Tax Deduction Account Number and reasons for the pendency (given by 4 wards) in 7 wards under 3 Commissioners charges of Andhra Pradesh:

Year	Total No. of persons responsible	Applications received	A/c No. allotted	Pending	Reasons for pending
1987-88	..	231	..	231	Higher authorities were addressed regarding prodecure/instructions received from higher authorities.
1988-89	..	372	60	312	Allotment in progress
TOTAL	not know	603	60	543	

In one ward 34 persons who were responsible to apply for Tax Deduction Account Number had not applied for it. Penalty leviable on them would be Rs. 1,70,000 (5000 × 34) under Section 272 BB. In a salary ward under one charge, no number was allotted as on 31 March 1988.

Rajasthan

(vii) Salary (Section 192)

Jodhpur Charge

Applications for the allotment of Tax Deduction Account Number (TAN) were received in 141 cases and account numbers were allotted by the department as against 511 employers listed in the Register of Employers. Action in remaining 370 cases was not taken as contemplated in the Act.

Jaipur Charge

As against 2094 names entered in the employers register. TAN numbers were allotted in 129 cases where applications were received by March 1989. No action was taken in the remaining cases. Interest on securities (Section 193), Dividends (Section 194), Interest other than interest on securities (Section 194A) Winning from lotteries (Section 194B), Payments to contractors (Section 194C), Insurance Commission (Section 194D), other sums (Section 195).

Jodhpur Charge

The department was not maintaining any record on the basis of which the number of persons responsible for deducting tax at source under the various head of income could be ascertained. Till March 1989 such returns were being received in the offices of the assessing officers having jurisdiction over such assessees. Tax Deduction Account Numbers were allotted in 6254, 16 and 4 cases where the applications were received for allotment under Sections 194A, 194C and 194D respectively.

Jaipur Charge

In Jaipur charge also no record was maintained to ascertain total number of persons responsible for deduction of tax at source under the provisions of these sections. However, out of 1196 applications received for allotment of account numbers under Section 194A, 194C and 194E, allotments were made in 1033 cases only and in the remaining 163 cases account numbers were not allotted till March 1989.

Punjab

It was noticed in Punjab charges that TAN was not quoted even in a single case on the periodical returns, challans and certificates upto December 1988. It was further noticed that although applications for allotment of TAN had been received from the persons concerned within the specified time, account numbers were not allotted upto August 1988. Penal provisions were not invoked in any case.

Madhya Pradesh

In two wards under two Commissioners charges 2305 applications were received during the years 1987-88 and 1988-89, but none of the applications were disposed of. The reasons for non-allotment of account number in these cases were stated to be (i) procedure for allotment of account number not received from Commissioner of Income-tax and (ii) shortage of staff.

The exact number of applications which were to be received could not be ascertained as the register of employers in Form ITNS 118 was not found maintained/complete with the result the exact amount of penalty could not be ascertained. It was, however, intimated by the Deputy Commissioner of Income-tax (Audit and System) under One Commissioner that the work of allotment of T.A.N. (Permanent Account of T.D.S.) was under process.

Gujarat

Test check of allotment of Tax Deduction Account Number in seven Commissioners charges in Gujarat revealed that in none of these charges, the total number of assessees who were required to apply for tax deduction account was available. In respect of assessees who had not yet applied for the tax deduction account, no action had been taken to initiate action against them. The penalty leviable in respect of the assessees who had not yet submitted the applications is not ascertainable in the absence of an alphabetical index of assessees who are deducting tax at source. In so far as the progress in allotment of tax deduction account number was concerned, it was noticed that as on, 31 March 1989, 26,458 applications had been disposed of and allotment was pending in respect of 6,310 applications (2,508 due to incompleteness of the applications forms in one Commissioner's charge and 3,802 due to transfer of allotment work in another Commissioner's charge).

West Bengal

The department in West Bengal charges stated that out of 8,000 persons responsible approximately for tax deduction at source, 5,110 applications had been received and all of them were allotted the Tax Deduction Account Number. The remaining 2,890 persons had either not applied for allotment of tax deduction account number or having applied for such were awaiting allotment of tax Deduction Account Number. Although there is a provision for levy of penalty under section 273 BB penalty proceedings had not been initiated against any such defaulters.

Delhi

In Delhi charges, no records containing the details of persons responsible for deduction of tax at source was being maintained in the absence of which it is not understood as to how it was ensured that the requisite applications had been received in all cases. A register in two volumes called 'Receipt Register' for 1988-89 was produced to audit wherein 11,422 applications for allotment of tax deduction account numbers were found recorded. But no periodical report/abstract showing the total number of applications received, number of cases in which Tax Deduction Account

Number was allotted, number of cases pending for allotment was ever prepared by the department. In the absence of details it could not be assessed in audit as to what extent the procedure envisaged in the new provision was being followed. The department could not furnish the total number of Tax Deduction Account Numbers allotted during the years 1987-88 and 1988-89 or the sectionwise details.

Bihar

In Bihar charges, the allotment of the Account Number was not taken up in wards/units at Ranchi till the end of 1988-89.

While no action was taken for stock taking of the applications received and for allotment of TAN in Ranchi ward/units till April 1989 the position of the allotment work in other wards/units under review was as shown below :

Year	Total No. of persons responsible for T.D.S.	No. of applications received for allotment of T.D.S. A/C No.			No. of persons to whom T.D.S. A/C No.not allotted			No. of applications pending		
		Patna	Begu-sarai	Hazari Bagh	Patna	Begu-sarai	Hazari Bagh	Patna	Begu-sarai	Hazari Bagh
1987-88	Not available	Nil	Not furnished	6	Nil	Not furnished	6	—	Not furnished	—
1988-89	,,	74	,,	9	70	,,	9	4	,,	—

Delay in allotment of account number was stated to be the want of printed forms and further administrative instructions in the matter.

Jammu and Kashmir

No account numbers were allotted. The department had not maintained any record with regard to allotment of Account Numbers.

Haryana

No T.D. Account number was allotted either by assessing officer or the T.D.S. Circle during 1987-88. During 1988-89 in 1,349 cases, T.D. Account numbers were allotted to the employers only by the I.T.O. (System-computer Cell.) T.D. Account numbers were not recorded on monthly returns/challans of February 1989 received in March 1989. No penal action was taken.

Orissa

Out of 152 applications received for allotment of TAN, the number was allotted in 119 cases, 33 cases were pending. The number of applications for allotment of TAN received in one circle could not be furnished by the department and no account number has so far been allotted in this circle.

Assam

It was seen from the records of D.C.I.T. Assessment Range 1 Guwahati and D.C.I.T. Assessment Range II. Guwahati that applications received during 1987-88 and 1988-89 from the persons for allotment of tax deduction account numbers were transferred to the I.T.O. ward I(4) Guwahati but the allotment of account number is still pending (July 1989) as the I.T.O. ward I(4) took no action in this regard.

2.02.25 Internal Audit

The department has a full-fledged Internal Audit Department. One of the duties of the Internal Audit parties is to check whether the tax demand and collections/recoveries are correctly brought to account and the relevant records/accounts are maintained properly and also to verify :

(a) Whether there is any inordinate delay on the part of employers to deduct T.D.S. from salaries and whether interest under section 201(1A) was levied by Income-tax Officer.

(b) Whether there has been any case where the employer has given a certificate for an assessee under section 203 regarding the amount of salary paid and tax deducted at source while actually no tax was deducted at source.

The departmental Manual of office Procedure also requires the Inspecting Assistant Commissioners (Now Deputy Commissioners) to watch the proper maintainance of prescribed registers and records as also the mechanism to ensure prompt receipt of returns and statements from employers etc., during their inspections.

Despite the codal provisions in this regard, it was seen during the review that no internal audit or inspection had been carried out in the wards covered by test check in Tamil Nadu, Bombay, Rajasthan, Punjab, Madhya Pradesh, Gujarat, West Bengal, Delhi, Haryana and Jammu and Kashmir. Most of the irregularities brought out in this review could have been detected in time, if only internal audit is strengthened and internal audit of the T.D.S. wards conducted according to a time-schedule.

The paragraph was referred to the Ministry of Finance for comments in September, 1989, the reply from the Government has not so far been received (October 1989).

2.03 Mistakes in assessments completed under the summary assessment procedure

A-INCOME-TAX

2.03.1 In para 3.1 of the Audit Report for the year ended 31 March 1987, the procedure of assessment, especially the summary assessment procedure, was reviewed and the review results involving substantial irregularities of diverse nature, suggested that the built-in-control in the procedure, including randum sample scrutiny with a view to ensuring that the proedure was not being abused, was not being strictly applied. Similar irregularities were reported in para 4.41 of the Audit Report for the year ended 31 March 1988.

2.03.2 According to the Action Plan for 1988-89, of the Income-tax department, the summary assessment scheme was extended to all income groups irrespective of the size of income or loss returned, and in every income group only a small percentage would be subjected to scrutiny working to an overall 3 percent. Thus the practice of even the limited randum sample scrutiny to act as a check on any abuse of the scheme was dispensed with.

2.03.3 In their 173rd Report (8th Lok Sabha) (1989-90) on para 3.1—Assessment procedure—Summary and scrutiny assessments, of the Audit Report for the year ended 31st March 1987, the Public Accounts Committee reviewed the implementation of the Summary Assessment Scheme and recommended that the effectiveness of the Scheme should be reviewed by a Committee of Experts, including economists. While observing that the irregularities, under assessments, etc., that are pointed out by Audit are directly indicative of the failure of the assessing officers in carrying out the summary assessments in a proper way, the Committee disapproved the Board's instructions for stoppage of all action on audit findings in summary assessment cases and recommended follow up action in respect of all cases commented in the audit paragraphs. The Committee also recommended that the Ministry may ensure proper implementation of the sample scrutiny system by all Commissioners by a time-bound programme for all past periods to gaurd against any misuse or abuse of the scheme.

2.03.4 The test audit of the cases decided under the summary assessment procedure during the year 1988-89 revealed further similar irregularities in 6,547 cases involving a total revenue effect of Rs. 1,848.61 lakhs (Rs. 837.79 lakhs in 5,836 cases during 1986-87 and Rs. 1,382.41 lakhs in 4,090 cases during 1987-88). The mistakes, covering the whole gamut of direct tax laws, fell broadly under the following categories :

Nature of irregularities	No. of cases	Tax Effect (In lakhs of Rs.)
(a) Arithmetical errors in returns, accounts and documents and *prima facie*, inadmissible expenses allowed.	1,426	313.82
(b) Omission to disallow deductions, allowances or reliefs, *prima facie*, inadmissible but claimed in the return and allowed.	1,387	306.00
(c) Irregular set off and carry forward and set off of unabsorbed losses, depreciation, etc., and other reliefs.	322	104.01
(d) Other Irregularities	3,412	1,124.78
Total	**6,547**	**1,848.61**

Arithmetical errors in returns, accounts and documents and prima facie, inadmissible expenses allowed

2.03.5 On test check it was noticed that in 29 Commissioners' charges, arithmetical mistakes in the returns and accounts filed by the assessees were not corrected in 229 cases involving a tax effect of Rs. 42.73 lakhs. Similarly in 1,197 cases, with a tax effect of Rs. 271.09 lakhs, expenditure, prima facie, not admissible but claimed by the assessees in the returns was not disallowed. A few important cases are given in the following table :

Name of the circle	Assessee	Assessment year	Nature of objection	Revenue effect (Rs.)
Andhra Pradesh	R.F.	1987-88	Due to a mistake in casting the total of credit side of profit and loss account, the net profit was worked out less by Rs. 1,30,200.	31,976
Himachal Pradesh	R.F./Indl.	1986-87 1987-88	In 8 cases assessed in four units, inadmissible expenses being irregular deductions under 40A(3) of Rs. 15,03,209 were allowed as claimed.	4,93,304
Uttar Pradesh	R.F.	1987-88	Expenditure of Rs. 8,96,048 debited to profit and loss account instead Rs. 6,24,640 as per details of expenditure, thereby reducing the income by Rs. 2,71,408.	56,597
Bihar	Indl.	1987-88	Share of cost of goodwill of Rs. 70,000 debited to profit and loss account not disallowed as capital expenditure.	37,485
Kerala	AOP	1984-85 1985-86	Double allowance of bonus and gratuity paid aggregating to Rs. 3,44,729—once as a direct deduction and again by including in other allowable expenditure.	1,40,600
West Bengal	Co.	1985-86	Contribution of Rs. 89,849 towards unapproved gratuity fund not disallowed.	1,02,096 (including interest for late filing of return).

Adoption of low profit rate

2.03.6 The test check disclosed that in 7 Commissioners charges, returns were filed adopting low profit rate than in earlier years in 88 cases involving a tax effect of Rs. 27.56 lakhs. A few instances are :

Name of the circle	Assessee	Assessment year	Nature of objection	Revenue effect (Rs.)
Himachal Pradesh	Contractor	1986-87 1987-88	Income estimated at less than 10 percent (as generally adopted in earlier years) in the assessment years 1986-87 and 1987-88 involving under assessment of income of Rs. 6,49,786.	2,15,901
Uttar Pradesh	Indl.	1986-87	Profit returned at 1.5 percent, though in earlier years the rate of profit of 7 percent was decided in appeal (under-assessment of income Rs. 1,12,700).	62,024
Uttar Pradesh	Indl.	1986-87 1987-88	Profit returned at 4 percent against 8 percent adopted in earlier years (under assessment of income of Rs. 2,53,828 and Rs. 3,58,560).	56,212
Bihar	Indl.	1987-88	Profit returned at 10 percent on gross receipts was reduced by inadmissible deductions or allowances aggregating to Rs. 1,15,242.	61,141
Assam	R./F.	1984-85 1985-86	Profit estimated and returned at 2.5 percent against the 12.5 percent (against 7 percent returned) adopted for the earlier three years (under-assessment of income Rs. 1,42,050.	98,759
Assam	R/F.	1985-86	Profit returned at 4.76 percent against 10 percent applied in earlier years (under-assessment of income of Rs. 1,92,083).	1,24,187
Gujarat	R/F.	1986-87	Fall in job receipts by Rs. 6.23 lakhs, to Rs. 0.22 lakhs despite increase in purchases, sales and closing stock.	3,55,774
Rajasthan	R/F.	1985-86	Under estimation of profit by 1.7 percent (12 percent to 4.3 percent).	1,07,990

Incorrect computation of salary income

2.03.7 Under the extant instructions, agents of Life Insurance Corporation of India who get commission on the basis of business secured by them are not entitled to any standard deduction applicable to salary income and in their cases where no detailed accounts are kept such income is subject to an adhoc deduction of 50 percent of the commission. The Development Officers of the Life Insurance Corporation are, however, regular employees of the corporation but are allowed to earn incentive bonus and commission. In their cases, the standard deduction is admissible only in computing the salary income.

Andhra Pradesh

(*i*)(*a*) In 49 cases under 4 Commissioners' charges, the Development Officers of the Life Insurance Corporation of India were allowed deduction of expenditure from the commission received by them in contravention of the Board's Instructions issued in October 1987, instead of restricting the standard deduction to salary (undercharge of tax Rs. 6,39,703).

(*b*) In the cases of three assessees, one an individual and two other Hindu Undivided Families, relief was allowed on contribution towards life insurance premia, etc., in excess of Rs. 40,000, at the prescribed rates. (Short demand of tax amounted to Rs. 43,787).

Karnataka

(*ii*) 17 Development Officers of Life Insurance Corporation of India, were in addition to standard deduction, allowed either deductions towards expenses or certain amount of incentive bonus was excluded from the total income, which resulted in short levy of tax of Rs. 2,52,988.

Gujarat

(*iii*) In the cases of 4 Development Officers in two Commissioners charges the deduction at 40 percent of the gross receipts of incentive bonus amounting to Rs. 1,89,880 was claimed and allowed towards expenses incurred by them during the assessment years 1985-86 to 1987-88. The assessees also claimed the additional conveyance expenses of Rs. 87,668 as exempt from tax. The irregular deductions resulted in total under-assessment of income of Rs. 2,77,548 with short levy of tax of Rs. 1,19,908.

Incorrect computation of property income

Karnataka

2.03.8 (*i*) An assessee claimed deductions of Rs. 91,503 and Rs. 49,327 for 1985-86 and 1986-87 respectively towards interest against income from house property which was allowed in the assessments concluded under summary assessment scheme, though while computing the assessment for the assessment year 1984-85 after scrutiny, the assessing officer had disallowed the claim on the ground that no capital was borrowed specially for the construction of the property. Besides, vacancy allowance of Rs. 1,10,833 was also claimed and allowed though the property was vacant throughout the assessment year 1986-87. Consequently, there was a short levy of tax of Rs.53,669 for both the years.

Uttar Pradesh

(*ii*) An Assessee HUF (specified) did neither return rental income of godown for assessment years 1983-84 to 1985-86 nor the assessing officer assessed the same, though in the assessment for the assessment year 1981-82, the Income Tax Officer had not accepted the plea of the assessee that the godown had been transferred to another person. The omission led to escapement of property income by Rs. 94,520, Rs. 84,775 and Rs. 74,735 respectively and consequent short charge of tax of Rs. 2,78,934.

Incorrect valuation of closing stock

2.03.9 It has been judicially held that the privilege of valuing closing stock in a consistent manner is available to only a continuing business and the closing stock has to be valued at market value in order to determine the true profit of a business on the date of closure of business when a business comes to an end.

Andhra Pradesh

(*i*)(*a*) On dissolution of a registered firm on 04.01-1986 the closing stock of Rs. 8,82,290 was distributed among the two partners of the firm and the two partners valued their shares of stock in their individual business as Rs. 31,76,830 and Rs. 29,15,812 respectively. The firm, on dissolution, had, however, not revalued its closing stock at market price which resulted in under-assessment of income to the extent of Rs. 52,10,352 (tax effect of Rs. 33,05,946, including interest for late filing of return and non payment of advance-tax).

(*b*) An assessee firm has been valuing, its closing stock consistently at cost price. For the assessment year 1987-88 the value was, however, adopted after an arbitrary or adhoc deduction of 20 percent from the earlier year's valuation which resulted in the closing stock being undervalued by Rs. 1,96,840 (Rs. 7,87,357 as against Rs. 9,84,197) and short demand of tax Rs. 1,10,222.

Karnataka

(*ii*) The closing stock, on dissolution of three firms, was not valued at market rate as required under law which resulted in short computation of income by Rs. 7,25,062 and consequent short levy of tax of Rs. 2,59,202 for the assessment years 1985-86 and 1987-88.

Uttar Pradesh

(*iii*) Two registered firms showed their opening value of stock at higher values and the same did not tally with the closing stock shown in the preceding years. The closing stock as on 31-03-1985 were Rs. 1,83,760 and 45,247 but the opening stocks as on 01-04-1985 (assessment year 1986-87) were shown at Rs. 7,41,806 and Rs. 3,17,500. These mistakes led to under-assessment of income by Rs. 8,38,299 (tax effect of Rs. 2,06,244).

Tamil Nadu

(iv) A registered firm was dissolved on (24-10-1984) the last day of the previous year relevant to the assessment year 1985-86 and was taken over as a proprietory concern by one of the partners. While completing the assessment of the firm, the value of the closing stock was adopted at the cost price of Rs. 5,24,744, even though market value was to be adopted in such cases. The total value of closing stock at market value worked out to Rs. 6,67,684 involving short assessment of income by Rs. 1,42,940 (tax effect of Rs. 98,135).

Omission to disallow liabilities on account of taxes, duties etc. collected but not credited

2.03.10. From the assessment year 1984-85, in computing the business income, liability on account of tax, duty, etc., payable under any law or sum payable as contribution to any provident fund, superannuation or gratuity fund are allowed as deduction only in the year in which the amounts are actually paid to the Government and to the fund, as the case may be, and the liability is not allowed on accrual basis.

In the cases of 410 assessees assessed in 19 Commissioner's charges in Himachal Pradesh, Delhi, Andhra Padesh, Karnataka, Orissa, Haryana, Assam, Uttar Pradesh and Rajasthan, Central Sales-tax, State Sales-tax, purchase-tax, turnover-tax and other duties and employers contribution to the provident fund,etc., amounting to Rs. 47.78 lakhs collected by the assessees during the period relevant to the assessment years 1982-83 to 1987-88 were not actually paid to the Government and to the Funds. However, the liabilities claimed by the assessees on account of payments of these taxes and duties were allowed in the computation of business income in the assessments made under summary assessment scheme.

A few examples are given below :

Name of circle	Assessee	Assessment year	Nature of objection	Tax effect Rs.
Himachal Pradesh	Firms/Indl.	—	In five units, liabilities of sales-tax and other taxes or duties amounting to Rs. 6,96,969 shown as outstanding in balance sheet not added back to the income of the assessees.	1,33,579
Delhi	Indl.	1986-87 1987-88	Central and Local sales tax included in sundry creditors and other liabilities shown in balance sheet not added back.	1,92,858

Name of cicle	Assessee	Assessment year	Nature of objection	Tax efiect Rs.
Andhra Pradesh	R/F.	1986-87 1987-88	In three cases the undischarged liabilities of sales tax/excise duty of Rs. 3,25,142 (1986-87) and Rs. 3,85,170 (1987-88) debited to profit and loss account and not paid, were incorrectly allowed.	2,89,480
Madhya Pradesh	Co.	1986-87	Unpaid sales tax not added back to total income.	1,90,000
Uttar Pradesh	R/F.	1985-86 1987-88	In the cases of three registered firms, the liabilities of sales-tax for Rs. 3,25,239, Rs. 4,02,820, Rs. 87,145 and Rs. 89,241 shown in balance sheet were not disallowed. In another case the excise duty of Rs. 1,80,273 not paid, was not disallowed.	3,01,150
Uttar Pradesh	R/F.	1986-87 1987-88	Two registered firms exhibited purchase tax liability of Rs. 82,005 and sales tax liability of Rs. 82,994 in the balance sheet but the same was not disallowed. In another case, the undischarged liabilities as shown below were not disallowed.	76,115
			(a) Liability for import duty for Rs. 21,64,552.	5,83,205
			(b) Liabilities for sales tax 1,68,915.	81,314
Uttar Pradesh	Trust/Indl.	1984-85	During the assessment years 1983-84 and 1985-86 a trust assessed as scrutiny case was not granted exemption as admissible to trusts. But while assessing the trust in a summary manner for the assessment year 1984-85, the trust claimed and was allowed the exemption which led to escapement of income of Rs. 86,030.	51,679
Uttar Pradesh	Indl.	1982-83 to 1986-87	In another case, an individual disclosed under Amnesty Scheme, the undisclosed investments of Rs. 2,39,910 for wealth-tax. For income-tax purposes the said investments should have been treated as unexplained investments and subjected to tax.	1,51,857
Assam	Indl.	1985-86 1986-87	In another case of an individual the outstanding liabilities of sales tax, Assam Finance tax and Central sales tax amounting to Rs. 2,13,242 were not disallowed being inadmissible expenditure till actually paid.	1,27,307 (including interest)
West Bengal	R/F. Company	1984-85 1986-87 1987-88	The unpaid liability of sales-tax amounting to Rs. 1,49,738, Rs. 1,59,665, Rs. 2,92,640 and Rs. 1,02,683 in the case of three registered firms and a company respectively were not disallowed and added back to income, although the liabilities were debited to profit and loss account and remained unpaid till the last day of the year.	3,98,644 (including interest)
Karnataka	Co. R/F. Indl.	1984-85 to 1987-88	Undischarged liability of Rs. 4,99,075 in four cases was not disallowed.	2,97,653
Rajasthan	R/F.	1987-88	In two cases, the laibilities for sales-tax and tax deducted at source not actually paid to the Government were wrongly allowed.	2,12,792

Irregular exemptions and excess reliefs and deductions

2.03.11 Chapter VI A of the Income-tax Act, 1961 provides for certain deductions to be made from gross total income. The overriding condition is that the total of deductions should in no case exceed the gross total income of the assessee. Gross total income has been defined as the total income computed in accordance with the provisions of the Act before making deduction under the chapter. Test-check revealed a number of wrong claims which went undetected due to adoption of summary assessment procedure. Some important cases are :

Name of circle	Assessee	Assessment year	Nature of objection	Tax effect (Rs.)
Karnataka	Co.	1986-87 1987-88	Relief for a newly industrial undertaking was wrongly allowed though the business of the assessee was old and established in 1975 and also, no new machinery or plant was purchased or installed during these years. Income short computed by Rs. 1,41,770.	47,430

Name of circle	Assessee	Assessment year	Nature of objection	Tax effect (Rs.)
Karnataka	Co.	1986-87 1987-88	Incorrect allowance of relief on profits derived from the export of goods or merchandise on interest income amounting to Rs. 82,816 (1986-87) and Rs. 54,285 (1987-88).	64,156
Karnataka	Coop. Society	1985-86 1986-87	A cooperative society is entitled for a relief in respect of income derived from letting of godowns or warehouse for storage, processing or facilitating the marketing of commodities. A cooperative society claimed and was erroneously allowed relief in respect of income received as commission from the Coffee Board for collection and processing of coffee amounting to Rs. 2,44,540 (1985-86) and Rs. 1,94,114 (1986-87).	1,87,707
Uttar Pradesh	R/F.	1987-88	Relief of Rs. 3,75,100 for newly established industrial undertaking was wrongly allowed without the requirements of the Act being fulfilled.	89,375
Uttar Pradesh	R/F.	1985-86 to 1987-88	In three cases the relief in respect of profits retained for export business was wrongly allowed, though there was no proof or certificate in the prescribed form, evidencing export of the goods or merchandise. The income underassessed in these cases amounted to Rs. 2,35,152.	96,950
			Where a proprietor's business was converted into registered firm business on 16-07-1983, the relief of Rs. 80,749 for profit on export business was allowed twice, in the hands of the proprietors as well as in the hands of the registered firm.	33,134
Haryana	R/F.	1987-88	Relief in respect of profits on export business wrongly allowed in the case of two assessees.	1,13,464
Kerala	R/F.	1985-86	Irregular allowance of deduction of Rs. 6,52,787 for profits retained for export business in respect of two firms, despite the fact that export turnover related to primary agricultural commodities.	3,56,700
Tamil Nadu	R.F. & Indl.	1985-86	Irregular relief allowed of Rs. 14,86,081 on export turnover of agricultural primary commodities, viz., chillies, potatoes, garlic, etc.	9,29,300
Tamil Nadu	Indl.	1986-87	Allowance of relief for export turnover of Rs. 2,13,000 without creation of the reserve by debit to profit and loss account.	1,04,670
Gujarat	R.F.	1984-85 to 1986-87	Reliefs of Rs. 1,29,507 and Rs. 84,120 were claimed and allowed to two firms on account of profits for new industrial undertaking although it was not a new industrial undertaking.	94,778
Gujarat	Co-op. Society	1986-87	Incorrect allowance of deduction applicable to a cooperative society doing business of marketing of agricultural produce of its members, to a society engaged in business of ginning and pressing of cotton with the aid of power. Undercharge of income by Rs. 2,29,959.	1,24,460
Tamil Nadu	A.O.P.	1982-83 to 1984-85	Allowance of relief in respect of newly established industrial undertaking in backward area on miscellaneous income representing cash incentive (Rs. 2,24,690) duty drawback (Rs. 5,82,049) and export benefit nominations (Rs. 6,16,837) resulted in excess allowance of relief Rs. 6,14,701.	2,38,120
West Bengal	Indl.	1986-87	Allowance of deduction of Rs. 3,99,022 being 50 percent profit from export of goods though no reserve account was created and there was no evidence to show that the sale proceeds of goods exported were receivable in convertible foreign exchange.	1,99,511

Mistakes in the allowance of depreciation, investment allowance, etc.

2.03.12. In computing the business income of an assessee a deduction on account of depreciation ranging between 15 percent and 100 percent on plant and machinery or other assets is admissible provided if these are owned by the assessee and used for his business. Depreciation on buildings, etc., are allowed at the rates prescribed in the Income-tax Rules, 1962. Further, a deduction on account of investment allowance equal to 25 percent of the actual cost of machinery to the assessee shall be allowed in the previous year of installation or in the previous year of first usage. During test-audit it was noticed that in 32 Commissioners charges, due to mistake in the allowance of depreciation, investment allowance, etc., there was short levy of tax of Rs. 104.84 lakhs. Illustrative of such cases are :

Name of circle	Assessee	Assessment year	Nature of objection	Tax effect (Rs.)
1	2	3	4	5
Andhra Pradesh	R.F.	1986-87 1987-88	Allowance of investment allowance to a firm dealing in photographic goods and doing processing works and not manufacturing or producing article or thing.	1,33,154
Andhra Pradesh	R.F.	1986-87	A firm filed two returns for two periods due to death of a partner and was allowed depreciation for whole year for the two broken periods. The irregular allowance of depreciation allowance led to underassessment of income of Rs. 1,60,790.	67,759 (in the hands of the firm and partners)
Karnataka	..	1987-88	Depreciation on buildings allowed at the rate of 30 percent instead of at 10 percent and 5 percent. Income short computed in two cases by Rs. 1,03,720 and Rs. 1,76,817.	1,74,059
Uttar Pradesh	R.F.	1987-88	Depreciation on buildings, furniture and fittings and surgical instruments was allowed at the rate of 30 percent instead of at 10/15 percent prescribed in the Income-tax Rules. Short computation of income by Rs. 1,38,790.	90,548
Uttar Pradesh	R.F.	1986-87 1987-88	Depreciation on fittings and furnishing allowed @ twenty two and half percent instead of at the rate of 15 percent. Income computed short by Rs. 83,795 and Rs. 37,298 for the two years.	63,804
Haryana	R.F.	1985-86	Irregular allowance of depreciation and investment allowance without the cost of generator being reduced by subsidy and excess allowance of extra shift allowance (45,239 +39,359).	84,598
Tamil Nadu	Indl.	1984-85 to 1987-88	Depreciation on motor lorries used in own business allowed at 40 percent instead of at 30 percent. Excess allowance of depreciation Rs. 4,94,413.	1,36,025
Tamil Nadu	Indl.	1982-83 to 1983-84	Depreciation allowance on rigs used in the business of leasing allowed at the rate of 30 percent instead of at the general rate of 10 percent. Excess allowance Rs. 1,31,853 and Rs. 79,112 respectively.	1,13,040
Tamil Nadu	R.F.	1984-85 to 1987-88	Depreciation on building used as hotel allowed at 15 percent instead of at 5 percent. Excess allowance of depreciation of Rs. 2,31,490, Rs. 1,89,161, Rs. 1,49,577 and Rs. 1,18,108.	1,22,888
Gujarat	R.F.	1987-88	Excess allowance of investment allowance of Rs. 1,12,662 at 35 percent on the additions to machinery of Rs. 6,56,819 instead of the actual additions of Rs. 4,68,098.	54,908
U.T. Chandigarh	R.F.	1986-87	Investment/depreciation incorrectly allowed.	1,03,780
Rajasthan	R.F.	1982-83 to 1987-88	Depreciation of Rs. 2,72,459 on generating set wrongly allowed at 30 percent instead of at 15 percent.	1,45,078
Karnataka	R.F.	1986-87 1987-88	Depreciation on building costing Rs. 2,79,547 was allowed at 15 per cent instead of at 5 per cent.	1,23,123
West Bengal	R.F.	1985-86	Terex pay loaders treated as road transport vehicles for the grant of normal depreciation, wrongly allowed additional depreciation of Rs. 2,04,626.	1,28,704 (including interest).

Omission to tax capital gains

2.03.13 Any profits or gains arising from the transfer of capital assets are chargeable to income-tax subject to the provisions of law, under the head 'Capital gains'. A few mistakes noticed in audit are:

Name of Circle	Assessee	Assessment Year	Nature of objection	Tax effect Rs.
Andhra Pradesh	Indl./HUF	1983-84 1984-85 1986-87	The assessee having more than one residential house claimed and was allowed exemption of Rs. 4,69,700 from capital gains tax, though not admissible.	3,08,042
Andhra Pradesh	Indl.	1978-79 to 1980-81	Escapement of Income being short term capital gains on sale of silver weighing 114kgs.	2,65,711
Karnataka,	Indl.	1985-86 1987-88	Five assessees informed the assessing officer that the net consideration on transfer of a long term capital asset would be invested for procuring a new residential house. The assessing officer accepted this contention of the five assessees and exempted the capital gains from tax. But the assessees failed to fulfil this statutory condition. Capital gains of Rs. 9,39,388 accordingly escaped assessment.	3,57,582
Karnataka	Indl.	1985-86	Omission to return capital gains on sale of a property of Rs. 4,50,000.	1,58,000
Uttar Pradesh	Indl.	1986-87	Omission to return short term capital gains of Rs. 1,26,400 on sale of a house constructed in May 1984 for Rs. 73,600 for a consideration of Rs. 2,00,000 in September 1985.	58,877
Haryana	Indl.	1987-88	Exemption from levy of capital gains tax irregularly allowed	69,350
Tamil Nadu	Indl.	1987-88	The exemption of Rs. 3,24,000 from capital gains tax on account of sale of a property was wrongly granted though condition of a construction of a new house within 3 years of sale was not fulfilled.	69,050
Tamil Nadu	Indl.	1987-88	Wealth tax records revealed that a capital gains of Rs. 1,39,000 in respect of sale of land had escaped assessment.	69,500
Tamil Nadu	Indl.	1987-88	Short assessment of capital gains by Rs. 4,88,118 due to incorrect adoption of market value as on 1-4-1974.	1,22,030
West Bengal	Indl.	1985-86	The capital gains of Rs. 3,28,500 arising out of sale of a flat not assessed.	1,96,824
West Bengal	Indl.	1985-86	As the assessee already owned another residential house on the date of transfer of a capital asset, capital gains exempted was irregular. Under-assessment of income Rs. 3,72,099.	2,25,520

Mistakes in the assessment of firms and partners

2.03.14 Under the executive instructions issued by the Central Board of Direct Taxes the assessing officers are required to maintain a register of cases of provisional share income from registered firms so that these cases are not omitted to be rectified. On test-check of cases assessed under the summary assessment scheme, it was noticed in audit that in the case of a number of partners of registered firms, the actual share income was not taxed according to the provisions of the Act by revising their assessments on completion of the assessments of the firms. The executive instructions of the Board regarding maintenance of registers for this purpose were not also followed by the assessing officers in 55 cases in 12 Commissioner's charges which involved a total revenue effect of Rs. 26.15 lakhs. A few instances are mentioned below :

Name of Circle	Assessee	Assessment year	Nature of objection	Tax effect Rs.
1	2	3	4	5
Madhya Pradesh	Firm/Partners	1986-87	Remuneration paid to partners by the firm were not added back while computing income of firm.	49,200
Madhya Pradesh	Firm/Partners	1987-88	Salaries paid to the sons and excess interest paid to partners not added back in firms' income computation.	73,819
Uttar Pradesh	Partners	1984-85 to 1986-87	In three cases, the actual share income from a registered firm was not taxed by reopening the partners assessment on completion of the firms' assessment, involving under-assessment of income by Rs. 2,34,543.	1,06,262
Haryana	Indl.	1985-86	The assessments of the partners of a firm not revised after the finalisation of assessment of the firm.	1,08,922
Rajasthan	R.F. Partners	1985-86 1987-88	Partner's provisional shares of income from registered firm at Rs. 37,485 and Rs. 33,275 were not revised by taking the correct share of income of Rs. 1,13,090 and Rs. 59,060 determined in the assessment of the firm.	48,736

Income escaping assessment due to concealment, etc.

2.03.15 On a test-check in 28 Commissioner's charges escapement of income from tax for different reasons such as concealment, incorrect allowance of expenditure, etc. in 1007 cases were noticed, involving short-levy of income-tax of Rs. 407.08 lakhs.

A few illustrative cases are given below :

Name of Circle	Assessee	Assessment Year	Nature of objection	Tax effect Rs.
Himachal Pradesh	—	1984-85 to 1986-87	In the sales-tax assessment proceedings it was noticed by the sales-tax department that in 3 cases the purchases/sales had been suppressed to the extent of Rs. 7,70,811 and the sales-tax department had levied sales-tax thereon also. The assessees did not, however, include these suppressed purchases/sales in their income-tax return, nor the income-tax department took any action.	3,54,103
Himachal Pradesh	—	—	In one case, the closing stock of Rs. 18,33,916 was incorrectly carried forward involving a loss of revenue.	4,05,531
Karnataka	HUF	1984-85 to 1986-87	Partition of HUF is not recognised under the Income-tax Act, 1961 with effect from 31-12-1978 for tax purposes, unless there is a total partition. The Income-tax Officer did not recognise the partial partition in one case during the assessment years 1981-82 to 1983-84 and included in the total income the shares of each member of the family. However, during the assessment year 1984-85 to 1986-87, assessed under the summary assessment scheme, the HUF returned its income excluding the income of members of each family pertaining to each of them after partial partition which led to under assessment of income by Rs. 63,010, Rs. 80,780 and Rs. 76,160 for the three years.	1,21,775
Karnataka	R.F.	1987-88	A firm hired two theatres on a weekly rent of Rs. 15,500. The firm debited Rs. 10.49 lakhs instead of the actual rent of Rs. 8.06 lakhs at the above rates in their profits and loss account. Under-assessment of income by Rs. 2,42,870.	92,906
Karnataka	R.F.	1987-88	An expenditure of Rs. 3 lakhs paid to the tenant to vacate the rented portion was allowed as revenue expenditure instead of treating it as capital expenditure.	1,64,575
Karnataka	A.O.P.	1986-87	Two assessees failed to return the interest received on Income-tax refund amounting to Rs. 94,003 and Rs. 1,03,740 respectively.	1,19,029
Do.	R.F. Indl.	1984-85 to 1987-88	Six contractors returned less receipts than given in Tax Deducted at Source certificates by Rs. 18,76,040.	9,95,195
Uttar Pradesh	Indl.	1985-86	In the case of a contractor the total receipts as per T.D.S. certificates were returned short by Rs. 9,60,794.	2,59,283
West Bengal	Indl.	1984-85 1985-86	According to the provisions of will of the deceased husband, the income derived from his properties should have been assessed in the hands of the assessee (wife). The omission to do so led to under-assessment of income by Rs. 27,180 and Rs. 88,060 for the assessment years 1984-85 and 1985-86 respectively.	53,312
West Bengal	Company	1984-85	The interest income of Rs. 1,80,996 accrued on the outstanding loan on Rs. 16,45,419 given to another company not assessed.	1,85,605 (including interest)

Irregular carry forward and set off of losses, depreciation, investment allowance, etc.

2.03.16 In 322 cases in 51 Commissioner's charges test-checked by audit the business, losses, unabsorbed development rebate and investment allowance were irregularly allowed to be carried forward and set off against the profits and gains of subsequent assessment years as indicated below, which involved undercharge of revenue to the extent of Rs. 104.01 lakhs.

Name of Circle	Assessee	Assessment year	Nature of mistake	Tax effect Rs.
Delhi	Regd. Firm	1987-88	A registered firm was allowed to carry forward its losses for the assessment years 1985-86 and 1986-87 amounting to Rs. 1,90,843 and set off the same against the profits of assessment year 1987-88 instead of in the hands of the partners.	31,801
Madhya Pradesh	Company	1985-86	Unabsorbed depreciation allowance of earlier years for set off was Rs. 74,745 against which a sum of Rs. 2,73,000 was actually set off.	1,35,559
Uttar Pradesh	R.F.	1984-85 1985-86	In two cases, the unabsorbed depreciation allowance of Rs. 2,64,829 was already allocated amongst the partners. The firm aforesaid claimed and was allowed the same to be absorbed against future income.	70,995

Uttar Pradesh	Indl.	1986-87	Loss to be carried forward was Rs. 81,181 whereas the assessee claimed and was allowed a sum of Rs. 1,95,430 which led to excess carry forward of loss by Rs. 1,15,605.	—
Bihar	R.F.	1986-87	The capital loss (Rs. 97,624) on surrender of the guest house and shortfall of depreciation allowance (Rs. 59,694) thereon was irregularly adjusted against the income from business and profession.	45,413
Tamil Nadu	Indl.	1987-88	The share of business loss of Rs. 1,44,644 from the firm was wrongly set off in the hands of an individual and HUF (Partners), though that firm was assessed as unregistered firm where the shares were not allocated among the partners.	1,14,644
Tamil Nadu	Indl.	1983-84 to 1985-86	The correct amount of business loss and unabsorbed depreciation of assessment years 1977-78 to 1981-82 worked out to Rs. 92,145 instead of Rs. 1,04,496 as allowed in assessment.	32,901
Madhya Pradesh	Company	1984-85	Unabsorbed depreciation of earlier years was allowed in excess by Rs. 1,98,617.	1,91,166
West Bengal	Company	1985-86 to 1987-88	The speculation losses of Rs. 2,28,712, Rs. 6,67,124 and Rs. 2,85,266 for the assessment years 1985-86, 1986-87 and 1987-88 respectively were wrongly set off against the business income of the company.	9,13,323 (including interest for late filing of returns)
Do.	Company	1985-86 1986-87	Speculation losses of Rs. 15,82,333 sustained in share dealing was also wrongly set off against business income.	13,55,174 (including interest).
West Bengal	Indl.	1987-88	The loss incurred in the activity of owning and maintaining race horses amounting to Rs. 1,12,444 wrongly set off against other income of the assessee.	46,062
West Bengal	Indl.	1986-87	The assessing officer computed net loss of Rs. 89,190 against returned loss of Rs. 2,01,186 for assessment year 1985-86. But in assessment year 1986-87 the loss of Rs. 2,01,186 was set off against the actual unabsorbed loss of Rs. 89,190 to be set off.	65,917

Incorrect status adopted in assessments

2.03.17 Tax is levied according to the rates prescribed in the Act to the different categories of assessees and any incorrect adoptionof status may lead to short levy of tax due to adoption of lower rates. A few instances noticed are:

Name of the Cirlce	Assessee	Assessment year	Nature of Objection	Tax effect Rs.
Uttar Pradesh	R.F.	1985-86 1986-87	A firm was assessed as registered firm instead of as an unregistered firm.	50,817 (including interest).
Kerala	Indl.	1985-86	Status adopted as non-resident instead of resident leading to exemption of amount of Rs. 57,461 (standing in N.R.E. account).	34,658

Other Irregularities

2.03.18. Under the provisions of the Income-tax Act, 1961, every person, carrying on business with total sales, turnover gross receipts exceeding Rs. 40 lakhs or carrying on profession having gross receipts exceeding Rs. 10 lakhs, is required to get his accounts audited by a chartered accountant before filing his income-tax return on the specified date.. For any default a penalty equal to one half percent of the total sales, turnover or gross receipts or a sum of Rs. 1,00,000 whichever is less, is payable.

(i) In the following cases although the assessees did not get their accounts audited, the assessing officers did not levy penalty as required under the provisions of the Income-tax Act, 1961 :

Name of the Cirlce	Assessee	Assessment year	Total sales, turnover or gross receipts Rs.	Penalty leviable Rs.
Orissa	—	1986-87	2,16,00,711	1,00,000
West Bengal	Indl.	1985-86	3,16,81,425	1,00,000
West Bengal	R.F.	1986-87	1,95,95,913	97,980
		1987-88	2,16,14,698	1,00,000

Andhra Pradesh

(ii) The Income of a trust which consisted of or, included income from profits and gains of business, is chargeable to tax on the whole of the income at the maximum marginal rates. In respect of five trust cases, whose income included income from property and gains of business, the tax was not levied. The tax at maximum marginal rate leviable worked out to Rs. 57,628 (including interest).

Karnataka

(iii) Under the provisions of the Portuguese Civil Code followed in Goa, marriage as per customs consists in communion between the spouses of all their estates, present and future not specifically excluded by the law. Thus, the half share of income from the communion of property is chargeable to tax separately in the hands of each spouse. But this does not extend to the income earned by each spouse due to personal exertion, individual skill and specialised knowledge. In respect of 110 assessees governed by Portuguese Civil Code, income from salary and profession was shared by spouses and each one was assessed separately which resulted in short levy of tax of Rs. 9,77,174.

Tamil Nadu

(iv) During the assessment year 1983-84 assessed under summary assessment scheme, an association of persons (trust) made contribution of Rs. 1,05,000 to another trust created for the welfare of employees and the same was allowed as deduction in computing the taxable income. It was noticed in audit that the contribution had been debited to the wages account in the assessee's books and did not represent any actual expenditure in connection with the welfare of the employees. In view of the fact, that it was not incurred wholly and exclusively for the purpose of the business of the assessee, the deduction claimed should have been disallowed. Failure to do so resulted in short computation of income by Rs. 1,05,000. The share of the major beneficiary was accordingly assessed less by Rs. 1,03,950 involving a tax effect of Rs. 62,800.

In the case of an individual, the income that arose from a house property gifted by the assessee to her minor child was not clubbed with the income of the assessee under the clubbing provisins of the Act. This led to under assessment of income by Rs. 45,230, Rs. 46,222 and Rs. 76,320 for the assessment years 1983-84 to 1985-86 leading to an aggreagate short levy of tax of Rs. 1,06,800.

With the introduction of new provisions in the Income-tax Act, 1961, with effect from 1-4-1987, the income from lottery winnings is taxable at the flat rate of 40 per cent. In the case of an individual a sum of Rs. 1,80,000, being winnings from a state lottery was taxed at ordinary rate which led to a short levy of tax by Rs. 36,649.

Gujarat

(v) An assessee trust compiled its accounts for the period from 1-7-1983 to 31-3-1984 and filed the return of his income for the previous year relevant to assessment year 1985-86 which was accepted and assessment finalised under summary assessment scheme. The income for the above period was, however, assessable in the previous year relevant to assessment year 1984-85. It was noticed in audit that the assessee had his previous year ending 30th June till assessment year 1983-84. The assessee changed his previous year to financial year and in this process of changing the previous year, he did not file the Income-tax return for the period from 1-7-1982 to 30-6-1983 which was assessable for the assessment year 1984-85. The taxable income for this period worked out to Rs. 1,99,462 which escaped assessment involving a tax effect of Rs. 47,587.

Bombay

(vi) An individual assessee filed her return for the assessment year 1986-87 showing the income of Rs. 1,80,000 from winnings from lotteries. The prize money of the lottery was received in May 1986, hence it was assessable in the assessment year 1987-88 instead in 1986-87. The assessment of prize money in the wrong assessment year led to short levy of tax by Rs. 45,750.

West Bengal

(vii) In the case of a registered firm for the assessment years 1984-85 and 1985-86, the department allowed credit for tax deducted at source for sums of Rs. 39,752 and Rs. 38,225 respectively. As the assessments resulted in losses, the entire sum of Rs. 77,977, being tax deducted at source, was refunded to the assessee. But the certificates of tax deducted at source revealed that the said amount refunded included the tax of Rs. 46,085 deducted at source by Government of Sikkim for works done in that State and credited to the accounts of Government of Sikkim. The refund of tax deducted at source in full should have been restricted to the extent of tax credited to the account of Central Government. The omission resulted in excess refund made to the extent of Rs. 46,088.

B. OTHER DIRECT TAXES (WEALTH-TAX, GIFT TAX AND ESTATE-DUTY)

2.03.19 The summary assessment scheme extended to wealth-tax, and estate duty cases. A test check of such cases during 1988-89 revealed a number of irregularities involving a total revenue effect of Rs. 45.47 lakhs. The mistakes fell broadly under the following categories :

Nature of irregularity	No. of cases	Tax effect (In lakhs of Rupees)
Wealth-tax		
(a) Escapement of Wealth	99	9.39
(b) Irregular or excess exemptions and deductions	72	2.11
(c) Incorrect valuation and computation of wealth	134	16.35
(d) Other Irregularities	89	6.42
Total	394	34.27
Estate Duty		
(a) Estate escaped assessment	12	5.13
(b) Incorrect computation of value of estate	20	4.19
(c) Other irregularities	2	1.88
Total	34	11.20

Details of some important cases are given in the following paragraphs :

Name of Circle	Assessee	Assessment year	Nature of objection	Tax effect Rs.
(1) *Escapement of wealth*				
Himachal Pradesh	Indl.	1983-84 to 1987-88	Though the assessee was liable for wealth-tax, he did not file his wealth-tax return (wealth escaping assessment Rs. 14 lakhs)	69,814
Uttar Pradesh	A.O.P.	1982-83 to 1985-86	An association of persons filed a nil wealth-tax return though it had taxable wealth of Rs. 8,38,660, Rs. 8,30,662, Rs. 4,04,126 and Rs. 3,93,597 respectively.	86,004
West Bengal	Indl.	1981-82 to 1985-86	The assessment records of income-tax and gift-tax revealed that the assessee had 8 flats in a metropolitan city but no wealth on this account was disclosed by the assessee (wealth escaping assessment Rs. 37,47,764).	54,179
(2) *Irregular Exemptions and Deductions*				
Himachal Pradesh	Indl.	1986-87 1987-88	Following liabilities were wrongly allowed as deduction: (a) Weatlh-tax liabilities already excluded from the net wealth Rs. 66,960. (b) loan liability not related to taxable wealth Rs. 5,79,589.	12,598
(3) *Incorrect valuation of assets.*				
Andhra Pradesh	Indl.	1983-84	The value of two properties and of cinema theatre was declared less than that returned for last year by Rs. 15,15,200.	40,458
-do-	-do-	1986-87	By adopting the lower rate or value of shares, wealth of Rs. 10,18,350 escaped assessment.	23,940
Karnataka	Indl.	1981-82 to 1987-88	In 4 cases undervaluation of assets as compared to earlier years where the assets were valued at correct market value and accepted by the assessee, led to under-assessment of wealth by Rs, 32,02,292.	34,043
-do-	-do-	-do-	Under the Wealth-tax Act, the value of a residential house is to be determined with reference to net maintainable rent. But in 4 cases, this was not done correctly.	30,642
-do-	Indl.	1978-79 to 1980-81 and 1982-83 to 1986-87	Had cross reference been made in 8 cases with the past assessment years and the next subsequent assessment years, wealth of Rs. 98,79,957 could have been assessed for wealth-tax.	1,21,003
-do-	Indl.	1982-83 to 1984-85	Information regarding revaluation of assets on dissolution of firm available in income-tax assessment records for 1985-86 was not made use of for wealth-tax assessment which led to incorrect valuation of assets for wealth-tax purposes by Rs. 22,43,096.	36,818
Andhra Pladesh	Indl.	1983-84 to 1986-87	Non-adoption of the value estimated by the Departmental Valuation Officer, in the assessments for the assessment years 1983-84 and 1984-85 as per the valuation reports and of value as on 31 March 1984 for the assessment years 1985-86 and 1986-87 to accord with past valuation, resulted in under-assessment of wealth of Rs. 16,04,438, Rs. 16,89,438, Rs. 16,89,438 and Rs. 14,90,977 respectively.	1,61,733
Bombay	co.	1984-85 to 1986-87	By not adopting, the market value of building, the value of Rs. 11.12 lakhs escaped assessment to wealth-tax.	65,000
Bombay	Indl.	1982-83	As compared to the value of assets adopted for assessment years 1981-82 and 1983-84, the value of wealth was short taken during the assessment year by Rs. 9.75 lakhs.	24,000
Karnataka	Indl. HUF	1982-83 to 1985-86	In three cases, the assessees had undervalued certain assets as compared to valuation of those assets adopted in earlier scrutiny assessments. Th under-assessment involed Rs. 2,64,67,000.	2,00,478
Andhra Pradesh	Indl.	1983-84 to 1986-87	Valuation of shares of the companies were adopted as returned by the assessee and not valued at market rates leading to under valuation of shares by Rs. 52,68,632	1,66,893
West Bengal	Indl.	1985-86	The income- tax assessment revealed that the shares whose value was declared as nil, were sold in the market for Rs. 32,17,500.	1,06,169
Karnataka	Indl.	1984-85 to 1986-87	The value of 7000 sq. ft. land was declared nil in the wealth-tax return but income-tax assessment records of 1986-87 revealed that the land was sold for Rs. 8.50 lakhs. Thus the wealth to the extent of Rs. 18,51,830 as value of land, escaped assessment.	47,170
Madras	Indl.	1983-84 1984-85	Non-adoptian of the value af an immovable property at Rs. 15,40,000 as determined by the Departmental Valuation Officer for assessment year 1982-83 in place of the returned value of Rs. 5,17,400 (under valuation of assets Rs. 10,22,600).	61,356

(4) *Other irregularities.*

Uttar Pradesh	HUF	1983-84 1984-85	The status of two HUFs was adopted as HUF (ord) instead of HUF (specified)	28,624
Madras	HUF	1978-79 to 1986-87	Value in certain immovable properties was taken at 1/4th in assessment of weath-tax, instead of at ½ share therefrom.	36,608
Estate Duty				
Punjab	Ind	—	In 7 cases the estate amounting to Rs. 14,52,040 escaped assessment.	3,28,412
Karnataka	Indl.	—	Excess allowance of liability by Rs. 2,50,000 due to allowance of share in lease advance in full instead of only 1/3 share with reference to share in immovable property.	1,47,203
Karnataka	Indl.	—	The share of the lineal descendants in the property of H.U.F. amounting to Rs. 4,64,666 not included in net principal value for rate purposes.	41,454
Karnataka	Indl.	—	The value of the shares was short computed by Rs. 1,20,324.	36,097

The paragraph was referred to the Ministry of Finance for comments in September, 1989, the reply from the Government has not so far been received (October 1989).

CHAPTER 3

CORPORATION TAX

3.01 The trend of receipts from corporation-tax i.e. income-tax and surtax payable by Companies was as, follows during the last five years :

Year	Amount (In crores of rupees)
1984-85	2,555.89
1985-86	2,865.08
1986-87	3,159.96
1987-88	3,432.92
1988-89*	4,407.21

*Figures furnished by the Controller General of Accounts are provisional.

3.02 **According to the Department of Company Affairs, Ministry of Law, Justice and Company Affairs, there were 1,79,931 companies as on 31 March 1989. These included 420 foreign companies and 1954 associations 'not for profit' registered as companies limited by guarantee and 319 companies with unlimited liability. The remaining 1,77,238 companies with unlimited liability comprised 1134 Government companies and 1,76,104 non-Government companies with paid up capital of Rs. 40,606.8 crores and Rs. 11,680.1 crores** respectively. Among non-Government companies, over 89.20 per cent (1,57,091) were private limited companies with a paid up capital of Rs. 2,851.5 crores.**

3.03 The number of companies on the books of the Income-tax Department during the last five years was as follows :

As on 31 March	Number
1985	58,478
1986	68,711
1987	77,203
1988	87,905
1989*	96,237

* Provisional figures as furnished by the Ministry of Finance.

**Figures furnished by the Ministry of Industry, Department of Company Affairs, are provisional.

3.04 The following table indicates the progress in the completion of assessment and collection of demand under corporation tax during the last five years :

(In crores of rupees)

Year	No. of assessments		Percentage	Amount of demands		Percentage
	Completed during the year	Pending at the close of the year		Collected during the year	In arrears at the close of the year	
(i)	(ii)	(iii)	(iv)	(v)	(vi)	(vii)
1984-85	64,059	57,861	90.32	2,555.89	1,028.17	40.22
1985-86	1,09,787	57,241	52.14	2,865.08	887.81	30.98
1986-87	73,633	88,130	119.69	3,159.96	1,341.21	42.44
1987-88	89,778	54,196	60.36	3,432.92	1,425.93	41.54
1988-89*	1,21,595	41,203	33.88	4,407.21	2,156.15	48.92

The pendency in assessment at the end of the year is still very high, despite further liberalisation of Summary Assessment Scheme. Similarly, the heavy arrears at the close of the year also indicates the need for bestowing adequate attention by the department to both aspects.

3.05 Some instances of mistakes noticed in the assessments of companies under the Income-tax Act, 1961, are given in the following paragraphs. 123 of these cases were checked by the Internal Audit but the mistake was not detected by it. In a number of these cases, assessment work had been done by Inspecting Assistant Commissioner (Assessment).

3.06 Avoidable mistakes in computation of income and tax

1. Under the Income-tax Act, assessment in a summary manner may be completed after, interalia, rectifying any arithmetical errors in the returns, accounts and documents. In a scrutiny case, the assessing officer shall make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by the assessee or refundable to him on the basis of such assessment.

* Provisional figures as furnished by the Ministry of Finance.

With a view to ensuring arithmetical accuracy in assessments, the Board from time to time (1968 to 1981) issued Instructions stressing the necessity for ensuring the arithmetical accuracy in the computation of income and tax, carry forward of figures, etc.

Under assessment of tax on account of mistakes in the computation of total income and in the determination of tax payable, involving substantial revenue, are being reported year after year in the Audit Reports. The extent of such mistakes as evidenced during test audit of the assessments completed by the tax officers during the last 5 years are as under :

Year	No. of items	Amount of tax underassessed (in lakhs of rupees)
1984-85	1,536	272.51
1985-86	1,257	133.61
1986-87	1,269	2,748.53
1987-88	796	291.84
1988-89	679	1,121.38

Since the mistakes are of avoidable nature, this obviously is an area where more strict control and supervision could result in significant additional yield of revenue.

The various types of mistakes noticed could be categorised as follows :

(i) incorrect adoption of figures,

(ii) incorrect adoption/dropping of digits,

(iii) totalling errors.

(iv) transcription errors,

(v) double allowance,

(vi) calculation errors in disallowance in income and tax, and many others.

The more important cases noticed in test check, under the above categories, are :

(i) *Incorrect adoption of figures*

S.No.	State/Name of the assessee	CIT Assessment year	Date of assessment	Nature of Mistake	Revenue effect (In lakhs of rupees)
1.	Karnataka A(Co).	E 1985-86	30-11-1987	Incorrect adoption of net loss figure as Rs. 68,604 instead of Rs. 1,67,872.	1.06 (P)
2.	Delhi B (Co.)	F 1985-86	14-3-88	Incorrect adoption of the figures of fees for rendering technical services as Rs. 24,41,351 instead of Rs. 27,17,267.	1.64
3.	Bombay C(Co.)	N 1985-86	30-3-88	Incorrect adoption of the sales tax refund receivable by the assessee as Rs. 17,50,000 instead of Rs. 18,51,083.	0.92

(ii) *Incorrect adoption/dropping of digits*

S. No.	State Name of assessee	C.I.T. Assessment year	Date of assessment	Nature of mistake	Revenue effect (Rs. in lakhs)
1.	(Orissa) A(Co).	G 1982-83 to 1983-84	29-3-1984 and 31-3-1987	Incorrect adoption of figure relating to relief to assessee on donations paid to approved institution as Rs. 50,000 instead of Rs. 5,00,000 and also failure to allow any deduction against the admissible deduction of Rs. 2,50,000.	1.13
2.	Karnataka B(Co.)	H 1979-80	18-8-82 Revised on 25-3-85 and 8-4-86.	Incorrect adoption of total income for computing the tax payable as Rs.8,71,910 instead of Rs. 12,71,910.	3.27
3.	West Bengal C(Co.)	Y 1985-86	21-1-1988	Incorrect adoption of the amount of accrued interest on sticky loans as Rs. 46,43,000 instead of Rs. 56,43,000.	5.78
4.	West Bengal D(Co.)	Y 1984-85	28-1-1987	Incorrect determination of the assessee's net income from United Arabic Republic at Rs. 1,01,570 instead of Rs. 40,01,570 resulting in short computation of tax/income by Rs. 1,00,000. Also excess computation of net income from Sri Lanka by Rs. 1,00,000 for not considering the amount of tax paid in that country at the rate of 24.15 per cent and other arithmetical errors.	1.44
5.	West Bengal E(Co.)	A 1978-79	28-3-81	Incorrect add back of a sum of Rs. 2,22,093 on account of bad debts instead of correct amount of Rs. 3,22,093.	0.98

(iii) *Totalling errors.*

S. No.	State Name of assessee	CIT Assessment year	Date of assessment	Nature of mistake	Revenue effect (Rs. in lakhs)
1.	Bombay A(Co.)	N 1985-86	1-3-1988	Totalling errors while arriving at the gross total income (Rs. 82,38,571 instead of Rs. 89,27,005) as also the income assessable (Rs. 40,86,492 as against the correct figure of Rs. 47,75,036).	6.45
2.	West Bengal B (Co.)	Z 1985-86	21-12-1987	Items to be disallowed arrived at as Rs. 42,09,043 instead of Rs. 40,57,139 (as arrived at in the assessment order).	1.80
3.	West Bengal C(Co.)	I 1983-84	31-12-1985	Total of the amounts of instalments of advance tax taken at Rs. 39,94,250 in place of correct sum of Rs. 38,94,250.	1.37
4.	Karnataka D (Co.)	J 1985-86	10-3-1988	Total income computed at Rs. 1,09,77,472 instead of Rs. 1,11,52,507 resulting in short computation of income by Rs. 1,75,035.	1.49

(iv) *Transcription errors*

S. No.	State/ Name of assessee	CIT Assess-ment year	Date of assessment	Nature of mistakes	Revenue effect (Rs. in lakhs)
1.	Bombay A (Co.)	O 1985-86	2-3-1988	Carry forward and set off of relief of Rs. 4,09,554 in the subsequent years instead of Rs. 2,20,204 resulting in excess carry forward of relief of Rs. 1,89,150.	1.19(P)
2.	Bombay B(Co.)	N 1985-86	30-3-1988	Omission to add in the total income the interest amount of Rs. 3,45,913 receivable on loans advanced by the company resulting in excess determination of loss by Rs.3,45,913.	2.18 (P)
3.	Bombay C(Co.)	M 1987-88	6-10-1988	Non-revision of the assesment for the assessment year 1987-88 to give effect to the withdrawal of disallowance of unpaid taxes of Rs. 1,49,219 made in the assessment for the assessment year 1986-87 revised in December 1987 resulting in under assessment of income by Rs. 1,49,219.	0.82
4.	Bombay D(Co.)	M 1981-82 to 1984-85	Between 18-8-83 and 21-3-86 (Revised on 15-2-1988	Omission while giving effect to appellate order to withdraw the depreciation allowance totalling to Rs. 1,40,069 allowed on the patterns'	0.84
5.	Delhi E(Co.)	B 1983-84	17-3-1986	Omission to add back a sum of Rs. 36,07,466 on account of difference in opening value of the work-in-progress as shown by the assessee and as assessed in 1982-83 while working out the taxable income for the asessment year 1983-84 resulting in excess computation of loss by Rs. 36,07,466.	25.88(P)
6.	Delhi F(Co.)	B 1985-86	22-3-1988	Omission to include the gross dividend income of Rs. 9,05,380 in the total taxable income of the assessee (underassessment of income by Rs. 9,05,380).	7.65
7.	Delhi G(Co.)	F 1985-86	26-2-88	Incorrect adding back of Rs. 1,07,49,000 only against the actual disallowance of Rs. 1,29,09,000 (excess computation of loss by Rs. 21,60,000)	12.47(P)
8.	West Bengal H(Co.)	J 1980-81	31-8-84 (revised on 24-2-1987)	Erroneous allowance of tax credit of Rs. 2,04,787 in full though this amount had been disallowed by the assessing officer for reasons recorded in the assessment order.	3.13
9.	West Bengal I(Co.)	I 1984-85	30-1-1987	Incorrect levy of tax on the revised total income at Rs. 89,83,652 instead of Rs 90,37,850 and erroneous transcription of total amount of inadmissible liabilities disallowed in the assessment at Rs. 15,50,843 in place of Rs. 15,81,127.	1.02
10.	West Bengal J (Co.)	L 1985-86	14-3-1988	Incorrect computation of business loss due to incorrect deduction of the net loss of Rs. 27,52,223 as against Rs. 7,80,066 resulting in underassessment of income by Rs. 10,26,027 and consequent excess carry foward of loss by the like sum.	6.46 (P)
11.	Uttar Pradesh K(Co.)	AA 1984-85	19-9-1986	Erroneous deduction of capital gain of Rs. 71,475 from the total income instead of adding the same thereto (under assessment of income by Rs. 1,42,950).	0.90 (P)

(v) *Double allowance*

(a) Due to omission to add debits to accounts before consideration separately and omission to assess certain incomes

S. No.	State/ Name of assessee	CIT Assess-ment year	Date of assessment	Nature of mistakes	Revenue effect (Rs. in lakhs)
1.	Tamil Nadu A(Co.)	T 1985-86	7-3-1988	Omission to add back a sum of Rs. 2,14,263 being the balance of gratuity liability claimed by the assessee.	1.35
2.	Tamil Nadu B(Co.)	U 1985-86	23-2-1988	Omission to disallow Rs. 1,78,109 claimed as depreciation on lifts and reserved areas being the property of the purchaser of flats or lessees and not the assessee.	1.62
3.	Tamil Nadu C(Co.)	U 1985-86	23-3-88	Mistake in the calculation of excess deprecitation allowed to the assessee and omission to add back the said sum of Rs. 2,79,292 resulting in under assessment of income of the same amount.	1.61
4.	Bombay D (Co.)	V 1985-86	17-2-1988	Omission to add back Rs. 1,42,635 which was debited in its account by the assessee on account of income-tax.	0.97(P)

5.	Bombay E (Co.)	W 1985-86	18-3-1988	Incorrect computation of income by not taking the same with reference to the net profit as arrived at in the profit and loss account but was made independently resulting in incorrect deduction of Rs. 8,78,560 which was credited to the profit and loss account	9.67
6.	Bombay F(Co.)	X 1986-87	29-2-1988	Omission to add back a sum of Rs. 1,68,384 which was debited in its profit and loss account by the assessee being 1/6th expenditure on technical know how.	1.25
7.	Bombay G(Co.)	N 1985-86	28-3-1988	Omission to add back expenditure towards scientific research and development amounting to Rs. 1,31,375 debited by the assessee to its profit and loss account.	0.76(P)
8.	Bombay H(Co.)	V 1985-86	29-3-1988	Mistake in the computation of taxable income deducting Rs. 80,244 being other income from the business income instead of adding it resulting in under-assessment of income of Rs. 1,60,488.	0.93
9.	Bombay I(Co.)	V 1985-86	10-2-1988	Omission to add to the income Rs. 2,50,000 being provision for taxation debited to the profit and loss account of the company in the previous year to the assessment year 1985-86.	2.24
10.	Bombay J(Co.)	N 1985-86	29-2-1988	Omission to reduce from the loss an amount of Rs. 36.76 lakhs debited in the accounts on account of depreciation before allowing the permissible amount of depreciation allowable under the Rules amounting to Rs. 25,59,118 resulting in under assessment of income of Rs. 11,16,748.	6.45 (P)
11.	West Bengal K(Co)	Y 1985-86	20-1-1987	Incorrect deduction of inadmissible items aggregating to Rs. 77,037 instead of adding back the same to the positive income of Rs. 90,628, resulting in excess computation and carry forward of loss of Rs. 1,54,074.	0.97(P)
12.	West Bengal I(Co.)	Y 1982-83 and 1984-85	26-3-1985 20-3-1987	Omission to add back depreciation of Rs. 96,774 already charged in the accounts by the assessee for the assessment year 1982-83 though actual depreciation of Rs. 40,151 was allowed separately resulting in excess carry forward of loss of Rs. 96,774 in the assessment year 1982-83 and consequent underassessment of income of the same amount for the assessment year 1984-85 as the loss for assessment year 1982-83 was set off against income for assessment year 1984-85.	0.94
13.	West Bengal M(Co)	Z 1985-86	21-1-1988	Omission to add back depreciation of Rs. 11,97,399 already debited to the Profit and Loss account for separate consideration although depreciation as admisible was allowed in the assessment.	7.54 (P)
14.	West Bengal N(Co)	Y 1985-86	25-3-1988	In the assessment year 1985-86 depreciaton of Rs. 1,37,054 already charged in the account was deducted for the net surplus and depreciation of Rs. 1,37,054 as admissible was further allowed resulting in underassessment of income of Rs. 2,74,108.	2.33
15.	West Bengal O(Co)	A 1985-86	22-3-1988	Omission to add back Rs. 64,648 being depreciation on additions to plant and machinery disallowed by the assessing officer but deducting the said amount of Rs. 64,648 from the total income, resulting in under assessment of total income by Rs. 1,29,296.	1.17
16.	West Bengal P(Co)	A 1984-85	22-1-1987	While deducting the amount of depreciation of Rs. 24,33,172 debited to the profit and loss account from the net loss of Rs. 23,25,448 as per profit and Loss account for separate consideration, the mistake in considering the resultant figure of Rs. 1,07,724 as minus figure instead of a plus figure resulted in excess computation of loss and carry forward of loss of Rs. 2,15,448.	1.24 (P)
17.	Delhi Q(Co)	B 1985-86	29-1-1988	Omission to add back Rs. 35,34,200 which had been disallowed while framing the assessment order.	29.08
18.	Gujarat R(Co)	C 1986-87	24-3-1987	Omission to add to the taxable income the depreciation of Rs. 3,98,259 debited to the profit and loss account though the admissible depreciation of Rs. 3,91,009 was separatly allowed.	2.25(P)
19.	Andhra Pradesh S(Co)	D 1986-87	25-3-1988	Mistake in deducting Rs. 47,940 representing inadmissible expenditure, depreciation and donation considered separately from the net profits as per the profit and loss account instead of adding the same, resulting in short computation of total income by Rs. 95,880.	0.75

(b) Other cases	—			
1. Bombay A (Col.)	M 1986-87	19-3-1987	Deduction of Rs. 80,03,114 allowed by the assessing officer in the original assessment of assessment year 1986-87 was deleted as per oders of Commissioner of Income tax (Appeals) and given effect in to the revision of the assessment for the assessment year 1985-86. Omission to withdraw the deduction of the said amount made in the original assessment for assessment year 1986-87 before revising the amount in March 1988 resulted in double deduction of the same amount.	42.02(P)
2. Bombay B (Co)	N 1982-83	27-2-1985	In giving effect to Commissioner of Income-tax (Assessment)'s orders for assessment year 1982-83 in March 1986, Rs. 80,000 already refunded to the assessee was again given credit while revising the a ssessment in March 1988. This resulted in double adjustment of tax and excess refund of the same amount.	1.09 (including interest).
3. Bombay C(Co)	N 1985-86	21-3-1988	Incorrect deduction of Rs. 90,434 in assessment year 1985-86 towards certain expenses which were disallowed in assessment year 1984-85 which had already been debited in the account of the previous year relevant to assessment year 1985-86 and had reflected in the net profit of the company. The mistake resulted in under assessment of income of Rs. 90,434.	0.82
4. Bombay D(Co)	O 1986-87	30-1-1987	Certain unpaid statutory liabilities amounting to Rs. 1,78,046 were disallowed in assessment years 1984-85 and 1985-86. In assessment year 1986-87 these deductions were allowed. In appeal, the appellate authority deleted the disallowance and the assessments for assessment years 1984-85 and 1985-86 were revised accordingly. However, the assessment for assessment year 1986-87 was not revised to withdraw these deductions earlier allowed resulting in double deduction.	0.93
5. Gujarat E(Co)	P 1985-86	17-2-1988	Double deduction of Rs. 21,40,962 once in the revised assessment for the assessment year 1984-85 and again in the assessment for the assessment year 1985-86 resulted in excess computation/carry forward of loss by Rs. 21,40,962.	12.36(P)
6. Delhi F(Co)	Q 1983-84	19-12-1985	Allowance of deduction of Rs. 2 lakhs on account of salary to staff twice, once from business income and again from other sources (Dividend income).	1.16 (P)
7. West Bengal G(Co)	R 1985-86	30-11-1987	Omission to add back depreciation of Rs. 22,52,245 although depreciation of Rs. 11,40,220 as admissible was allowed resulting in double deduction.	8.08
8. West Bengal H(Co)	S 1985-86	22-2-1988	Omission to add back depreciaton of Rs. 4,41,754 although depreciation of Rs. 5,97,316 as admissible was allowed.	1.63
(VI) *Calculation errors*				
1. Bombay A(Co)	X 1984-85	18-11-1986	A net demand of Rs. 20,15,066 after adjusting credit of advance tax of Rs. 39,46,259 was raised in the assessment for assessment year 1984-85. Earlier the department had already refunded Rs. 5,08,815 on the basis of provisional assessment made out of the aforesaid advance tax. Omission to take the refund into account while determining the tax payable during regular assessment resulted in short demand.	5.09
2. Bombay B(Co)	X 1984-85	20-11-86	A net demand of Rs. 1,27,646 after adjusting credit of advance tax of Rs. 9,84,000 was raised in the assessment for assessment year 1984-85. Earlier the department had already refunded Rs. 2,21,478 on the basis of provisional assessment made out of the aforesaid advance tax. Omisson to take the refund into account while determining the tax payable during the regular assessment resulted in short demand.	2.21
3. West Bengal C(Co)	A 1985-86	9-3-1988	Omission to take into account refund of Rs. 88,945 by way of adjustment against the demand for assessment year 1984-85 at the time of provisional assessment for assessment year 1985-86, during the regular assessment resulted in short demand of Rs. 88,945. Also failure to restrict the relief allowed by appellate authority amounting to Rs. 46,915 at 40 per cent thereof resulted in under charge of Rs. 19,211.	1.08

The above cases were referred to the Ministry of Finance for comments during January 1989 and August 1989. The Ministry of Finance have accepted the objection in 24 cases. The reply of the Government has not been received in the remaining cases (October 1989). However the department has accepted the objection in 2 other cases.

2. In the assessment of a company for the assessment year 1972-73 completed by the Inspecting Assistant Commissioner (Assessment) in September 1984, an addition of Rs.13,29,545 was made for under-valuation of closing stock. In the assessment for the assessment year 1973-74 completed on the same date (20.9.1984) the under-valuation of closing stock was worked out at Rs.21,41,083 and after making adjustment of Rs. 13,29,545 for the increase in the value of opening stock for this year as a result of increase in value of the closing stock for the assessment year 1972-73, a net addition of Rs. 8,11,538 was made. On an appeal by the assessee company, the Commissioner of Income-tax (Appeals) in his orders dated 21 January 1985 deleted the addition of Rs.13,29,545 made on this account for the assessment year 1972-73 and set aside the assessment order of the assessing officer for the assessment year 1973-74 with the directions to make a fresh assessment after giving an opportunity to the assessee to produce evidence on the point of under valuation of closing stock. In the fresh assessment order for the assessment year 1973-74 completed by the Inspecting Assistant Commissioner (Assessment) in February 1987, the under-valuation of closing stock was again worked out at Rs.21,41,083 and after making adjustment of Rs.13,29,545 for the addition made in the assessment year 1972-73, net addition of Rs. 8,11,538 was made. Since addition of Rs.13,29,545 made in the assessment year 1972-73 had been deleted in appeal and effect of it given in February 1985, the adjustment made in the fresh assessment of February 1987 for the assessment year 1973-74 was not in order. The mistake resulted in under-assessment of income of Rs.13,29,545 for the assessment year 1973-74 with consequent short levy of tax of Rs. 9,33,610 (including interest for short payment of advance tax).

The audit objection was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection.

3.07 Application of incorrect rate of tax

1. Under the provisions of the Finance Acts, 1980-81 to 1984-85, an industrial company means a company which is mainly engaged in the business of generation or distribution of electricity or any other form of power or in the manufacture or processing of goods or in mining. A company shall be mainly engaged in the manufacturing or processing of goods if the income attributable to such activities included in its gross total income of the previous years is not less than fifty one per cent of such total income. A domestic company in which the public are not substantially interested and which is mainly engaged in industrial activity is charged to tax at 60 per cent where the income exceed Rs. 2 lakhs. From the assessment year 1984-85 such company is charged to tax at the flat rate of 60 per cent. In the case of a company which is not engaged in industrial activity, the rate of tax is 65 per cent.

(i) Thirteen private non-industrial companies were taxed at the rate of 60 per cent of the total income (in 3 cases at the rate of 55 per cent) in 9 different Commissioners' charges for the assessment years 1980-81 to 1985-86 instead of at the correct rate of 65 per cent, treating them as industrial companies or companies in which the public was substantially interested.

(ii) Similarly, 6 other private limited companies in 5 different Commissioners' charges were assessed to tax for the assessment year 1984-85 to 1987-88 at the rate of 55 per cent instead of at the correct rate of 60 percent treating them erroneously as companies in which public are substantially interested.

(iii) In the case of one company in which the public were substantially interested, for the assessment year 1980-81, tax was levied at the rate of 45 per cent instead of the correct rate of 55 per cent.

(iv) In the case of yet another company, surcharge on income-tax for the assessment year 1984-85 was erroneously levied at the rate of 2.5 per cent instead of at the correct rate of 5 per cent.

The appplication of incorrect rate of tax in the above 21 cases resulted in short levy of tax of Rs. 39,13,423.

Of these, 15 companies were assessed by the Inspecting Assistant Commissioner (Assessment).

The paragraphs were referred to the Ministry of Finance for comments between January 1989 and August 1989.

The Ministry of Finance have accepted the objection in 4 cases. The reply of the Government has not so far been received in the remaining cases (October 1989). However, the department has accepted the objection in 6 other cases.

2. Under the Income-tax Act, 1961, as amended by Finance Act, 1985, where the total income of a company other than a company in which public are sustantially interested, includes any income chargeable under the head, 'capital gains' relating to capital assets other than short term capital assets, on so much of the amount of such long term capital gains as relate to building or land or any rights in buildings or lands the income-tax payable shall be the aggregate of the income-tax calculated on the amount of long term capital gain included in the total income, at the rate of fifty percent and the amount of income-tax with which it would have been chargeable had its income been reduced by the amount of long term capital gains.

The assessment of a private limited company for assessment year 1984-85 was completed in March 1988 on the total income of Rs. 37,85,280 which included long term capital gains of Rs. 27,73,418 arising from sale of land. While computing the tax payable on the capital gains so arrived at, the tax was incorrectly charged at the rate of forty per cent as against the correct rate of fifty per cent. The application of incorrect rate of tax resulted in short levy of tax of Rs. 2,77,370 (tax leviable Rs. 13,86,709 minus tax levied Rs. 11,09,339).

The Ministry of Finance have accepted the objection.

3. Under the provisions of the Income-tax Act, 1961, as applicable to the assessment year 1977-78, and subsequent years, income by way of royalty or fees for technical services received by foreign companies under approved agreements made on or after 1 April

1976, is chargeable to tax at a flat rate of forty per cent on the gross amount of income. A lower rate of twenty per cent is, however, applicable to lump sum payments received by foreign companies under approved agreements for the transfer outside India, or imparting of information outside India, in respect of any data, documentation, drawings etc. These rates do not apply in respect of royalty income received by a foreign company from the Indian concern in pursuance of an agreement made by the former with the latter after 31 March 1976, if such agreement is deemed under the provisions of the Act to have been made before 1 April 1976.

In the previous year relevant to the assessment year 1984-85, a foreign company received royalty of a sum of Rs.5,03,525 from an Indian company. In the assessment order made by the Inspecting Assistant Commissioner (Assessment) in October 1986, for the assessment year 1984-85, the assessing officer stated that the royalty of Rs.5,03,525 received from the Indian company was liable to be taxed at forty per cent. However, while working out the tax leviable, tax was levied at twenty per cent on Rs.5,03,525. The omission to apply the correct rate of tax resulted in short levy of tax of Rs.1,00,705.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection in principle.

4 Under the provisions of the Income-tax Act,1961, the Central Government may enter into an agreement with the Government of any foreign country for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains. According to the terms of agreement of Great Britain and the Government of India in April 1981, with effect from 23 November 1981 the income-tax leviable on the income from interest accruing or arising in India to a non resident in respect of a loan or debt first created after the date of entry into force of the convention, viz., 23 November 1981, shall not exceed 15 per cent of the gross amount of interest. The term" interest' as used in the agreement means income from debt, claims of every kind and in particular income from Government securities and income from bonds or debentures including premiums and prizes attaching to such securities, bonds or debentures. Income-tax on such interest prior to November 1981, is, accordingly taxable at the rates prescribed in the relevant Finance Act.

During the previous years relevant to the assessment years 1984-85 and 1985-86, five non-resident companies were in receipt of interest aggregating to Rs. 35,87,324 against deposits continuously held with banks and other institutions in India since 12 November 1980. In the assessments completed between March 1984 and December 1985, the department erroneously levied tax at the concessional rate of 15 per cent amounting to Rs.5,38,232 on such interest income instead of at the correct rate of 70 per cent for income-tax and 5 per cent for surcharge as prescribed in the relevant Finance Acts. The incorrect adoption of tax rate led to aggregate short levy of tax of Rs. 20,98,441 in assessment years 1984-85 and 1985-86.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3.08 Incorrect status adopted in assessment

Under the provisions of the Income-tax Act, as amended by the Finance Act, 1983, with effect from 2 April 1983, a company is deemed to be a company in which the public are substantially interested if, inter alia, it fulfils the conditions that the shares in the company were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India or the shares carrying not less than fifty per cent of the voting power throughout the relevant previous year were beneficially held by the Government or a corporation establsihed by a Central, State or Provincial Act, or any company or any subsidiary company as provided.

According to the provisions of the Finance Act ibid, the incidence of tax is lower (fifty five per cent) in respect of a company in which the public are substantially interested than in the case of one in which the public are not substantially interested, which is sixty per cent if it is an industrial company and sixty five per cent if it is other than an industrial company.

1. While completing the assessment of a limited company for the assessment year 1984-85 in March 1987, the assessing officer treated the company as a company in which the public were substantially interested and levied the tax at the rate of 55 per cent. It was, however, noticed in audit that the shares of the company were neither listed in a recongised stock exchange nor even a single share of the company was held throughout the relevant previous accounting year by any of the specified authorities/bodies. As the prescribed conditions were not fulfilled in this case the assessee company was to be treated as the one in which public were not substantially interested and subjected to a higher rate of tax of 65 per cent, the company not being an industrial company. Omission to do so resulted in undercharge of tax of Rs. 2,32,332 including interest for non-payment of advance-tax.

The Ministry of Finance have accepted the objection.

2. In the assessment of a leasing and finance company for the assessment year 1985-86, assessment completed in March 1988, the company was treated as a company in which public were substantially interested and tax was levied at concessional rate of 55 per cent of the total income. However, it was seen from the return of income filed by the company in October 1985 that in regard to the query regarding status of the company as to whether it was a company in which the public are substantially interested, the company had replied in the negative. Also there was no evidence on records to show that the shares were listed in a recognised stock exchange in India as on the last day of the previous year and also no evidence to indicate that the shares of the company carrying not less then fifty per cent of the voting power had been unconditionally held by the Government or a statutory corporation, etc. In view of this the correct rate of tax applicable was 65 per cent of the total income and surcharge as applicable to a private non-industrial company. Omission to do so

resulted in short levy of tax of Rs. 3,79,303 (including interest leviable for late filing of the return and under estimate of advance tax).

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

3. The authorised share capital of a company amounted to Rs. 9,90,000 consisting of 99,000 equity shares of Rs. 10 each. Out of 99,000 equity shares, 98,930 shares were offered to the public and were fully subscribed during the previous year relevant to the assessment year 1984-85. The assessee company could not prove the genuineness and whereabouts of the share holders. While completing the assessment for the assessment year 1984-85 in March 1987, the assessing officer assessed the entire amount of Rs.9,89,300 representing share capital subscribed by the share holders under the head 'other sources' treating the amount as the assessee's income from undisclosed source. The shares of the company were not listed in any recognised stock exchange in India. In absence of details of shareholders, the company was to be treated as a company in which public were not substantially interested and charged to tax at 65 per cent instead of at 55 per cent incorrectly levied by the department treating the company as one in which public were substantially interested. The mistake resulted in short levy of tax of Rs. 1,62,429 including short levy of interest of Rs. 58,793 for late filing of return and short payment of advance tax in the assessment year 1984-85.

The Ministry of Finance have accepted the objection.

3.09 Incorrect computation of income from house property

1. Under the Income-tax Act, 1961, the annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to tax, shall be chargeable to income-tax under the head 'Income from house property'. The income is to be computed on a notional basis and not necessarily with reference to actual receipts.

In completing the assessment of an assessee company for the assessment years 1983-84 and 1984-85 in March 1986 and March 1987 respectively, the assessing officer determined the gross maintainable rent of the let out property at Rs. 12 lakhs per annum and computed the income from house property accordingly. The assessing officer, while making the assessments for the assessment years 1985-86 and 1986-87 in June 1987 took the gross maintainable rent of Rs. 7,17,286 and Rs. 6,83,718 respectively as the annual letting value of the property as disclosed in the relevant profit and loss account instead of at Rs. 12 lakhs as determined in the preceding assessment years but without assigning any reasons. The omission to consider the annual letting value at Rs. 12 lakhs as determined in preceding assessment years, led to under assessment of income of Rs. 4,05,886 and Rs. 4,30,235 in the assessment years 1985-86 and 1986-87 respectively resulting in an aggregate undercharge of tax of Rs. 7,50,703 including interest of Rs. 65,188 for delay in submission of return and Rs. 1,37,450 for short payment of advance tax for the two assessment years.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

2. In computing the income from house property the Act provides for certain deductions from annual value which includes a deduction for repairs equal to one sixth of the annual value. The Act also provides that profits and gains of a cooperative society attributable to banking business are to be allowed as deduction in full and are not thus chargeable to tax.

A co-operative bank owned a building which was used partly for its own banking businesss and partly in the occupation of a tenant. In the original assessments of the co-operative bank for the assessment years 1984-85 and 1985-86 completed in February 1987 and November 1987 by the Inspecting Assistant Commissioner (Assessment) the profits and gains from banking business were not charged to tax and accordingly the annual value in respect of the portion of the building used for its own business was determined at Rs. 11,67,120 and Rs. 12,33,300 respectively and was charged to tax after allowing deduction for repairs. In appeal for both the years, the Commissioners of Income-tax (Appeals) ordered (November 1987 and June 1988) to reduce the annual value by Rs. 4,66,848 and Rs. 4,93,320 respectively. While revising the assessments in January 1988 and July 1988 to give effect to the appellate orders, the house property income as originally assessed was reduced by Rs. 4,66,848 and Rs. 4,93,320 respectively for the two years. It was pointed out in audit (December 1988) that on reduction of the annual value in appeal, the amount of deduction for repairs as originally allowed was also required to be reduced but was not reduced while giving the appeal effect. The omission resulted in under-assessment of income of Rs. 77,808 and Rs. 88,220 for the assessment years 1984-85 and 1985-86 respectively with consequent total short levy of tax of Rs. 72,013.

The Ministry of Finance have accepted the objection.

3. In case of a building comprising one or more residential units, the erection of which is complete after 31 March 1978 but before 1 April 1982, the annual value is to be reduced by certain prescribed amounts for a period of five years from the date of completion of the building.

In the case of a public sector corporation, the assessment for the assessment years 1982-83 and 1984-85 were completed in March 1986 and March 1987 respectively. The corporation was owning certain house properties. While working out the income from house property, the annual value was reduced by the deduction permissible for residential units. As the house property, consisted of industrial blocks, the annual value should have been arrived at without giving the deductions admissible only for residential units. Incorrect application of the statutory provisions resulted in under assessment of income of Rs. 65,831 for assessment year 1982-83 and Rs. 24,000 for assessment year 1984-85 involving potential short levy of tax aggregating to Rs. 50,972 for both the assessment years.

The Ministry of Finance have accepted the objection.

INCORRECT COMPUTATION OF BUSINESS INCOME

Representative cases of mistakes noticed in the computation of business income in the case of companies and corporations are given below : The total tax effect (including potential) of these 122 cases comes to Rs. 1,714.35 lakhs.

3.10 Incorrect allowance of expenditure on scientific research

Under the provisions of the Income-tax Act, 1961, a weighted deduction in respect of expenditure incurred on scientific research under approved need based programmes is admissible provided the expenditure is certified by the prescribed authority to have been so incurred during the previous year.

(*i*) The original assessment of an assessee company for the assessment year 1983-84 was revised in November 1985 to allow weighted deduction of Rs. 1,71,323 on account of contribution to a recognised institution for conducting scientific research. As the approval of the prescribed authority for this programme of scientific research was not obtained, the grant of weighted deduction of Rs. 1,71,323 was irregular and this led to under-assessment of income by the same amount involving undercharge of tax of Rs. 96,583 in assessment year 1983-84.

The Ministry of Finance have accepted the objecton.

(*ii*) In the previous year relevant to the assessment year 1984-85, a private limited company paid a sum of Rs. 3,00,000 to the institute 'Aparna Ashrama', approved by the prescribed authority. While completing the assessment in June 1985, the assessing officer allowed a deduction of Rs. 4,00,000 (Rs. 3,00,000 plus weighted deduction of Rs. 1,00,000). It was, however, noticed in audit that the specific certificate to the effect that such sums were not to be used for acquisition of any land or building or for the construction of any building was not recorded on the receipt furnished by the Institute. In the absence of such a certificate, the weighted deduction of Rs. 1,00,000 allowed on the contribution of a sum of Rs. 3,00,000 was not in order. This resulted in under-assessment of income to the extent of Rs. 1,00,000 and short levy of tax of Rs. 63,000.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3.11 Excess allowance of expenditure on know—how

Under the Income-tax Act, 1961, with effect from 1 April 1986, where the assessee had paid in any previous year any lumpsum consideration for acquiring any know—how for use for the purpose of business, one sixth of the amount so paid shall be deducted from the profits of the business in the previous year of payment and the balance in equal instalments in the five immediately succeeding previous years.

In the case of a private limited company, an amount of Rs. 94,215 on account of technical know—how fees was debited in its accounts relevant to the assessment year 1986-87. In the assessment for the assessment year 1986-87 completed in November 1987, the assessing officer allowed the deduction for the fees in full instead of an amount of Rs. 15,702 only, being one sixth of the fees paid. The mistake resulted in under-assessment of income by Rs. 78,513 leading to short levy of tax of Rs. 50,618 (including interest of Rs. 1,644 for late filing of return and excess payment of interest of Rs. 3,633 by the department on excess advance-tax).

The paragraph was referred to the Ministry of Finance for comments in August 1989 ; the reply from the Government has not so far been received (October 1989).

3.12 Mistake in grant of export markets development allowance

1. The Income-tax Act, 1961, as it stood prior to its amendment by the Finance Act, 1983, provided for export markets development allowance to domestic companies and resident assessees enaged in the business of export of goods outside India or in providing services or facilities outisde India. A domestic company was entitled to a deduction on account of this allowance from the income assessed under the head "Profits and gains of business or profession" at one and one third times the qualifying expenditure as provided in the Act.

The assessment of a State owned company for the assessment year 1984-85, was completed in December 1986 at a loss of Rs. 40,21,772. Audit scrutiny (January/February 1988) revealed that the assessee was allowed inadmissible deductions of Rs. 60,112 on account of weighted deduction for expenditure incurred on development of export markets in the accounting year 1983-84 relevant to assessment year 1984-85, though such deduction already stood withdrawn from April 1983. Further a sum of Rs. 2,53,858 towards provisions for doubtful debts was allowed though the same was merely a provision and not established as irrecoverable debt. Also, a sum of Rs. 2,795 allowed as depreciation on 'Rest house' building was not admissible as no depreciation is allowable on rest house building. Besides, the amount of interest paid towards 'Chief Minister's relief fund' was disallowed less by Rs. 8,750. These omissions led to over computation of loss by Rs. 3,25,515 with notional tax effect of Rs. 2,05,074.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

2. Payment of commission for processing orders from the foreign buyers not qualifying for weighted deduction.

An assessee, a private limited company, claimed and was allowed weighted deduction of Rs. 2,84,717 for the assessment year 1984-85 (assessment completed in January 1987) as export markets development allowance being one-third of Rs. 8,54,151 paid by the assessee as commission to foreign agents for rendering services of marketing abroad. As the weighted deduction was not allowable on such expenditure, the grant of deduction resulted in under-assessment of income by Rs. 2,84,717 involving short levy of tax of Rs. 1,79,367.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989 ; the reply from the Government has not so far been received (October 1989).

3.13 Incorrect allowance of preliminary expenses

Under the provisions of the Income-tax Act, 1961, the admissible deduction towards preliminary expenses incurred prior to commencement of business or in connection with the extension of the industrial undertaking is limited to $2\frac{1}{2}$ per cent of cost of the project or capital employed and is allowed in equal instalments spread over ten years. The preliminary expenses are not, however, allowable for any previous year in which the business has not commenced or the extension programme is not completed.

1. During the previous year relevant to the assessment year 1983-84, a company engaged in hotel business issued 15 per cent non-convertible cumulative debentures for Rs. 10 crores for expansion of its hotel. An expenditure of Rs. 60,56,076 incurred in connection with the issue of debentures was entirely allowed as deduction in the assessment for the assessment year 1983-84 completed by the Inspecting Assistant Commissioner (Assessment) in March 1987. Since the debentures were raised by the assessee for the purpose of expansion of its business, the allowable preliminary expenses should have been limited to Rs. 25,00,000 only, being $2\frac{1}{2}$ per cent of Rs. 10 crores. Consequently the assessee was entitled to a deduction of Rs. 2,50,000 only being one tenth of the said $2\frac{1}{2}$ percent and not Rs. 60,56,076. The mistake resulted in excess allowance of deduction amounting to Rs. 58,06,076 leading to under-assessment of income by the same amount with consequent undercharge of tax of Rs. 51,79,755 (including interest of Rs. 1,30,924 for delay in filing the return and Rs. 17,75,656 for short payment of advance tax).

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. While computing the income of a Government corporation for the assessment year 1981-82 in February 1984 (revised in September 1985), preliminary expenses including expenditure on preparation of feasibility reports of projects amounting to Rs. 4,86,758 were allowed by the assessing authority. The expenditure was of capital nature and pertained to the project which had not materialised. No part of it could, therefore, have been allowed as deduction by way of preliminary expenses and the entire expenses should have been disallowed. The omission to do so resulted in under-assessment of income of Rs. 4,86,758 involving short levy of tax of Rs. 3,85,649 (including interest of Rs. 97,852 for short payment of advance tax).

The Ministry of Finance have accepted the objection.

3. During the previous years relevant to the assessment years 1982-83 and 1983-84, an assessee company incurred expenditure amounting to Rs. 1,00,000 and Rs. 75,000 towards fees to registrars and registrar's charges respectively in connection with issue of share capital. In the assessments for the assessment years 1982-83 and 1983-84 completed in December 1985 and July 1986 respectively, the department allowed the aforesaid expenditure in full, as claimed by the company. The expenditure being capital in nature is not admissible in computing the business income of the assessee. If, however, the funds received by the assessee by issue of share capital were utilised for the purpose of extension of its industrial undertaking, sums of Rs. 10,000 (being one tenth of Rs. 1,00,000) for assessment year 1982-83 and Rs. 17,500 for assessment year 1983-84 were admissible. However, while computing the total taxable income, the assessing officer allowed the entire sum aggregating to Rs. 1,75,000 instead of the correct amount of Rs. 27,500. The mistake resulted in under-assessment of income aggregating to Rs. 1,47,500 involving under-charge of tax of Rs. 1,07,236 for the two assessment years 1982-83 and 1983-84 (including non-levy of interest of Rs. 24,082 for short payment of advance tax for assessment year 1982-83).

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

3.14 Excess allowance of provision for bonus

The payment of Bonus Act, 1965, prescribes the maximum payment of bonus at a rate, not exceeding 20 percent of the effective gross salary of the employees, subject to availability of allocable surplus. The allocable surplus is computed at the rate of 60 per cent of available balance of profits, which is determined in the manner prescribed in the Act.

In the assessment of a company for the assessment year 1982-83 completed in November 1984 (revised in March 1985), the provision for bonus for the year 1981-82 amounting to Rs. 9,02,714 debited in its profit and loss account for the year ended 31 March 1982, was allowed in full. It was noticed in audit (July 1986) that the 'allocable surplus' for the period, worked out as prescribed in the payment of Bonus Act, was only Rs. 5,96,160. The omission to restrict the allowance to the amount of 'allocable surplus' (as had been done in the preceding assessment year) resulted in under-assessment of income of Rs. 3,06,554, and consequent short levy of tax of Rs. 2,40,641.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

3.15 Incorrect allowance of contribution to gratuity, pension and superannuation fund

1. Under the provisions of the Income tax Act, 1961, no deduction shall be allowed in respect of any provision for gratuity to employees on retirement or on termination of employment for any reason, unless it is by way of contribution towards an approved gratuity fund or for payment of gratuity that has become payable during the previous year.

In the assessment of a company for the assessment year 1984-85 completed in March 1987, a sum of Rs. 5,62,255 debited in the accounts for the previous year ending 30 June 1983 towards contribution to the gratuity fund was allowed as deduction. It was, however, noticed in audit that there was no approved gratuity fund of the company during the previous year relevant to the assessment year 1984-85. As no approved gratuity fund was in existence during the relevant previous year, the allowance of gratuity provisions of Rs. 5,62,255 in the assessment year 1984-85 was not in order. The mistake resulted in excess computation and carry forward of loss by Rs. 5,62,255 involving potential tax effect of Rs. 3,24,702.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

2. The Income-tax Rules, 1962, further provide that the amount to be allowed as a deduction on account of annual contribution which an employer may make in respect of services of an employee shall not exceed eight and one third percent of the employees' salary during each year.

During the previous year relevant to the assessment year 1982-83, a company provided a sum of Rs. 19,24,579 in its accounts for payment to its approved staff gratuity fund on the basis of valuation made by the actuary. However, under the Income-tax Rules, 1962, the amount deductible as gratuity liability was to be restricted to Rs. 17,04,094. While completing the assessment in August, 1984 (revised in March 1986) the Inspecting Assistant Commissioner omitted to reduce the gratuity liability deductible by Rs. 2,20,485. The mistake resulted in under-assessment of income by Rs. 2,20,485 involving short levy of tax of Rs. 1,24,298.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

3. In respect of initial contributions to the superannuation fund, the Central Board of Direct Taxes have clarified that an amount equal to 80 per cent of the contribution actually paid to the fund shall be allowed in five equal instalments commencing from the assessment year relevant to the previous year in which the amount was actually paid and four immediately succeeding assessment years.

(*i*) In the case of an assessee company for the assessment year 1984-85 (assessment made in March 1987) initial contribution of Rs. 3,00,656 made towards senior staff pension fund was allowed by the Inspecting Assistant Commissoner (Asstt.) as deduction. As per Boards' instruction, the deductible amount of Rs. 2,40,525, being 80 per cent of Rs. 3,00,656 was allowable in five equal instalments of Rs. 48,105 in each of the assessment years 1984-85 and four succeeding years. The incorrect allowance of Rs. 3,00,656 instead of correct amount of Rs. 48,105 resulted in excess carry forward of loss of Rs. 2,52,551 in the assessment year 1984-85 with a potential under-charge of tax of Rs. 1,45,848.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(*ii*) In the case of a widely held company, the approval to the superannuation fund created by it was accorded in September 1986 and the intitial contribution payable by it determined at Rs. 4,01,295. This was paid by the company in two instalments of Rs. 80,413 and Rs. 3,20,882 during the previous years relevant to the assessment years 1984-85 and 1985-86 and the same were allowed by the Deputy Commissioner (Special Range) as admissible expenditure in the assessments completed in November 1986 and December 1987 respectively. As per the Board's instruction, the total amount of initial contribution should have been restricted to Rs. 3,21,036 and the deduction allowed at Rs. 64,207 per year for each of the five assessment years from assessment year 1984-85. Failure to do so resulted in under-assessment of income by Rs. 16,205 for assessment year 1984-85 and Rs. 2,56,675 for assessment year 1985-86 involving an aggregate short levy of tax of Rs. 1,57,587.

The assessing officer replied that though the objection is supported by Board's instructions, a High Court has held that the restriction of the admissible amount of contribution to superannuation fund to 80 per cent was not correct and was in excess of the rule making power of the Board. The reply of the department is not acceptable since the Board's instructions still generally hold the field and are binding on the assessing officers.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.16 Incorrect deductions allowed on contribution towards other funds

Under the Income-tax Act, 1961, as amended by Finance Act 1984 with retrospective effect from 1 April 1980, no deduction shall be allowed in respect of any sum paid by the assessee as an employer towards the setting up or formation, of, or as contribution to any fund or other institution for any purpose, except where such sum is so paid by way of contribution towards a recognised provident fund, approved superannuation fund or gratuity fund created for the benefit of employees.

1. During the previous year relevant to the assessment year 1984-85, a tea company and one of its subsidiaries debited their profit and loss accounts with the sums of Rs. 13,67,753 and Rs. 4,96,439 respectively representing contribution to a 'common pool' for payment of commission to their managerial staff. The above sums featured as outstanding liabilities at the end of the relevant previous year. As contribution to such nonstatutory funds was not an admissible deduction, it was disallowable in assessment. The Inspecting Assistant Commissioner (Asstt.), however, made no disallowance in the assessments made between January and March 1988. This led to an aggregate under-assessment of income of Rs. 7,45,676 (40 per cent of Rs. 18,64,192 being tea companies) involving under-charge of tax of Rs. 4,30,628 in assessment year 1984-85.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. For the assessment years 1982-83 and 1983-84 (assessments made in February 1986 and March 1987), an assessee company was allowed deduction of Rs. 70,000 and Rs. 56,000 respectively in respect of contributions made to certain welfare and benevolent Funds. As these contributions were not admissible deductions, the allowance of the same resulted in under-assessment of assessee's income by Rs. 70,000 and Rs. 56,000 in the assessment years 1982-83 and 1983-84 respectively involving short levy of tax aggregating to Rs. 1,07,891 (including interest for short payment of advance tax of Rs. 36,859 for both the assessment years).

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

3.17 Incorrect allowance of capital expenditure

1. Under the provisons of the Income-tax Act, 1961, any expenditure, not being expenditure of a capital nature or personal expenses of the assessee laid out or expended wholly and exclusively for the purposes of business, is allowable as deduction in computing the income chargeable under the head 'Profits and gains of business'.

(*i*) An assessee company took over seven textile sick mills on 1 April 1974. While deciding the compensation payable to the erstwhile units, the amount of gratuity payable to the employees in respect of the services rendered by them before the period of takeover i.e., upto 31 March 1974, was determined on acturial valuation and was adjusted against the amount of compensation given by the assessee company to the units. The amount of gratuity so determined was shown in the accounts of the company under the head 'Gratuity provision account'. In the accounts of the company for the accounting years relevant to the assessment years 1981-82 to 1983-84, actual payments of gratuity to the extent of Rs. 42,00,184, Rs. 44,38,242 and Rs. 68,84,457 respectively relatable to the services rendered upto 31 March 1974 was debited to the above gratuity provision account and the rest of the payments pertaining to the services rendered after 31 March 1974 were charged to the profit and loss account. The assessee company, however, claimed that the aforesaid payments which were debited to the gratuity provision account may be allowed as its revenue expenditure as the payments though debited to the 'Provision account' were actually incurred during the relevant year(s). The claim of the assessee company was accepted by the assessing officer in the assessments for the three years made in March 1984, March 1985 and November 1986 respectively. It was pointed out in audit (July 1986) that the actual payments relating to the period upto 31 March 1974 had not been met out of the current year's income but had been met out of the amount recovered from the erstwhile units and kept in the 'Provision account'. As such the expenditure was not a revenue expenditure of the assessee company. The mistake in not allowing the assessee's claim on this account resulted in excess computation of loss by Rs. 42,00,184, Rs. 44,38,242 and Rs. 68,84,457 respectively for the assessment years 1981-82 to 1983-84 with consequent potential tax effect aggregating to Rs. 88,66,530.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1988; the reply from the Government has not so far been received (October 1989).

(*ii*) The assessment of a State Electricity Board for the assessment year 1984-85 was completed by the Inspecting Assistant Commissioner (Assessment) in November 1986 allowing a deduction of Rs. 76,62,851 towards trial running expenses. It was seen in audit that the expenses related to the power plants which had not been commissioned. As the power plants had not been commissioned during the previous year relevant to the assessment year 1984-85, the expenditure incurred on the trial running was required to be treated as capital expenditure and was not allowable as revenue expenditure. The mistake resulted in under-assessment of income of Rs. 68,96,566 involving notional short levy of tax of Rs. 39,82,766. Even though the assessment was rectified in March 1987 and November 1987, the mistake remained to be corrected.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. It has been judicially held that expenditure on shifting machinery constituted capital expenditure and was not allowable as revenue expenditure.

A public limited company debited a sum of Rs. 35,71,828 in the profit and loss account for the period relevant to assessment year 1985-86 towards shifting the machinery from one place to another. In the assessment finalised by the Inspecting Assistant Commissioner of Income-tax in March 1988 the above expenditure was allowed deduction as claimed by the assessee company. As the expenditure was in the nature of capital expenditure, it was not allowable as revenue expenditure. The mistake resulted in under-assessment of income of Rs. 35,71,828 involving short levy of tax of Rs. 24,49,490 (including interest of Rs. 3,80,760 leviable for under-estimate of advance tax).

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

3. It has been judicially held by the Supreme Court that payments made for obtaining technical know-how in the shape of drawings, design, plans, processing data and other literature is capital in nature.

A company engaged in the manufacture of electrical products was allowed deduction of Rs. 24,91,692 paid to a foreign company for technical services in the assessment for assessment year 1985-86 completed in March 1988. Audit scrutiny revealed that the payment of Rs. 24,91,692 was made to the foreign company for obtaining enduring benefit in the form of drawing, designs and know-how for manufacture of 'paint finish system' by the assessee company. The expenditure, the like of which was judicially held to be capital in nature, was required to be disallowed. The omission to do so led to under assessment of income of Rs. 24,91,692 with consequent undercharge of tax of Rs. 20,68,470 (including short levy of interest of Rs. 6,29,518 for short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4. In a case where a foreign company transferred to an assessee company its technical know-how and the right to use its trade mark in consideration of payment of royalty, it was judicially held that the technical know-how acquired by the assessee fell within the definition of 'plant' and the expenditure incurred in acquiring the same was capital expenditure although there was no absolute transfer of the technical know-how, the ownership of which continued with the foreign company, and the assessee company being entitled only to its use. It was also held that the assessee company was entitled to depreciation and development rebate on the technical know-how since it was treated as a plant, a depreciable asset (1986) 161 ITR 36 (Kerala). It has also been judicially held by the Supreme Court that the aim and object of the expenditure would determine the character of the expenditure whether it is a capital expenditure or revenue expenditure. The source or the manner of the payment would then be of no consequence (155) 27 ITR 34.

The assessment of a private limited company engaged, inter alia, in the execution of mini cement plants, for the assessment year 1985-86, was completed in January 1988 after allowing an expenditure of Rs. 9,05,000 debited to its profit and loss account towards 'Technical know-how fees'. This payment represented the amount of fees paid to Cement Research Institute in consideration of the grant of non-exclusive licences of the patent relating to vertical shaft kiln cement plant and of the know-how for the said cement plant technology made available to the assessee. There was no absolute transfer of technical know-how, the ownership of which continued with the Cement Research Institute. The assessee company was entitled to the use of it on payment of fees to the Cement Research Institute which was worked out at 5 per cent of net of ex-works and value of all plant and equipment on each contract on plant to plant basis for which orders were received.

The above expenditure, being of a capital nature should have been disallowed and depreciation at 15 per cent only should have been allowed while computing the income. Omission to disallow expenditure resulted in under-assessment of income of Rs. 7,69,250 (after allowing depreciation at 15 per cent) and a short levy of tax of Rs. 6,96,635 (including short levy of interest of Rs. 12,118 and Rs. 1,99,939 for late filing of return of income and short payment of advance tax respectively).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1939).

5. It has been judicially held that loss due to fluctuation of rates of foreign currency in respect of repayment of loan taken for the purchase of asset is capital expenditure.

(i) A limited company had obtained terms loans in foreign exchange. The repayment of loan was to be made in foreign exchange. In the previous year relevant to the assessment year 1985-86 an amount of Rs. 7,72,430 representing payment due to fluctuation in rates of foreign exchange was debited to the profit and loss account. While completing the assessment in March 1988, the Inspecting Assistant Commissioner (Assessment) allowed the expenditure treating it as revenue expenditure although similar expenditure was not allowed in the assessment year 1982-83 and the disallowance was also upheld in appeal. The mistake resulted in under-assessment of income of Rs. 7,72,430 involving short levy of tax of Rs. 6,41,203 (inclusive of interest of Rs. 1,95,125 for short payment of advance tax).

The paragraph was fererred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(ii) While completing the assessment of a statutory corporation for the assessment year 1981-82 in February 1984 (revised in September 1985) to give appeal effect, the Inspecting Assistant Commissioner allowed deductions of Rs. 4.25 lakhs and Rs. 3.21 lakhs paid by the assessee to foreign Government for sponsoring the assessee corporation to carry on business operations in their countries. The deductions allowed were not admissible as the payments towards sponsorship fees were made with a view to securing enduring benefits of acquiring rights to carry on business in those countries and were of a capital nature. The omission to disallow these expenses resulted in under-assessment of income by Rs. 7.46 lakhs involving under charge of tax of Rs. 5,91,292.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April, 1989; the reply from the Government has not so far been received (October 1989).

(iii) A company manufacturing railway equipments debited a sum of Rs. 4,62,048 in its profit and loss accounts towards payment of royalty to a foreign company in the previous year relevant to the assessment year 1985-86. As the payment of Rs. 4,62,048 was made for obtaining enduring benefit in the form of drawings, designs and acquiring formula for manufacture of air brakes by the assessee company it was required to be treated as capital expenditure. In the assessment for the assessment year 1985-86 completed in February 1988 the Inspecting Assistant Commissioner (Assessment) discussed this issue in the assessment order and decided to disallow the expenditure but omitted to add back the same while computing total income. The mistake led to under-assessment of income of Rs. 4,62,048 involving short levy of tax of Rs. 2,66,832.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

6. It has been judicially held that expenditure incurred for increasing authorised share capital of a company is a capital expenditure.

In the assessment of a company for the assessment year 1984-85 completed in April 1986 by the Inspecting Assistant Commissioner (Assessment) interest of Rs. 9,61,669 for the period upto the end of the accounting year ending 31 December 1983 was allowed as revenue expenditure. It was noticed in audit (February 1988) that the interest related to the term loan obtained from financial institutions in respect of the company's new industrial undertaking which started production in June 1983. The interest paid/payable prior to the commencement of business of the new undertaking was a capital expenditure and hence it was required to be disallowed. The mistake resulted in under-assessment of income of Rs. 3,20,900 (after considering depreciation on asset on the amount of interest capitalised) involving potential tax effect of Rs. 1,85,320.

The Ministry of Finance have accepted the objection.

3.18 Incorrect allowance of entertainment expenditure

The Act prescribes the amount of entertainment expenditure allowable on a graded percentage of the profits of a company. Entertainment expenditure has been explained in the Act to include, inter-alia, expenditure on provision of hospitality of evrey kind including provision of food and beverages to employees of the assessee in places other than office, factory or other place of work.

1. During the previous year relevant to the assessment year 1985-86, an assessee company incurred an expenditure of Rs. 1,85,739 towards payment made to a hotel for accommodation, food etc., for senior officers sales executives, salesman and others for attending various functions at the hotels for celebrating the centenary of the company. While completing the asesssment for the assessment year 1985-86 in March 1988 (revised in July 1988), the Inspecting Assistant Commissioner (Assessment) disallowed a sum of Rs. 37,148 only being 20 per cent of aforesaid expenditure of Rs. 1,85,739 on account of payment made to hotel as per other provisions of the Act. The balance expenditure of Rs. 1,48,591, was, however, allowed in full. Since the expenditure was incurred towards provision of food, etc., for the employees of the company outside the office/factory and place of work, the same would come under the purview of entertainment expenditure as per provisions of the Act.Hence, out of the expenditure of Rs. 1,48,591, an amount of Rs. 24,471 only (calculated at the prescribed rate on the profits of the company) should have been allowed as admissible entertainment expenditure and the balance amount of Rs.1,24,120 was required to be disallowed. This having not been done there resulted an under-assessment of income of Rs. 1,24,120 to leading under charge of tax of Rs. 1,12,365 (including short levy of interest of Rs.34,169 for short payment of advance tax) for the assessment year 1985-86

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. In the assessment of a public company for the assessment year 1984-85 made in March 1987, entertainment expenditure of Rs 1,86,148 debited to profit and loss account was allowed in full instead of restricting it to the maximum permissible limit of Rs. 50,000. The mistake resulted in under-assessment of income of Rs. 1,36,148 with consequent tax under charge of Rs. 89,612 (including short levy of interest of Rs. 1,058 and Rs. 9,929 for late filing of return and non submission of estimate of advance tax respectively).

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

3.19 Incorrect allowance of bad debts

1. Under the provisions of Income-tax Act, 1961, the amount of any debt or part thereof or any irrecoverable dues which is established to have become bad in the previous year and written off in the accounts shall be allowed as deduction in computing the business income of the assessee.

An assessee company had debited a sum of Rs. 4,08,572 in its profit and loss account for the year relevant to the assessment year 1984-85 as provision for doubtful debts and the same was allowed as a deduction by the Deputy Commissioner of Income-tax in the assessment made in March 1987. As the sum represented only a provision and had not thus been established to have become a bad debt, it was not deductible. The mistake resulted in under assessment of income of Rs. 4,08,572 with consequent short levy of tax of Rs. 3,35,618 (including interest for short payment of advance tax).

The Ministry of Finance have accepted the objection.

2. The Act as amended by Finance Act, 1985 with effect from 1 April 1985, provided that in respect of any provision for bad and doubtful debts made by a scheduled bank or a non-scheduled bank an amount not exceeding ten per cent of the total income (before making any deduction under this provision and Chapter VI-A) or an amount not exceeding two per cent (one and a half per cent upto the assessment year 1984-85) of the aggregate average advances made by the rural branches of such bank, computed in the prescribed manner, whichever is higher, shall be allowed in computing the business income of the assessee.

For the assessment year 1985-86, a domestic banking company claimed a deduction of Rs. 64,02,064 towards provision for bad and doubtful debts in respect of advances made by its rural branches, in the return of income filed in June 1985. In January 1986 the assessee revised upwards the claim for deduction to Rs. 85,36,064 in view of the enhanced rate of deduction (1.5 per cent to 2 per cent) provided in the Finance Act, 1985. In the assessment completed by the Deputy Commissioner of Income-tax (Assessment) in August 1986 the deduction of Rs. 85,36,064 was allowed in full notwithstanding the fact that the assessee company had created a provision in account for Rs. 64 lakhs only in this regard. The amount of deduction allowable was required to be limited to Rs. 64 lakhs since the creation of provision for bad and doubtful debts to the required extent is a precondition to the allowance of such deduction. Omission to do so resulted in excess carry forward of unabsorbed depreciation of Rs. 21,36,085 involving a potential tax effect of Rs. 12,33,592.

The Ministry of Finance have accepted the objection.

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3.20 Incorrect deduction of loss on account of fluctuations in the rate of exchange

The loss arising on account of fluctuations in the exchange rate of foreign currency with reference to Indian rupees is to be treated as capital expenditure. The Ministry of Law clarified in October 1984, that exchange loss arrived at on the basis of fluctuations in the rate of exchange and not backed by actual remittance, cannot be allowed as a deduction in computing the total income under the Income-tax Act.

During the previous year relevant to assessment year 1984-85, an assessee company debited in its accounts a sum of Rs. 2,43,16,000 towards exchange loss due to fluctuation in rate of exchange and the same was allowed as deduction in the assessment for the assessment year 1984-85 completed in February 1988. Since there was no actual remittance of foreign currency during the previous year and loss having arisen due to fluctuation in the rate of exchange on the first and last day of the accounting year, the allowance of exchange loss as a deduction in the computation of business income was not in order. The mistake resulted in under assessment of income by Rs. 2,43,16,000 with consequent excess carry forward of loss of an identical amount involving potential tax effect of Rs. 1,40,42,490.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3.21 Omission to disallow excessive expenditure on advertisement, publicity and sales promotion, etc.

Under the provisions of the Income-tax Act, 1961, as applicable during the period 1 April 1984 to 31 March 1986, where the aggregate expenditure incurred by an assessee on advertisement, publicity and sales promotion, running and maintenance of air crafts or motor cars and payments made to hotels exceeds one hundred thousand rupees, twenty per cent of such excess shall not be allowed as deduction in computing the income chargeable under the head 'profits and gains of business or profession'.

1. In the assessment of a public company for the assessment year 1984-85 completed in March 1987, the assessing officer disallowed a sum of Rs. 1,80,000 representing 20 per cent of the estimated motor car expenses in excess of Rs. 1 lakh. The assessing officer estimated the above expenditure for the purpose of disallowance as the assessee company had not furnished the details of expenditure incurred by it. For the assessment year 1985-86 the auditor's report indicated the expenditure towards advertisement, publicity and running and maintenance expenses of motor cars and payments to hotels in that year. The turnover for the assessment year 1984-85 was more or less the same as for the assessment year 1985-86 and as such, expenditure on the above head in assessment year 1984-85 were also more or less the same as in the assessment year 1985-86. In the return of income for the assessment year 1985-86 the assessee company had added back a sum of Rs. 28,73,828 representing 20 per cent of the expenditure in excess of Rs. 1 lakh i.e. Rs. 1,43,69,142 being expenses incurred for maintenance of motor cars. Accordingly the estimated disallowance of Rs. 1,80,000 for the assessment year 1984-85 was on the low side. The return of income for the assessment year 1985-86 was filed in December 1985 i.e., much before the date of assessment for the assessment year 1984-85. However this escaped the notice of the assessing officer. Omission to do so resulted in under assessment of income of Rs. 36,26,527 in the assessment year 1984-85 with consequent undercharge of tax of Rs. 23,88,001 (inclusive of short levy of interest of Rs. 28,269 and Rs. 2,65,414 for late filing of return and non payment of advance tax).

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

2. In the computation of business income of a private limited company for the assessment year 1985-86 made in March, 1988 (revised in July 1988) the Inspecting Assistant Commissioner (Assessment) disallowed a sum of Rs. 20,96,305, being 20 per cent of aggregate expenditure in excess of Rs. 1 lakh, incurred on advertisement, publicity and sales promotion. It was, however, noticed from the details of such expenditure filed by the company that the assessee had incurred further expenditure aggregating to Rs. 11,40,048 on calendar, magazines and diaries. The said amount of Rs. 11,40,048 was allowed in full. The said expenditure was debited to the profit and loss account under the head 'advertisement, publicity and sales promotion'. As the expenditure was, obviously incurred in connection with the advertisement, publicity and sales promotion, a further sum of Rs. 2,28,010 being 20 per cent of Rs. 11,40,048 was required to be disallowed under the provision of the Act. Further the disallowance on the similar expenditure was made by the department itself in the assessment of the same assessee for the assessment year 1984-85 revised in June 1988. Omission to disallow the expenditure in the assessment year 1985-86 resulted in under assessment of income of Rs. 2,28,010 with consequent tax under-chage of Rs. 2,06,471 (including short levy of interest of Rs. 62,825 for short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3. While completing the assessment of a private limited company for the assessment year 1984-85 in February 1987, the assessing officer made a disallowance of Rs. 10,041 only in respect of an expenditure aggregating to Rs. 11,67,965 incurred by the assessee on advertisement, exhibition, commission, maintenance of car, etc. However, the correct amount of the disallowance worked out to Rs. 2,13,593 being 20 per cent of Rs. 11,67,965 minus Rs. 1,00,000. The omission to disallow the balance amount of Rs. 2,03,552 resulted in under-assessment of income of Rs. 2,03,552 involving, a tax effect of Rs. 1,80,816 (including interest for short payment of advance tax).

The Ministry of Finance have accepted the objection.

4. While completing the assessment of a Government Company for the assessment year 1985-86 in February 1988 the assessing offier made a disallowance of Rs. 5,71,182 only in respect of an expenditure aggregating to Rs. 50,61,073 incurred by the assessee on advertisement, sales promotion, etc., whereas the disallowance worked out to Rs. 9,92,214, being 20 per cent of Rs.

49,61,071 after allowing initial deduction of Rs. 1,00,000 from the total expenditure. The mistake resulted in excess computation of loss by Rs. 4,21,032 involving potential tax effect of Rs. 2,43,145. While taking rectificatory action in March 1989 at the instance of audit the department redetermined the expenses of the nature of advertisement, sales promotion, etc. at Rs. 45,77,693 and computed the disallowance at Rs. 8,55,540 and accordingly reduced the loss by Rs. 2,84,388 having notional tax effect of Rs. 1,64,236.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

5. In the assessment of a public limited company for the assessment year 1985-86 made in January 1988 and revised in March 1988, the Inspecting Assistant Commissioner (Assessment) disallowed a sum of Rs. 23,98,826 being 20 per cent of aggregate expenditure in excess of Rs. 1 lakh, incurred on advertisement, publicity and sales promotion, etc. It was, however, noticed from the tax audit report appended to the accounts of the relevant previous year that the company had incurred further expenditure aggregating to Rs. 10,20,561 on repairs, insurance, garage rent, salaries and bonus to drivers and other expenses on motor cars. The said amount of Rs. 10,20,561 was allowed in full, as claimed by the company. Since the aforesaid expenditure was obviously incurred in connection with the running and mintenance of motor cars, a further sum of Rs. 2,04,112 being 20 per cent of Rs. 10,20,561 was required to be disallowed under the provisions of the Act. Omission to do so resulted in under-assessment of income of Rs. 2,04,112 leading to short levy of tax of Rs. 1,52,369 (including under-charge of surtax of Rs. 34,495) in the assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

6. In the assessment of a non-resident company, for the assessment year 1985-86, completed in March 1988, the miscellaneous expenses debited to the profit and loss account included an amount of Rs. 3,09,914 on account of car hire expenses. Further an amount of Rs. 3,92,323 though debited as travelling expenses actually represented hotel expenses. Under the provisions of the Act, 20 per cent of the expenditure amounting to Rs. 7,02,237 in excess of one hundred thousand rupees was required to be disallowed. The omission to do so resulted in under-assessment of income of Rs. 1,20,447 involving short levy of tax of Rs. 1,27,244 (including interest for short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

7. In the assessment of a public limited company for the assessment year 1985-86 completed in March 1988, the Inspecting Assistant Commissioner (Assessment) disallowed a sum of Rs. 24,48,226 being twenty per cent of aggregate expenditure in excess of Rs. 1 lakh, incurred on advertisement, publicity and sales promotion, etc. It was, however, noticed from the details of such expenditure furnished by the company that it incurred further expenditure aggregating to Rs. 10,45,799 on repairs, insurance and garage rent on motor cars. This amount of Rs. 10,45,799 was allowed in full, as claimed by the company. Since the aforesaid expenditure was obviously incurred in connection with the running and maintenance of motor cars, a further sum of Rs. 2,09,160 being twenty per cent of Rs. 10,45,799 was required to be disallowed under the provisions of the Act. Further, the department itself had disallowed the similar expenditure on motor cars in the assessment of the same assessee for the assessment year 1984-85 (assessment made in February 1987 and last revised in March 1988). Omission to disallow the expenditure in the assessment year 1985-86 resulted in under-assessment of income of Rs. 2,09,160 leading to short levy of tax of Rs. 1,16,476 (including interest of Rs. 1,438 for late filing of return).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

8. A closely held domestic company incurred during the previous year relevant to assessment years 1984-85 and 1985-86, expenditure of Rs. 4,37,423 and Rs.3,01,534 respectively on advertisement, publicity, sales promotion, conveyance and hotels, etc. In tax audit report for the year 1985-86, mention was made of this expenditure incurred by the assessee (for the assessment year 1985-86) under different items which was, however, worked out in audit from the details of expenditure furnished along with the return for assessment year 1984-85. As the aggregate expenditure on advertisement, publicity, running and maintenance of car including conveyance to directors, payments to hotels and sales promotion during the above two assessment years exceeded one hundred thousand rupees, 20 per cent of this expenditure in excess of statutory limit was required to be disallowed in computing the business income of the company. In the assessment for assessment years 1984-85 and 1985-86 (March 1987) the assessing officer, however, did not disallow the excess expenditure on this account. The omission resulted in under-assessment of income of Rs. 67,484 and Rs. 40,306 in the above two assessment years involving under charge of tax aggregating to Rs. 1,09,354 (including interest of Rs. 3,022 for late filing of return and interest of Rs. 32,667 for short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

9. In the assessment of a company for the assessment year 1984-85 completed in February 1987 and rectified in May 1987, a sum of Rs. 5,99,644 was disallowed by the department out of aggregate expenditure of Rs. 30,98,222 on advertisement, sales promotion and motor car expenses. It was noticed in audit in February 1988 that a further sum of Rs. 8,38,896 was debited in the accounts towards repairs to motor cars. The assessing officer, however, omitted to consider this amount also while making the disallowance although he had kept a note of this amount in the respective schedule. The omission to do so resulted in under

assessment of income by Rs. 50,334 and excess carry forward of unabsorbed investment allowance by Rs. 1,17,446 involving undercharge of tax of Rs. 1,08,783 (including excess payment of interest of Rs. 11,890 and potential undercharge of tax of Rs. 67,825).

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

10. While assessing the income of a private limited company, for the assessment years 1984-85 and 1985-86 in April 1986 and October 1986 respectively, expenditure aggregating to Rs. 4,06,890 for assessment year 1984-85 and Rs.5,12,397 for assessment year 1985-86, on publicity maintenance of vehicles and hire charges of vehicles, was allowed in full as claimed by the assessee, without disallowing twenty per cent of the expenditure in excess of Rs. 1 lakh each year. Such disallowance worked out to Rs. 61,378 and Rs. 82,479 for the assessment years 1984-85 and 1985-86, respectively. The mistake resulted in a potential tax effect of Rs. 41,892 for assessment year 1984-85 and under charge of tax of Rs. 98,185 for assessment year 1985-86.

The Ministry of Finance have accepted the objection.

3.22 Incorrect allowance of expenditure on guest house

Under the provisions of the income-tax Act, 1961, no deduction is allowed in respect of any expenditure incurred by an assessee after 28 February 1970 on the maintenance of any residential accommodation in the nature of guest houses. The Act was amended restrospectively with effect from April 1979 by the Finance Act, 1983, to include any accommodation by whatever name called, arranged by the assessee for the purpose of providing lodging or boarding and lodging to any person (including an employee or company director) on tour or visit to the place at which such accommodation is situated.

1. During the previous year relevant to the assessment year 1984-85 an assessee company maintained several guest houses at different places. The assessee did not furnish the details of expenditure on guest houses. The assessing officer while making the assessment in March 1987, for the assessment year 1984-85 estimated the disallowance at Rs. 2,44,000 on this account. The assessee on its own accord added back guest house-expenses of Rs. 38,74,373 to its total income for the assessment year 1985-86. It was further noticed that the turnover for the assessment year 1984-85 was more or less similar to that of the assessment year 1985-86. It was, therefore, obvious that the disallowance of expenditure incurred towards guest house for the assessment year 1984-85 was on the low side and expenditure of Rs. 38,74,373 could have been disallowed in the assessment for the assessment year 1984-85 also instead of Rs. 2,44,000 only actually disallowed by the assessing Officer. The mistake resulted in under assessment of income of Rs. 36,30,373 with consequent under charge of tax of Rs. 23,90,549 (inclusive of short levy of interest of Rs. 28,300 and Rs. 2,65,710 for late filing of return and non payment of advance tax respectively).

The department has accepted the objection in principle.

The paragraph was referred to the Ministry of Finance for comments in June, 1989; the reply from the Government has not so far been received (October 1989).

2. In the assessment of a private limited company for the assessment year 1985-86, the assessment of which was completed by the Inspecting Assistant Commissioner (Assessment) in March 1988 and revised in July 1988, an expenditure of Rs. 11,31,979 incurred on rates and taxes, electric charges, telephone expenses, staff mess and water charges, etc., in connection with the maintenance of its guest houses outside India, was allowed as deduction, as claimed by the company. Since no deduction in respect of any expenditure incurred on the maintenance of guest house was admissible as per provisions of the Act, the incorrect deduction allowed resulted in under-assessment of income by Rs. 11,31,979 leading to under charge of tax of Rs. 11,94,488 (including short levy of interest of Rs. 1,69,361 and Rs. 3,11,981 for late filing of return and short payment of advance tax respectively).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3. In the assessment of a non-resident company for the assessment year 1985-86 (completed in March 1988) expenditure incurred for hiring of rooms for more than 182 days in a hotel for residence of employees was allowed as a deduction while computing the total income. As this hired hotel accommodation was in the nature of a guest house, the expenditure incurred thereon should have been disallowed. The omission to do so resulted in under-assessment of income of Rs. 6,73,855 involving short levy of tax of Rs. 7,11,932 (including interest of Rs. 2,16,650 for short payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3.23. Incorrect allowance of provisions

Under the Income-tax Act, 1961, any expenditure laid out or expended wholly and exclusively for the purpose of business or profession shall be allowed in computing the business income of an assessee provided the expenditure is not of a capital nature or personal expenses of the assessee. A provision made in the accounts for an accrued or known liability is an admissible deduction, while other provisions made do not qualify for deduction.

1. A private limited company debited in its profit and loss account for the previous year relevant to the assessment year 1979-80 an amount of Rs. 42,72,953 being'provisons for tank repairs'. It was however, noticed in audit that the actual expenses incurred during the year on such repairs were only Rs. 1,14,953. While computing the taxable income in February 1987 the assessing officer, however, allowed the entire provision of Rs. 42,72,953 and a further sum of Rs. 2,29,906 (double of Rs. 1,14,953) as deduction. As the amount taken to the provision for 'tank repair account' was merely a provision and not an ascertained liability it was not an allowable deduction. Further, the assessing officer erroneously allowed twice the amount of the

actual expenses incurred on the repair of the tank. The mistake resulted in an aggregate under-assessment of income of Rs. 43,87,906 with consequent undercharge of tax of Rs. 37,04,243 (including interest of Rs. 9,39,862 for short payment of advance tax in assessment year 1979-80).

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

2. In the case of a limited company for the assessment years 1982-83 and 1983-84 (assessments completed in November 1985 and June 1986 respectively), the Inspecting Assistant Commissioner (Assessment) allowed deductions of Rs. 16,65,850 and Rs. 17,89,439 on account of provision for amortisation of sunk cost of mining equipment. This being merely a provision did not qualify for deduction and was required to be disallowed. Omission to do so resulted in excess computation of loss by Rs. 34,55,289 involving potential tax effect of Rs. 19,47,920.

The Ministry of Finance have accepted the objection.

3. In the case of a limited company for the assessment year 1984-85, completed by the Inspecting Assistant Commissioner in November 1986, a deduction of Rs. 7,98,263 being provision for amortisation of sunk cost of mining equipment was allowed. As this was merely a provision it did not qualify for deduction and was required to be disallowed. The omission to do so resulted in excess computation of loss by Rs. 7,98,263 involving potential tax effect of Rs. 4,60,995.

The Ministry of Finance have accepted the objection.

4. A widely held company regularly debited in its profit and loss account with the actual amount of consumption of stock. The provision for stock was debited or written back under a separate head. The former was allowed as deduction in the computation of income and the latter was added back to the business income. In the assessment for the assessment year 1984-85, completed in March 1987, the assessing officer, however, omitted to disallow the amount of Rs. 7,16,300 debited in the profit and loss account under the head 'provision for stock' while allowing deduction on account of actual consumption of stock debited to profit and loss account. The omission to disallow the provision led to excess computation and excess carryforward of business loss of Rs. 7,16,300 for the assessment year 1984-85 involving potential tax effect of Rs. 4,13,663.

The Ministry of Finance have accepted the objection.

5. The assessment of a widely held company for assessment year 1981-82 was originally completed in December 1983 (revised in June 1984, March 1987, October 1987 and January 1988) allowing a total deduction of Rs. 15,79,473 as actual payments towards bonus and incentive. The scrutiny of assessment records for assessment year 1980-81, however, revealed (October 1988) that a sum of Rs. 6,50,145 representing provision made in the accounts towards incentive payments was allowed in assessment year 1980-81. The above sum of Rs. 6,50,145 was again allowed in the assessment for assessment year 1981-82 on actual payment basis included in the total of Rs. 15,79,473. The double deduction of the same amount resulted in under-assessment of income of Rs. 6,50,145 for assessment year 1981-82 involving an undercharge of tax of Rs. 3,99,770 (including short levy of interest for belated filing of return).

The Ministry of Finance have accepted the objection.

6. The assessments of a private limited company for the assessment years 1982-83 to 1985-86 were completed between June 1984 and August 1985 computing 'nil' income for the assessment year 1982-83, loss of Rs. 17,116 and Rs. 5,230 for the assessment years 1983-84 and 1984-85 respectively and 'nil' income for the assessment year 1985-86. While computing the taxable income the assessee's claim for deduction of interest payable to another company was allowed by the department in the respective assessments. However, the said amount was not provided for in the accounts on the ground that the assessee was disputing the interest liability in the courts of law. As the liability to pay interest had not crystallised till the decision of the court, the amount of interest was merely a contingent liability and not an ascertained liability to be allowed as deduction. The incorrect allowance of deduction resulted in under-assessment of income aggregating to Rs. 4,38,922 for the assessment years 1982-83 to 1985-86 involving short levy of tax of Rs. 3,23,988 (including interest of Rs. 27,894 for short payment of advance tax).

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

7. A public limited company debited an amount of Rs. 3,50,000 in its profit and loss account on account of provision for golden jubilee celebrations in the previous year relevant to the assessment year 1984-85 and the same was allowed by the department as a business expenditure while completing assessment in January 1987. As the amount was merely a provision for a possible payment at a future date, it did not qualify for deduction and was required to be disallowed. The omission to do so resulted in under-assessment of income of Rs. 3,50,000 involving a short levy of tax of Rs. 3,16,899 (including interest of Rs. 1,14,776 for late filing of return and short payment of advance tax.

The Ministry of Finance have accepted the objection.

8. A public limited company debited in its accounts for the year relevant to the assessment year 1985-86 a sum of Rs. 3,49,575 towards 'Price Insurance Account', which was taken as a reserve under reserves and surpluses and shown as liability in the balance sheet. While computing the taxable income the Deputy Commissioner of Income-tax (Assessment) allowed the provision as deduction. As the amount was merely a provision and not an ascertained liability, it was not an allowable deduction. The mistake resulted in excess refund of Rs. 2,82,602.

The Ministry of Finance have accepted the objection.

9. While completing the assessment of a Government undertaking for the assessment year 1984-85 in August

1986, the assessing officer allowed full deduction in respect of a provision of Rs. 2,47,91,444 made by the assessee against actual payment of Rs. 2,43,68,491 on account of bonus. The excess provision of Rs. 4,22,953 made by the assessee was required to be disallowed. The omission to do so resulted in excess computation of loss by Rs. 4,22,953 involving a potential tax effect of Rs. 2,44,253.

The Ministry of Finance have accepted the objection.

10. A private limited company following cash system of accounting for royalty payments debited in its accounts for the previous year relevant to the assessment year 1985-86, a sum of Rs. 2,89,950 towards royalty payments. Audit scrutiny of the accounts revealed that the amount of Rs. 2,89,950 merely represented a provision for the same and not actual payment. Since the assessee company was following cash system of accounting for royalty, the provision for royalty payable should have been disallowed. No such disallowance was, however, made by the assessing officer in the assessment order for the assessment year 1985-86 made in December 1987. Omission to do so resulted in under assessment of income of Rs. 2,89,950 with consequent short levy of tax of Rs. 1,82,668.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

11. A company debited an estimated amount of Rs. 19.84 lakhs in its accounts for the previous year relevant to the assessment year 1985-86 on account of provisions for obsolescence stores and the same was allowed by the Deputy Commissioner of Income-tax (Assessments), in the assessment completed in February 1988. The provision for loss on account of obsolescence stores was only a mercantile provision and not an actual loss to be allowed as deduction. The incorrect allowance resulted in under-assessment of income-of Rs. 19.84 lakhs with consequent undercharge of tax of Rs. 18,57,337 (including interest).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

12. The assessment of a public company for the assessment year 1985-86 was completed in March 1988 at a loss of Rs. 26,55,378. It was, however, noticed in audit that the company had debited in its profit and loss account for the year ending 31 March 1985 relevant to the assessment year 1985-86, an amount of Rs. 19,68,000 being 'Provision for obsolete inventory'. While computing the taxable income, the assessing officer allowed this provision as deduction. As the amount was merely a provision and not an ascertained liability, it was not an allowable deduction. A similar provision was disallowed in the assessment of the same company for the assessment year 1983-84 completed in March 1986, and this was upheld by the appellate authority in March 1988. The mistake resulted in under-assessment of income of Rs. 19,68,000 and consequent excess computation and carry forward of loss by the same amount in the assessment year 1985-86 involving a potential tax effect of Rs. 11,36,520.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

13. In the case of a private limited company, provisions for warranty and field services and for the work to be executed for customers aggregating to Rs. 18,73,602 were debited in its accounts relevant to the assessment year 1984-85. In the assessment completed in September 1986 for the assessment year 1984-85, the Inspecting Assistant Commissioner (Assessment) allowed deduction for these provisions. As the provisions did not represent ascertained liabilities, they should have been disallowed. Omission to do so resulted in under-assessment of income by Rs. 18,73,602 leading to short levy of tax of Rs. 10,82,005.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3.24 Omission to disallow the value of perquisite

Under the provisions of Income-tax Act, 1961, any expenditure incurred by a company which results directly or indirectly, in the provision of any remuneration, benefit or amenity to a director, who is also an employee of the company, is not allowable as deduction from business income to the extent such expenditure is in excess of Rs. 72,000 (Rs. 1,02,000 with effect from 1 April 1985) during the previous year comprising more than 11 months.

During the previous years relevant to the assessment years 1983-84, 1984-85 and 1985-86, a company paid sums of Rs. 1,46,527, Rs. 5,21,800 and Rs. 4,29,732 respectively by way of perquisites and remuneration to its directors. In the assessments for the assessment year 1983-84 completed in February 1984 and for the assessment years 1984-85 and 1985-86 in March 1987 respectively the expenditure on account of perquisite and remuneration as above were allowed in full without restricting the same to Rs. 1,44,000 for two directors in assessment year 1983-84, and Rs. 4,32,000 for six directors in assessment year 1984-85 and Rs. 4,08,000 for four directors in the assessment year 1985-86. The mistakes resulted in under-assessment of income aggregating to Rs. 1,14,059 involving undercharge of tax of Rs. 1,06,534.

The paragraph was referred to the Ministry of Finance for comments in April 1989, the reply from the Government has not so far been received (October 1989).

3.25 Incorrect deduction in the computation of business income

Under the Income-tax Act, 1961, as amended by the Finance Act 1986, with retrospective effect from 1 April 1974, interest capitalised and forming part of the actual cost of the assets will be allowed as revenue expenditure only after such assets are first put to use. However, the actual cost of such assets will be reduced by the interest element and the net value thus arrived at will qualify for the grant of depreciation and investment allowance. Further, during the period such assets bearing interest are not put to use, the interest element so capitalised will not be allowed as revenue expenditure.

In the assessments of a public limited company for the assessment years 1983-84 and 1984-85 completed by the Inspecting Assistant Commissioner (Assessment) in July 1986 and December 1987 (revised in January 1988) respectively sums of Rs. 1,72,53,457 and Rs. 1,47,48,922 being the capitalised interest on borrowed moneys paid or payable for acquiring plant and machinery held under the head 'capital work in progress' were allowed as revenue expenditure in the respective assessments. It was, however, noticed in audit that the said plant and machinery were not put to use in the previous years relevant to the assessment years 1983-84 and 1984-85. Since the plant and machinery were not put to use in the relevant previous years, the company was not entitled to deductions on account of the aforesaid capitalised interest. Hence, the allowance of Rs. 1,72,53,457 and Rs. 1,47,48,922 as revenue deduction in the assessment years 1983-84 and 1985-86 respectively was not in order. The incorrect allowance of deductions resulted in under-assessment of business income of Rs. 1,72,53,457 and Rs. 1,47,48,922 in the assessment years 1983-84 and 1984-85 respectively leading to under-charge of tax of Rs. 97,26,636 in the assessment year 1983-84 and excess computation and carry forward of loss of Rs. 1,47,48,922 in the assessment year 1984-85 involving potential tax effect of Rs. 85,17,502.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.26 Incorrect allowance of liabilities

Under the provisions of the Income-tax Act, 1961, as applicable from the assessment year 1984-85, in computing the business income of an assessee a deduction for any sum payable by the assessee by way of tax duty under any law for the time being in force or for any sum payable by him as an employer by way of contribution to any provident fund or superannuation or gratuity or any other fund for the welfare of the employees, will be allowed out of the income of the previous year in which such sum is actually paid irrespective of the method of accounting employed by the assessee. In other words, these deductions are admissible only on actual payment and not on accrual basis.

In the assessments of 20 companies for the assessment years 1984-85 to 1985-86 assessed in 14 different Commissioner's charges between August 1986 to March 1988 the assessing officers erroneously allowed deductions amounting to Rs.498.06 lakhs in respect of unpaid liabilities on account of Central/State Sales Tax, Central/State Excise duty, contribution to provident funds, superannuation Funds, etc., which were outstanding in the balance sheets as unpaid liability at the end of the relevant previous years. The omission to add back the unpaid liabilities resulted in under charge of tax aggregating to Rs.301.96 lakhs (including potential tax effect and short/non-levy of interest). The details of the cases are as under:

Sl. No.	Name of the assessee	Assessment year	Amount of unpaid liability	Tax effect
	CIT Charge			
1	A Delhi I	1985-86	2,78,78,458	1,60,99,810 (Potential)
2	B Delhi III	1984-85	55,55,948	32,08,560 (Potential)
3	C Andhra Pradesh I	1984-85	30,68,953	17,72,319 (Potential)
4	D West Bengal II	1984-85	27,35,595	4,73,942 1,94,316 11,05,865 (Potential)
5	E West Bengal VI	1985-86	18,52,753	10,69,964 (Potential)
6	F West Bengal XI	1985-86	13,81,827	7,98,005
7	G West Bengal II	1984-85	12,00,804	3,29,077 4,19,286 (Potential)
8	H Bombay City I	1985-86	7,61,000	6,04,252
9	I Orissa	1984-85	5,81,533	5,21,168
10	J Ranchi Bihar	1985-86	12,62,502	3,97,837 4,81,842 (Potential)
11	K Bombay City V	1984-85	6,78,388	4,27,384 (Potential)
12	L Delhi III	1984-85	4,76,390	3,98,010
13	M Bombay City V	1985-86	3,97,110	3,69,013

14	N Bombay City III	1985-86	5,24,008	3,30,125
15	O Jaipur	1984-85	3,12,796	3,12,185
16	P Delhi III	1984-85	3,93,598	2,47,965 (Potential)
17	Q Jaipur	1984-85	3,38,357	2,30,928
18	R West Bengal IV	1984-85	2,17,815	1,84,290
19	S Bombay City IV	1985-86	1,90,556	1,20,050
20	T West Bengal IV	1984-85 and 1985-86	97,569	1,00,335

The paragraphs were referred to the Ministry of Finance for comments between April 1989 to August 1989. The Ministry of Finance have accepted the objection in four cases. The replies from the Government in the remaining cases have not so far been received (October 1989). However, the department has accepted the objection in ten cases.

3.27 Other mistakes in the computation of business income

1. According to the terms and conditions between a company and its certificate holders in the event of death of a certificate holder after six months from the date of acceptance of the concerned proposal, the subscription (deposit) paid was to be refunded to the legal heirs of the deceased without any interest paid thereon. The first year's subscription received from the certificate holders less refund made and also less provision for refund was credited by the assessee company to its profit and loss account and the same was duly taxed. The provision for refund was credited to a fund styled 'Welfare Endowment Certificate Fund' and the same was exhibited on the liability side of the Balance Sheet. Interest on the balance standing to the credit of the aforesaid fund was credited to the said fund every year by contra-debit to the profit and loss account. The interest (paid) as debited to profit and loss account was allowed as deduction in the relevant assessment.

As according to the terms and conditions between the assessee and the certificate holders subscriptions were to be refunded in case of death after six months of acceptance of proposal but without paying any interest thereon, there was no legal liability on the part of the assessee to pay interest and also because no interest was actually paid by the assessee on refund made, allowance of interest as deduction was not in order. This led to under assessment of income by Rs.1,42,74,436 in aggregate for the assessment years from 1980-81 to 1983-84 (assessed by the Inspecting Assistant Commissioner during September 1983 and March 1987) and led to undercharge of tax of Rs.1,35,83,766 (inclusive of interest of Rs. 34,63,374 and Surtax of Rs. 5,28,457).

The Ministry of Finance have accepted the objection.

2. In the assessment of a widely held company for assessment year 1984-85 originally completed in March 1987 and revised in March 1988, a sum of Rs.30,84,238 being the difference between the provision for bonus made and actual payment made and added back by the assessee himself in the adjustment statement was omitted to be reckoned in the computation of business income. This resulted in short computation of income of Rs.16,80,347 for assessment year 1984-85 (after applying the provision regarding minimum tax on pre-incentive total income) and the balance of Rs. 14,03,897 for assessment year 1985-86 involving an aggregate short levy of tax of Rs. 17,81,142 for the two assessment years.

The Ministry of Finance have accepted the objection.

3. Under the Income-tax Act, 1961, 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 assessee had obtained whether in cash or in any other manner whatsoever any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount obtained by him or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession chargeable to income-tax as the income of that previous year.

A company running a sick industry in West Bengal executed a scheme of compromise/or arrangement with its creditors. The Director's Report annexed with the company's accounts relevant to the assessment year 1980-81 showed that the financial effect of the scheme of compromise/and/or arrangement sanctioned by the High Court in March 1979 was shown in the accounts for the year relevant to the assessment year 1980-81. As part of this scheme of compromise, a trading liability on account of outstanding bank interest amounting to Rs. 1,30,00,139 was waived. The company had credited the amount in its profit and loss Appropriation account relevant to the assessment year 1980-81. It was further seen that the entire amount of outstanding interest was allowed as deduction in the assessment for the assessment years 1978-79 and 1979-80. As the trading liability allowed earlier was remitted in the previous year relevant to the assessment year 1980-81, the same should have been deemed as income for the year. Omission to include the same in the assessment made in September 1983 for 1980-81, resulted in under-assessment of income of Rs. 1,30,00,139 and undercharge of tax of Rs. 16,52,940 and excess carry forward of loss of Rs. 1,02,04,468 involving a further potential tax effect of Rs. 60,33,391.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4. Investment in securities by banks is incidental to carrying on of the business of banking business and the securities do not constitute stock-in-trade of the business. Any loss arising on revaluation of the investment is, therefore, only a notional loss and not a loss actually sustained by the banks during the course of business and is not an allowable deduction.

A non-resident banking company had made investments in securities. The investments were valued by the bank at cost or market price, whichever is the lower at the end of each year and the resultant loss due to revaluation was debited to the relevant profit and loss account. In the previous year relevant to the assessment year 1983-84, the adjustment towards losses amounting to Rs. 16,73,367 on revaluation of securities was debited in the profit and loss account, which was allowed also as deduction in the assessment completed in February 1986 as claimed. As the loss was a notional loss and not one on account of any actual loss sustained in the business, the claim for deduction was required to be disallowed. Omission to do so resulted in under-assessment of income of Rs. 16,73,367 involving short levy of tax of Rs. 13,35,708 (including interest for short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in January 1989; the reply from the Government has not so far been received (October 1989).

5. While computing the income of an assessee, the assessing officer normally proceeds with the income as computed by the assessee as the starting point and then makes necessary adjustments by way of additions and deletions, in keeping with the provisions of the Act and rules to arrive at the total taxable income.

(i) The assessment of a public sector company for the assessment year 1983-84 was completed in February 1986 determining a loss of Rs. 15,23,92,026. In the assessment the assessing officer allowed a deduction of Rs. 12,43,449 towards loss representing excess of expenditure over receipts incurred under the head 'prior period adjustments'. Audit scrutiny (July/August 1986) revealed that the amount of Rs. 12,43,449 was not a deficit and was in fact a surplus (excess of receipts over expenditure) under the aforesaid head which was wrongly determined as a loss. The omission resulted in over computation of loss by Rs. 24,86,898 (Rs. 12,43,449+Rs. 12,43,449) involving notional tax effect of Rs. 14,01,988.

The Ministry of Finance have accepted the objection.

(ii) During the previous year relevant to the assessment year 1985-86, an assessee company debited in its accounts a sum of Rs. 1,92,990 towards donation. As the net income for the assessment year 1985-86 was a minus figure, the amount of donations of Rs. 1,92,990 was required to be deducted from the net loss as an inadmissible expenditure and amount admissible allowed thereafter. While completing the assessment in March 1988, the donation of Rs. 1,92,990 was, however, not considered by the assessing officer.

It was also noticed in audit in September 1988 that there were no receipts in support of donation paid and no deduction was admissible. The mistake resulted in excess computation of loss to the extent of Rs. 1,92,990 and potential short levy of tax of Rs. 1,21,583.

The Ministry of Finance have accepted the objection.

(iii) An assessee company had debited in its profit and loss account for the year ending 31 March 1985 relevant to the assessment year 1985-86 an amount of Rs. 2,08,000 towards donation. In computing the business income of the company for the assessment year 1985-86 in March 1988 the assessing officer, however, did not add back the said sum of Rs. 2,08,000 for separate consideration of deduction, if any, on donation. Since the gross total income for the year was assessed at a loss, the company was not entitled to any deduction on account of donation. The omission to add back the sum of Rs. 2,08,000 towards donation, charged in the accounts, therefore, resulted in excess computation and carry forward of loss by the same amount in the assessment year 1985-86 involving a potential tax effect of Rs. 1,20,120.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(iv) A Government owned shipping company, was regularly following the accounting procedure of debiting certain payments pertaining to the earlier years made in a particular assessment year to the profits and loss appropriation accounts of the subsequent assessment year. At the time of assessment, the assessing officer was allowing as deduction, in respect of such expenditure, the amount debited in the profit and loss appropriation accounts of the subsequent assessment year. Accordingly, in the assessment year 1983-84, the assessing officer allowed as deduction an amount of Rs. 1,78,14,275 debited in the assessment year 1984-85. In the assessment for the assessment year 1984-85 the amount of Rs. 1,22,80,496 debited in the assessment year 1985-86 was to have been allowed. However, in the assessment completed in March 1987 for the assessment year 1984-85, the assessing officer allowed as deduction the amount of Rs. 1,78,14,275, debited in the accounts relevant to the assessment year 1984-85, which had already been allowed in the assessment year 1983-84. The mistake resulted in excess allowance of deduction of Rs. 55,33,779, involving notional short levy of tax of Rs. 31,95,757.

The Ministry of Finance have accepted the objection.

(v) An assessee company following mercantile system of accounting debited in its accounts for the previous year relevant to the assessment year 1984-85, an amount of Rs. 36,71,000 on account of differential rate of interest not charged by the bank in respective earlier years. While completing the assessment for the assessment year 1984-85 in February 1987 the said sum was allowed by the assessing officer. As the expenditure of Rs. 36,71,000 did not pertain to the previous year relevant to the assessment year 1984-85, the deduction allowed was not in order. The mistake resulted in excess computation and carry forward of business loss of Rs. 36,71,000 involving a potential tax effect of Rs. 21,20,002.

The Ministry of Finance have accepted the objection.

6. The income computed for assessment should be the income actually earned bringing into credit income when it becomes legally due. It has also been judicially held that a claim by a firm to profits from certain sale could not be said to accrue until it was adjudicated and determined in favour of the firm.

The income-tax assessments of awidely held company for the assessment year 1985-86 and 1986-87 were completed by the Deputy Commissioner (Assessment) in March 1987 on a total income of Rs. 49,29,671 and a loss of Rs. 1,67,29,674 respectively. The income determined for assessment year 1985-86 was set off in full against the business loss of Rs. 39,97,265 relating to assessment year 1977-78 and Rs. 9,32,406 relating to assessment year 1978-79. Audit scrutiny in December 1987 revealed that the income assessed for assessment year 1985-86 included a sum of Rs. 2,76,17,000 being the compensation due to the assessee company from one of its contractors for non fulfilment of contract, in pursuance of an arbitration award passed in July, 1984. As the receipt by way of compensation cannot be said to have accrued until the arbitrator gave the award and as the assessee's previous year for the assessment year 1985-86 ended on 30 June 1984, the compensation received against the award passed in July 1984 was rightly assessable as income of the previous year relevant to the assessment year 1986-87 and not that of assessment year 1985-86. Had this been done, the total income for assessment year 1985-86 would have been a loss of Rs. 2,26,87,329 and no part of loss carried forward from the assessment year 1977-78 could have been set off in that year's assessment. Since the business loss cannot be carried forward beyond a period of 8 years, the loss of Rs. 39,97,265 relating to assessment year 1977-78 would have lapsed and could not have been set off in the assessment for the assessment year 1986-87 in which the assessee would have a net taxable income of Rs. 38,21,709 after setting off the unabsorbed depreciation carried forward from assessment years 1979-80, 1983-84 and 1985-86. The incorrect carry forward and set off of loss resulted in short levy of tax of Rs. 20,06,397 for the assessment year 1986-87.

7. In the accounts for the previous year relevant to assessment year 1984-85, an assessee company debited a sum of Rs. 36,71,000 representing expenditure towards payments of interest in respect of earlier years. While completing the assessment for the assessment year 1984-85 in February 1987, the Inspecting Assistant Commissioner (Asstt.) disallowed a sum of Rs. 16,77,037 on the ground that the expenditure was incurred in earlier year. As the system of accounting was mercantile and the assessments for all the earlier assessment years had been completed after considering all the expenditure incurred by the assessee, the entire amount of Rs. 36,71,000 should have been disallowed. The omission to do so resulted in excess carry forward of loss by Rs. 19,93,963 involving potential tax effect of Rs. 11,51,514.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

8. The assessment of a company for the assessment year 1983-84 was completed in January 1986, on a total income of Rs. 36,14,560. It was noticed in audit in August 1986 that 'Manufacturing and other expenses' allowed in the assessment, included a sum of Rs. 13,13,449 which, according to a note in the printed accounts related to earlier years. As the assessee was following the mercantile system of accounting, this was not an admissible deduction in computing the income for the previous year relevant to the assessment year 1983-84. The incorrect allowance of expenditure resulted in under-assessment of income aggregating to Rs. 13,13,449 involving undercharge of tax of Rs. 75,770 in the assessment year 1983-84 and a reduction of loss to be carried forward by Rs. 11,78,617 having a further tax effect of Rs. 6,80,650 in the assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

9. In the assessment of a company, engaged in the operation of ships in coastal and international waters, for the assessment year 1982-83, it was observed that the assessing officer worked out profit on incomplete voyages amounting to Rs. 3,92,042 being the net difference between opening and closing balance of freight, (less expenses) and added it to the assessable income of the assessee. On the same analogy an amount of Rs. 3,38,227, being the difference between the opening and closing balance of freight (less expenses) was required to be added back to the assessable income of the assessee company for the assessment year 1984-85. But in the assessment made in March 1987, the assessing officer did not add back the same. The ommission to do so resulted in excess computation of loss to the extent of Rs. 3,38,227 and consequent short levy of tax of Rs. 2,30,840 (notional).

The Ministry of Finance have accepted the objection.

10. In the case of a public limited company for assessment year 1985-86 (completed in January 1988) the assessee company claimed a deduction of Rs. 2,15,494 on account of expenditure pertaining to earlier years.

While completing the assessment in January 1988, the Inspecting Assistant Commissioner (Assessment) examined this claim of the assessee company and allowed only Rs. 1,23,168 and disallowed the balance. Howeveer in the final computation of income, the assessing officer again deducted the amount of Rs. 2,15,496 from the taxable income. The mistake resulted in under-assessment of income by the like amount involving tax effect of Rs. 1,80,428 (inclusive of interest of Rs. 4,665 for late filing of the return and Rs. 51,315 for under-estimate of advance tax).

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

11. The assessment of a closely held Industrial Company for assessment years 1986-87 and 1987-88 were completed in December 1987 and February 1988 on a total income of Rs. 18,830 and Rs. 7,600 respectively. Audit scrutiny revealed (June 1988) that the assessee company was following mercantile system of account ing and had claimed in the adjusted memo of income for the previous years releant to the assessment years 1986-87 and 1987-88, sums of Rs. 2,60,446 and Rs. 73,678 as expenses relating to earlier assessment years and these expenses were allowed as claimed. Consequent to the allowance of these expenses unabsorbed investment allowance of Rs. 2,60,446 and Rs. 73,678 were allowed to be carried forward for set off in future assessment years. As the expenditure claimed did not relate to the assessment year 1986-87 and 1987-88 the allowance was not in order. The mistake resulted in short computation of income for the assessment year 1986-87 and 1987-88 by Rs. 78, 134 and Rs. 22,103 (at 30 per cent of the pre-incentive income) involving a short levy of tax of Rs. 45,123 and Rs. 11,051 for the two assessment years respectively. It also resulted in excess carry forward of unabsorbed investment allowance by Rs. 1,82,312 and Rs. 51,575 (at 70 per cent of these expenses with a potential tax effect of Rs. 91,156 and Rs. 25,787).

The paragraph was referred to the Ministry of Finance for comments in August 1989, the reply from the Government has not so far been received (October 1989).

12. From the assessment year 1984-85, a deduction otherwise allowable under the Act in respect of any sum payable by the assessee by way of tax or duty under any law for the time being in force shall be allowed only in computing the income of the previous year in which the sum was actually paid by the assessee.

In the case of an assessee, a private limited company, while completing the original assessment for assessment year 1984-85, the assessing officer made an addition of Rs. 1,86,937 on account of unpaid sales-tax liabilities. A sum of Rs. 1,49,692 out of this was, however, allowed as a deduction in the computation of income for the assessment year 1985-86, completed in January, 1988, on the basis of actual payment. On an appeal against the addition made in assessment year 1984-85, the Commissioner of Income tax (Appeals) granted the relief in March 1988 on the ground that the said liabilities were discharged within statutory period allowed in the respective Laws. The appellate decision for the assessment year 1984-85 was given effect on 30 March 1988. But the deduction allowed in the subsequent assessment for assessment year 1985-86, was not withdrawn. Omission to do so resulted in excess allowance of deduction of Rs. 1,49,692 with short levy of tax of Rs. 1,33,205 for assessment year 1985-86 (including additional interest of Rs. 38,900 leviable for default in payment of advance tax).

The Ministry of Finance have accepted the objection.

13. The assessment of a public sector coal company for the assessment year 1981-82 was completed in February 1985 on a loss of Rs. 92,73,22,180. Audit scrutiny revealed that out of an amount of Rs. 4,29,54,751 allowed in the assessment for the assessment year 1981-82, an amount of Rs. 3,13,62,000 was towards expenditure relating to the pre-incorporation period which was being written off separately for the earlier years in the accounts of the company as preliminary expenses and allowed in the respective assessments. Hence, the expenses relating to pre-incorporation period were not allowable as revenue expenditure in the previous year relevant to the assessment year 1981-82. This amount was, however, allowed by the assessing authority in the assessment made in February 1985. The incorrect allowance thereof led to excess computation of loss of Rs. 3,13,62,000 leading to excess carry forward of loss by the like amount in the assessment year 1981-82 with a potential tax effect of Rs. 1,85,42,783.

The department has accepted the objection in principle.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

14. It has been judicially held that expenditure incurred on account of payment of penalties for breach of law was not an allowable expenditure.

The previous year of an assessee, a private limited company, for the assessment year 1981-82 ended in March 1981. While scrutinising the income-tax assessment records of the company, for the assessment year 1981-82 (assessment completed in April 1983), it was noticed that penalty aggregating to Rs. 5,00,200 paid in September 1980 and November 1980 by the assessee company to the customs authorities, was not added back to its total taxable income. As penalty is not an admissible business expenditure, the sum of Rs. 5,00,200 was required to be added back to the assessable income. Omission to add back Rs. 5,00,200 to the total income, resulted in under-assessment of income to that extent and consequent short levy of tax of Rs. 3,22,629.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

15. Under the Income-tax Act, 1961, where any depreciable asset, is sold the difference between the sale price and the written down value is chargeable to tax as income.

During the previous year relevant to the assessment year 1980-81, an assessee company sold all the assets (other than land) of its Jute Mills to an individual for a declared consideration of Rs. 26.50 lakhs. As per terms of agreement, out of total sale price of Rs. 26.50 lakhs, a sum of Rs. 1.50 lakhs was to be paid by the buyer on behalf of the assessee company to a creditor in discharge of a liability of the assessee company and the balance amount of Rs. 25 lakhs was to be paid to the assessee company in cash. While completing the assessment in August 1983 (revised in December 1986) the Income-tax officer determined the profits chargeable to tax on sale of the Jute Mills. In doing so, the sale price was erroneously adopted at Rs. 25 lakhs only instead of the correct figure of Rs. 26.50 lakhs. The mistake resulted in under-assessment of income of Rs. 1,50,000 in the assessment year 1980-81 involving an aggregate short levy of tax of Rs. 1,26,786 (including interest for late filing of return and short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in June 1989 ; the reply from the Government has not so far been received (October 1989).

16. It has been judicially held that infraction of law is not a normal incident of business and therefore no expense which is paid by way of penalty for breach of law can be said to be an amount wholly and exclusively laid for the purpose of business and hence not an allowable expenditure.

While completing the assessment of a limited company for the assessment year 1985-86 in December 1987 at a loss of Rs. 5,01,51,346, the assessing officer disallowed interest of Rs. 57,37,015 paid by the assessee on account of delayed payment of provident fund dues to the appropriate authority on the ground that it was not related to the business of the assessee. But an amount of Rs. 3,15,273 being interest paid to the provident fund authority for non payment of provident fund dues in time included in Rs. 1,20,37,773 was not disallowed. As the payment of interest was made because of infringement of law, it was not a deductible expenditure. The incorrect allowance of expenditure resulted in excess computation of loss by Rs. 3,15,273 with potential tax effect of Rs. 1,82,070.

The Ministry of Finance have accepted the objection.

17. Where a provision allowed in an assessment year is later found to be unnecessary on account of remission or cessation of the liability, it has to be treated as income of the previous year in which the remission or cessation takes place.

A closely held company engaged in the processing and export of cashewnuts wrote back and credited in its accounts for the year ended 30 June 1980, relevant to the assessment year 1981-82, the provision for purchase tax, amounting to Rs. 21,77,276, debited in its accounts for earlier years. This included an amount of Rs. 7,29,599, debited in its accounts for the year ended 30 June 1979, which had been allowed as deduction in the revised assessment for the assessment year 1980-81 completed in November 1983. While completing the assessment for the assessment year 1981-82 in June 1984, the assessing officer again erroneously allowed the deduction and reduced the profit for the relevant previous year to that extent. The mistake resulted in under assessment of income of Rs. 7,29,599, with consequent short levy of tax of Rs. 5,45,887 (including interest).

The Ministry of Finance have accepted the objection.

18. It has been judicially held that the payment on account of retrenchment compensation made on the closure of the business could not be considered to be a payment necessary for carrying on the business.

In the assessment of a private limited company for the assessment year 1983-84 completed in May 1987, the assessing officer allowed an expenditure of Rs. 4,43,820 being payment made for retrenchment compensation and benefit to the employees, as claimed. Scrutiny of the assessment records revealed that the company had no manufacturing activities in the assessment year 1983-84 as the business was closed in the year 1979. Since the payment was made on account of closure of the business, such a payment could not be considered to be a payment necessary for carrying on the business, and hence was not an allowable expenditure. The incorrect allowance led to the excess computation of business loss by Rs. 4,43,820 involving potential tax effect of Rs. 2,95,695.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

19. An assessee company included in its accounts for the assessment year 1985-86, an amount of Rs. 13,85,820 representing an expenditure relating to earlier assessment year 1984-85. This amount was already allowed as deduction in the assessment for the assessment year 1984-85 completed in March 1987. The company also did not claim this amount as deduction for the assessment year 1985-86. However, in the assessment for the assessment year 1985-86 completed in March 1988 the Inspecting Assistant Commissioner (Assessment) allowed the deduction. The incorrect deduction resulted in excess determination of loss by Rs. 13,85,820 leading to potential short levy of tax of Rs. 8,00,311.

The Ministry of Finance have accepted the objection.

20. The Income-tax Act, 1961, provides where the assessee incurres any expenditure in respect of which payment has been made to any person, who has a substantial interest in the business or profession of the assessee, or any relative of such assessee, or any director of the company who has substantial interest in the business of the assessee and the assessing officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the benefit derived by or accruing to him therefrom, so much of the expenditure as is so considered by him to be excessive or unreasonable shall not be allowed as a deduction.

An assessee company engaged in growing, manufacturing and sale of tea disclosed in its accounts, purchase and sales of 14,58,588 Kg. and 2,10,255 Kg. of green leaves at the rates varying from Rs. 1.89 to Rs. 2.28 per Kg. in the assessment for the assessment year 1985-86 except one purchase @Rs. 3.02 per Kg. Audit scrutiny in July 1988 revealed that during the relevant previous year the assessee sold 77,188 Kg., of green leaves @Rs. 2.00 per kg. and again purchased 2,90,068 kg. @Rs. 3.02 per kg. from the same tea estate against the prevailing average market price of Rs. 2.08 per kg. While completing assessment (March 1988) the Inspecting Assistant Commissioner (Assessment) noticed that both the companies had some common directors and added back Rs. 77,188 being suppression of profits in terms of sales of green leaves instead of disallowing the excessive expenditure of Rs. 0.94 (Rs. 3.02—Rs. 2.08) per kg. for purchase of green leaves from connected concern at a higher price. This resulted in under-assessment of income of Rs. 1,95,476 and short levy of tax of Rs. 2,23,816 (including interest of Rs. 43,983 and Rs. 54,731 for late filing of return and short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

21. The Income-tax Rules, 1962, provide that where the Indian income of a non-resident assessee cannot be definitely ascertained the amount of such income may

be calculated on any amount which bears the same proportion to the total profits and gains of the business of such person as the receipts so accruing or arising bear to the total receipts of the business.

In the assessment of a non-resident airline company for the assessment year 1985-86 (assessment made in March 1988) the business loss attributable to the assessee's business in India was determined at Rs. 37,37,636. However, while computing the loss the gross world transportation receipts were incorrectly taken at DG 4,24,96,20,255 (in Dutch currency) without adding back agents commission of DG 3,68,38,700 (in Dutch currency) which had been deducted from the gross receipts amounting to DG 4,61,80,07,255 (in Dutch currency) in the relevant trading and profit and loss account. As income/loss attributable to business in India was determinable with reference to the proportion that gross Indian receipts bore to the gross world receipts, there was excess computation of the loss arising in India by a sum of DG 82,757 in Dutch currency equivalent to Rs. 3,00,934. The mistake resulted in excess carry forward of loss by the identical amount involving a potential tax effect of Rs. 2,21,185 in the assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

22. In the case of an assessee, a private limited company the assessing officer had stated in the assessment order for assessment year 1982-83 that an amount of Rs. 3 lakhs out of the conference expenditure of Rs. 3,66,080 is disallowed, as the assessee did not furnish the details of the expenditure. However, the disallowed amount of Rs. 3 lakhs remained to be added to the taxable income of the assessee. The omission resulted in excess computation of loss by Rs. 3 lakhs with potential tax effect of Rs. 1,69,125.

The Ministry of Finance have accepted the objection.

23. Under the Income-tax Act, 1961, where the assessee has acquired any asset from a country outside India for the purpose of his business or profession and in consequence of a change in the rate of exchange at any time after the acquisition of such asset, there is an increase or decrease in the liability of the assessee as expressed in Indian currency for making payment towards the whole or a part of the cost of the asset or for the repayment of the whole or a part of moneys borrowed by him, the amount by which the liability aforesaid is increased or reduced during the previous year shall be added to or as the case may be deducted from the actual cost of the asset.

In the case of a private limited company for the assessment year 1985-86 completed in March 1988 a deduction of Rs. 51,02,645 towards investment allowance was granted. It included an amount of Rs. 2,24,220 being the fluctuation in the rate of foreign exchange based on the journal entries passed by the company in December 1986 in respect of liability as at the end of December 1986. As the increase at the time of payment did not arise during the previous year relevant to assessment year 1985-86 the deduction as claimed by the assessee, in respect of the enhanced liability as on 31-12-1986 should not have been allowed by the assessing officer in the assessment year 1985-86. The mistake resulted in under-assessment of income of Rs. 2,24,220 involving short levy of tax of Rs. 1,41,258.

The Ministry of Finance have accepted the objection.

24. During the previous year relevant to assessment year 1985-86, an assessee company disclosed sale of 5,57,731 kg. of black tea, out of which 4,80,485 kg. of tea was sold by auction at average rate of Rs. 27.97 per kg. Private sales of 57,246 kg (to two parties) reportedly was made at Rs. 10.51 and Rs. 20.20 per kg. In the assessment for assessment year 1983-84, the assessing officer observed that private sales was disclosed at much lower price than that fetched through auction and added back Rs. 2,22,627 as under recording of sale price of tea. Omission to consider this aspect in assessment year 1985-86 resulted in under-assessment of business profit to the extent of Rs. 6,38,543. Further, in the assessment year 1984-85, initial depreciation of Rs. 2,52,890 on labour quarters had been allowed in assessment. But in assessment year 1985-86 written down value of building was not determined correctly by reducing the value by the amount of initial depreciation allowed, which resulted in excess allowance of depreciation of Rs. 12,645 in assessment year 1985-86. These mistakes resulted in undercharge of tax of Rs. 2,42,574 (including interest of Rs. 4,103 for late filing of return and interest of Rs. 74,374 for non submission of estimate and short payment of tax).

The Ministry of Finance have accepted the objection.

25. An assessee company had debited in the profit and loss accounts for the accounting years relevant to the assessment years 1983-84 and 1984-85 amounts of Rs.1,08,680 and Rs. 1,13,143 respecitvely towards remuneration paid as well as payable to the directors including managing director. In the assessments for the assessment years 1983-84 and 1984-85 made in June 1986 and March 1987 (revised in November 1987), the aforesaid amounts were allowed as deductions. It was, however, noticed from the Auditor's reports appended to the respective accounts that the company had applied to the Government of India in April 1985 for approval of the appointment of the directors and the managing director and sanction of minimum remuneration to be paid to them but the approval of the Government of India had not been received. In the absence of the approval of the Government of India payments to the directors including managing director was not legally due and such payments including provision thereof are not to be allowed as deduction in computing the business income of the assessee. Such a disallowance was done in the assessment of the company for the assessment year 1985-86 revised in November 1987. Omission to do so resulted in under-assessment of income aggregating to Rs.2,21,823 in the asssessments made for the assessment years 1983-84 and 1984-85 involving a short levy of tax of Rs.1,54,212 (including short levy of interest of Rs.27,605 for non-furnishing of estimate of advance tax for the assessment year 1984-85.)

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

26. Any amount paid or payable as interest in connection with the acquisition of an asset and relatable to a period after the asset is first put to use shall not form part and shall be deemed never to have formed part of the actual cost of the asset. Such interest is, therefore, to be treated as revenue expenditure.

A private limited company was allowed a deduction of Rs.2,51,060 claimed by it towards interest relatable to 'acquisition of assets', in the assessment for the assessment year 1985-86 completed in December 1987. A further claim made by the assessee in October 1988 for deduction of Rs. 1,32,697 as interest to be charged to revenue in view of the retrospective amendment of the Act was also allowed by rectifying the assessment (November 1988). As the assessee's claim for interest had already been allowed in full in the original assessment in December 1987, the rectification of the assessment again in November 1988, resulted in excess allowance of interest expenditure, leading to under-assessment of income of Rs. 1,32,697 involving short levy of tax of Rs. 83,601

The Ministry of Finance have accepted the objection.

27. Under the provisions of Interest-tax Act,1974, in computing the income of a scheduled bank chargeable to income-tax under the head 'profits and gains of business or profession' the interest tax payable by the bank for any assessment year shall be deductible from the profits and gains of the bank for that assessment year.

During the previous year relevant to the assessment year 1985-86, a nationalised bank was required to pay interest-tax of Rs.6,24,02,380 calculated at the prescribed rate of 3.5 per cent on the interest of Rs. 1,78,29,25, 100 in the original and revised computation of income for the previous year the bank claimed the correct sum of Rs. 6,24,02,380 as interest tax payable by it. The assessing officer, however, omitted to consider the correct interest tax liability of the bank which was the interest tax payable. In the assessment for the assessment year 1985-86 completed in March 1988, the Deputy Commissioner (Assessment) however, allowed the same at Rs. 6,26,50,000 being advance interest tax paid by the bank. The mistake led to under-assessment of income of Rs. 2,47,620 involving a tax under-charge of Rs. 2,10,927 (including interest for late submission of return and short payment of advance tax) in assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989.)

28. Under the provisions of the Income-tax Act, 1961, and the rules made there under, where the assessee's income is partly agricultural and partly business, the market value of agricultural produce of the assessee which is used as raw material for the assessee's business is allowed to be deducted in computing the business income.

In the assessments of a sugar manufacturing company for the assessment years 1982-83 and 1983-84 completed in February 1986 and March 1986, deduction was allowed for sugar cane produced in assessee's own farm and used as raw material for manufacture of sugar, valuing sugar cane at Rs. 21 per quintal as shown by the assessee. The company had also purchased sugarcane from cultivators and the average purchase rates of such purchases during the relevant two previous years were Rs. 17.833 and Rs. 17.246 per quintal respectively. In the assessments for the subsequent two years 1984-85 and 1985-86, completed by the Inspecting Assistant Commissioner in March 1987 and February 1988 respectively the aforesaid deduction was allowed taking the market rate as the average purchasing rate of purchase made from the cultivators and the assessee's claim to allow deduction at the higher rate was not accepted. In view of the method of valuation adopted in subsequent years, the assessment for the assessment years 1982-83 and 1983-84 were required to be revised to withdraw the deduction allowed at higher rate of Rs. 21 per quintal against the average purchasing rate of Rs. 17.833 and Rs. 17.246 per quintal respectively. This was not done. The mistake resulted in total excess allowance of deduction by Rs. 6,34,290 for the assessment years 1982-83 and 1983-84 and consequent excess carry forward of business loss to that extent involving short levy of tax of Rs. 3,66,300 in the assessment year 1984-85 in which there was a positive income.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

29. A sugar company sold in the previous year relevant to assessment year 1987-88 levy sugar at a price in excess of the price fixed by Government. Simultaneously, the assessee filed a writ petition in the High Court contending that the sale price fixed by the Government was not commensurate with the expenses incurred and hence needed revision upwards. The High Court granted interim injuction and allowed the assessee to retain the excess, amount realised by it on sale of sugar at higher price subject to furnishing a bank guarantee for the amount of differential prices realised. The High Court also held, inter-alia, that in the event of any amount becoming refundable by the assessee, it would be liable to pay interest at a specified rate on the amount realised in excess.

In the previous year relevant to the assessment year 1987-88, the assessee company included amongst others interest items debited in its accounts, Rs. 17,26,345. This being a provision for interest on excess price realised on levy sugar, was not an admissible deduction. In the assessment for the assessment year 1987-88 completed in September 1987, the assessee's claim for deduction of Rs.17,26,345 was allowed by the Deputy Commissioner (Special Range) in full though it was noticed in audit that. a sum of Rs 3,76,930 only became payable by the assessee to the Government in terms of Court's orders. The difference of Rs. 13,49,415 pending decision of the Court, therefore, represented contingent liability only and deduction thereof was incorrectly allowed by the department. The mistake resulted in under-assessment of income of Rs. 13,49,415 involving undercharge of tax of Rs. 7,16,877 (including interest of Rs. 42,169 for short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the government has not so far been received (October 1989).

30. It has been judicially held that when lands are converted into plots and sold, the transaction is an adventure in the nature of trade and profits arising from such sale is to be assessed only as business income and not as capital gains.

The assessment of a closely held company engaged in the business of running a lodging house and dealing in real estate for assessment year 1985-86 was completed in March 1988 determining a loss of Rs.82,853. In determining the loss, a capital gain of Rs.99,243 was computed in respect of the sale of land and super structure. Scrutiny of records (July 1988) revealed that the department has not accepted the stand of the assessee from assessment years 1979-80 to 1983-84 except assessment year 1982-83, that the profit of sale of lands was capital gain as the Memorandum of Association of the assessee specifically authorised dealing in real estate and had assessed the income as business income only. Though this stand was reversed by Commissioner of Income-tax (Appeals) in favour of the assessee, the department had gone in appeal to the Tribunal and the matter is pending. Consistent with the stand of the department in this matter in respect of earlier years and also based on the ratio of the judicial decision, the profit on sale of land should have been treated as business income as the earlier years decision had not become final. Omission to do so resulted in under-assessment of income by Rs.4,99,420 involving undercharge of tax of Rs.3,40,854 for assessment year 1985-86 and a potential tax effect of Rs.22,203 in respect of unabsorbed depreciation carried forward.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

31. Under the provisions of the Income-tax Act, 1961, where any buildings machinery and plant or furniture owned by an assessee and used for the purpose of business or profession is sold for a consideration in excess of written down value, the amount of difference not exceeding the cost price of the asset, between the sale consideration and written down value is to be brought to tax under the head 'income from business and profession' during the previous year in which the money becomes due, the balance if any, is to be taxed under the head 'Capital gain'. However, capital gain arising from the transfer of agricultural land in India is exempt from tax.

During the previous year relevant to assessment year 1984-85, an assessee company sold its tea estate for a consideration of Rs.43,97,054 which included value of agricultural land and fallow land amounting to Rs. 10,30,000. While completing the assessment for the assessment year 1984-85 in December 1987 (revised in March 1988) the assessing officer computed a profit of Rs.7,20,529 arising out of the above sale transaction. Audit scrutiny revealed that in computing the profit of Rs.7,20,529 the assessing officer incorrectly deducted Rs.17,26,156 in respect of agricultural land and fallow land in place of the correct amount of Rs.10,30,000. The excess deduction of Rs.6,96,156, thus resulted in under-assessment of income of Rs.2,78,462 (40 per cent of Rs.6,96,156 being tea company) involving tax undercharge of Rs.1,65,636 (including interest of Rs.4, 824 for late filing of return).

The Ministry of Finance have accepted the objection

32. In the assessment of a limited company running a large textile complex for the assessment year 1983-84, completed in March 1986, unabsorbed tax holiday relief of Rs.8,80,109 in respect of "Draw Tax units" pertaining to the assessment year 1979-80, was allowed. It was noticed in audit that while giving effect to certain appellate order in November 1986, for the assessment year 1983-84, the tax holiday relief of Rs. 8,80,109 was again allowed. The mistake resulted in under-assessment of income of Rs.8,80,109 involving potential short levy of tax of Rs.4,96,161.

The Ministry of Finance have accepted the objection.

3.28 Mistakes in the computation of income from tea business.

1. Under the Income-tax Rules, 1962, only 40 per cent of the Income derived from the sale of tea grown and manufactured by a seller in India is deemed to be income derived from manufacturing and selling operations of the assessee and liable to income tax, the remaining 60 per cent being deemed to relate to the cultivation of tea, income from which is agricultural in nature and hence not liable to Income-tax. It has been judicially held that this rule regarding apportionment of income applies only to the income from tea business and not to any other income by way of interest on loans advanced by the concerns.

In the previous year relevant to assessment year 1985-86 an assessee tea company, apart from its income from tea business also derived income from interest of Rs.4,27,242 on loan advanced to a private company and rental income of Rs. 38,562. The aforesaid sums aggregating to Rs. 4,65,804 was, however, assessable under the head income from other sources, and taxable in full under the provisions of the Act. Audit scrutiny revealed (February 1989) that while completing the assessment for the assessment year 1985-86 in March 1988, (subsequently revised in September and October 1988) the assessing officer incorrectly adopted 40 per cent of the income of Rs. 465,804 instead of the entire amounts, as income liable to income tax. The mistake resulted in under-assessment of income of Rs. 2,79,482 involving undercharge of tax of Rs.2,61,698 (including interest of Rs. 85,626 for late filing of return and short payment of advance-tax.)

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. In the assessment of a tea company carrying on business of sale of tea grown and manufactured by it for the assessment year 1983-84 (assessment completed in July 1986 and revised in September 1986) an incentive deduction of Rs. 3,23,615 calculated at one per cent of the assessee's total export turnover of Rs. 3,23,61,496 was allowed. Since 40 per cent of the assessee's total income was assessed to tax and the remaining 60 per cent was treated as agricultural income, the incentive deduction on the total export turnover of the company was also required to be restricted to 40 per cent at Rs.1,29,446. Thus, incentive deduction of Rs. 1,94,169 was allowed in excess resulting in identical under-assessment of income with consequent undercharge of tax of Rs.1,09,462 in the assessment year 1983-84.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3. In the assessment of a tea company, income from interest on fixed deposits in banks amounting to Rs. 2,10,078 received by the assessee in the previous year relevant to assessment year 1985-86 assessable as income under the head 'other sources' and taxable in full under the provisions of the Act was erroneously treated as income from tea business. While completing assessment (January 1988) the Inspecting Assistant Commissioner (Assessment) took only 40 per cent of the aforesaid interest income for income-tax purpose. Further, depreciation of Rs.6,412 on plant and machinery was allowed in excess due to incorrect determination of written down value of the assets (not reduced by additional depreciation of Rs.42,742 allowed in earlier years). The incorrect treatment of interest income and excess allowance of depreciation resulted in net under-assessment of income of Rs. 78,590 with consequent under charge of tax of Rs.63,829 (including interest of Rs.14,317 due to short payment of advance-tax).

The Ministry of Finance have accepted the objection.

4. Where an assessee engaged in the business of growing and manufacturing tea in India, carries out plantation of tea bushes on land owned by him which had not been planted at any time with tea bushes or had been previously abandoned, he is entitled to a deduction by way of development allowance equal to 50 per cent of the actual cost of such plantation. The Income-tax Rules, 1962, further provide that the assessee claiming such deduction in respect of any previous year shall, at the time of filing of return of income, furnish a certificate from the Tea Board in the prescribed form on the fulfilmnt of the prescribed conditions.

In the assessment of a tea company for the assessment year 1983-84 (assessment completed in March 1986 and last revised in April 1987) development allowance aggregating to Rs. 6,77,835 including Rs. 4,79,222 pertaining to three new areas claimed to have been brought under plantation in the relevant previous year was allowed by the assessing officer. The claim was not allowable because the assessee had not obtained the relevant certificate from the Tea Board. Further, a similar claim was disallowed by the department for the assessment years 1982-83 and 1984-85 since the requisite certificate from the Tea Board in respect of the three new areas could not be furnished. Omission to do so resulted in under-assessment of income of Rs. 1,91,688 being 40 per cent of Rs. 4,79,222 and excess computation of loss by the like sum for the assessment year 1983-84. The entire loss for the assessment year 1983-84 was set off in assessment for the assessment year 1984-85 made in July 1986 and revised in April 1987. The mistake thus resulted in under charge of tax of Rs. 1,48,615 (including interest of Rs. 37,915 for late submission of return and short payment of advance-tax in assessment year 1984-85).

The paragraph was referred to the Ministry of Finance of comments in July 1989; the reply from the Government has not so far been received (October 1989)

5. In the case of a limited company, for the previous years relevant to assessment years 1981-82, 1982-83 and 1983-84, the assessee company had incurred expenditure aggregating to Rs.18,76,507. It was noticed in audit that the assessee had been allowed for the three previous years relevant to assessment years 1980-81, 1981-82 and 1982-83, a deduction of Rs. 9,36,198 by way of development allowance. The development allowance admissible for the third succeeding previous year relevant to assessment year 1983-84 was, therefore, Rs.2056, being 50 per cent of the aggregate expenditure of Rs.18,76, 507 for the assessment years 1981-82 to 1983-84 as reduced by the development allowance allowed for 1980-81 to 1982-83. However, while completing the assessment for assessment year 1983-84 in March 1986, the Inspecting Assistant Commissioner (Assessment) allowed development allowance of Rs. 9,38,254 as against Rs.2,056. The excess development allowance of Rs.9,36,198 allowed in assessment year 1983-84 resulted in under-assessment of income to the extent of Rs.3,74,479 being forty per cent of Rs. 9,36,198 and short levy of tax of Rs. 2,11,113.

The Ministry of Finance have accepted the objection.

6. With effect from the assessment years 1986-87 and 1987-88 where an assessee carrying on business of growing and manufacturing tea in India has, during the previous year deposited with the National bank for Agricultural and Rural Development any amount in a special account maintained by the assessee with the bank in accordance with the scheme approved in this behalf by the Tea Board, the assessee will be allowed a deduction of the amount so deposited during the previous year or 20 per cent of the profits of eligible business, whichever is less.

The assessment of a widely held company engaged in the business of growing and manufacturing tea, for assessment year 1986-87 was completed in March 1988 after allowing a deduction of Rs.6,09,500 being the amount of deposit made by the assessee with the specified bank. Audit scrutiny of assessment records (October 1988) revealed that the deposit account with the specified bank was opened by the assessee only in July 1985, after the last day of the previous year which is 30 June 1985 in the assessee's case. As the amount was deposited after the close of the previous year, it will not qualify for the aforesaid deduction. The incorrect allowance of deduction resulted in short computation of income by Rs.2,43,800 involving a short levy of tax of Rs. 1,27,995.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989),

3.29 Incorrect computation of profits and gains of shipping business of non-residents

Under the provisions of the Income-tax Act, 1961' in the case of a non-resident assessee engaged in the business of operation of ships, a sum equal to seven and half percent of the amount paid or payable (whether in or out of India) to the non-resident assessee or to any person on his behalf on account of the carriage of passengers, live stock, mails or goods shipped at any port inside or outside India constitutes its income chargeable to tax. Demurrage, however, being compensation paid by the shipper of goods to ship owner for the delay in taking his goods on board or out of the ship which carries them and being in the nature of rent collected by the shipowner at the shippers' end at the conclusion of the carriage operation could not be said to arise on account of carriage of goods, etc. Accordingly the entire income on account of demurrage charges collected by the assessee is chargeable to income-tax and not only 7½ per cent of such income.,

The assessments of a non resident shipping Company for the assessment years 1982-83 to 1985-86 were made in June 1986. While completing the assessments the Inspecting Assistant Commissioner brought to tax an amount aggregating to Rs.16,01,431 being 7½ per cent of the total amount of demurrage charges of Rs.2,13,52,415 received by the assessee during the relevant previous years. Since demurrage charges cannot be construed as receipts on account of carriage of goods, the entire amount of demurrage charges received by the company was assessable to tax. In fact while framing the assessment of this company for the assessment year 1986-87 in March 1987, the assessing officer assessed the entire demurrage charges received in the relevant previous year to tax. Omission to do the same for the assessment years 1982-83 to 1985-86 resulted in under-assessment of business income by Rs.1,97,50,984 with consequent under charge of tax of Rs.73,05,066.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

IRREGULARTIES IN ALLOWING DEPRECIATION, INVESTMENT ALLOWANCE AND DEVELOPMENT REBATE

3.30 Mistakes in the allowance of depreciation

1. In the assessment of 34 companies for the assessment years 1978-79 to 1987-88 assessed in 21 different Commissioners' charges between May 1983 and September 1984 due to incorrect application of rates of depreciation allowance and other irregularities in the calculation of depreciation allowance, there was an aggregate excess allowance of depreciation of Rs.68,51,446 resulting in short levy of tax of Rs.63,34,856 in 20 cases and excess carry forward of unabsorbed depreciation/over computation of loss amounting to Rs. 1,56,74,082 involving potential tax effect of Rs.90,28,826 in 14 cases. The particulars of these cases are:

Sl. No.	CIT/Assessment Year	Nature of mistake	Tax effect Rs.
1	A 1980-81 and 1981-82	Incorrect allowance of depreciation of Heat Treatment Shop machinery at 15 per cent instead of correct rate of 10 per cent resulting in excess allowance of depreciation including additional depreciation and extra shift allowance aggregating to Rs. 23,30,530.	13,77,935
2	A 1983-84	Incorrect allowance of depreciation and extra shift allowance on plant and machinery at 15 per cent instead of correct rate of 10 per cent and additional depreciation at 7½ per cent instead of 5 percent. resulted in excess determination of loss by Rs. 17,79,603.	10,27,721(P)
3	B 1982-83 and 1983-84	Omission to withdraw erroneous depreciation allowed in assessment years 1982-83 and 1983-84.	1,41,097
4	C 1985-86	Incorrect allowance of depreciation and extra shift allowance on generator at 30 per cent instead of 15 per cent and additional depreciation at 15 per cent instead of 7½ per cent.	2,02,994 (P)
5	B 1985-86	Incorrect allowance of depreciation and additional depreciation on machine tools at 30 per cent and 15 per cent instead of general rate of 15 per cent and 7½ per cent respectively.	88,410
6	D 1985-86	Incorrect allowance of depreciation and additional depreciation on construction machinery' at 30 per cent and 15 per cent instead of 15 per cent and 7½ per cent respectively resulted in excess allowance of depreciation of Rs. 5,41,800.	5,71,712
7	E 1984-85	Erroneous allowance of depreciation on additions classifiable under the head general building at the rate of 10 per cent instead of at the rate of 5 per cent.	1,29,742
8	D 1978-79 1979-80 1984-85	Mistake in calculation of depreciation allowance on machinery and enabling works during revision of the assessments from 20 per cent to 15 per cent as decided by the assessing officer resulted in excess carry forward of unabsorbed investment allowance and unabsorbed depreciation allowance of Rs. 30,65,155.	17,70,125(P)
9	F 1984-85, 1985-86, 1986-87	Incorrect allowance of depreciation at the rate of 30 per cent on plant and machinery relating to rubber and plastic goods factories against the correct rate of 15 per cent resulted in excess carry forward of loss of Rs. 9,89,149.	6,03,778(P)
10	D 1981-82, 1982-83, 1983-84	Incorrect allowance of depreciation on machineries of petrochemical complex at 15 per cent instead of correct rate of 10 per cent resulted in an aggregate under assessment of in come of Rs. 7,34,143.	4,31,790
11	G 1985-86	Incorrect allowance of depreciation on earthmoving machinery not employed in heavy construction at 30 per cent instead of general rate of 15 per cent.	1,33,755
12	H 1984-85	Mistake in calculation of normal depreciation allowable as Rs. 5,37,912 instead of Rs. 6,65,817 and incorrect allowance of additional depreciation on machineries installed in office premises.	1,18,712
13	G 1981-82 to 1984-85	Erroneous grant of extra shift allowance and incorrect allowance of depreciation at the rate of 10 per cent instead of the correct rate of 15 per cent on ice making plant and machinery resulting in net demand.	1,41,371

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14	E 1985-86	Incorrect allowance of depreciation on tubewells at the rate of 15 per cent as against the correct rate of 5 per cent.	1,85,777
15	I 1985-86	Incorrect allowance of depreciation on permanent non-factory buildings at the rate of 10 per cent prescribed for factory building against the admissible rate of 5 per cent.	2,94,529(P)
16	I 1984-85	Erroneous allowance of depreciation allowable as Rs. 26,24,799 as against Rs. 30,30,953	2,55,875(P)
17	J 1985-86	Incorrect calculation of depreciation on buildings and electric supply installations as Rs. 24,87,292 instead of Rs. 22,77,861.	1,20,946
18	K 1985-86	Incorrect allowance of depreciation on furniture and fittings at the special rate of 15 percent against the admissible rate of 10 per cent.	4,79,320(P)
19	L 1985-86	Incorrect allowance of depreciation on general buildings including water supply system at the rates varying from $7\frac{1}{2}$ per cent to 15 per cent against the admissible rate of 5 per cent resulted in excess allowance of depreciation of Rs. 14,17,563.	8,18,640(P)
20	L 1985-86	Incorrect allowance of depreciation at the rate of 100 per cent on building for weigh bridge class II, at the rate of $7\frac{1}{2}$ per cent on roads and culverts and at the rate of 10 per cent on water supply and sewage system as against the admissible rate of 10 per cent, 5 percent and 5 per cent respectively.	1,65,882
21	M 1982-83 and 1983-84	Incorrect allowance of depreciation on road culverts and bridges and water supply drainage at the rate of 10 per cent and mobile equipment at the rate of 20 per cent against the admissible rate of 2.5 per cent on road culverts and bridges, 5 per cent on water supply drainage works and 10 per cent on mobile equipment resulted in excess allowance of depreciation and consequential over computation of loss by Rs. 43,63,241.	24,92,560 (P)
22	M 1983-84 and 1984-85	Erroneous allowance of depreciation on residential flats not owned by the assessee.	3,31,076 (P)
23	N 1983-84	Incorrect allowance of depreciation on plant and machinery at the special rate of 15 per cent applicable to plant and machinery used in the manufacture of rubber and plastic goods instead of at the general rate of 10 per cent.	1,20,365
24	O 1985-86	Erroneous allowance of depreciation and additional depreciation on additions to plant and machinery which were actually tools to the investment transformer and switch gear machinery at the special rate of 30 per cent and 15 per cent instead of the general rate of 15 per cent and $7\frac{1}{2}$ per cent respectively.	1,24,953
25	P 1984-85	Incorrect allowance of depreciation on water works buildings at the rate of 15 per cent instead of the correct admissible rate of 10 per cent and erroneous allowance of depreciation at the rate of 100 per cet on temporary quarters instead of the correct rate of 5 per cent admissible.	2,30,762 (P)
26	Q 1985-86	Erroneous allowance of depreciation of Rs. 4,02,750 as claimed by the assessee instead of Rs. 3,03,568 admissible.	1,04,501
27	Q 1985-86	Erroneous allowance of depreciation of Rs. 5,53,588 as claimed by the assessee instead of Rs. 4,40,452 admissible.	84,727
28	R 1983-84	Erroneous allowance of depreciation of Rs. 6,47,644 as claimed by the assessee instead of Rs. 4,40,452 admissible.	1,30,530 (P)
29	R 1982-83	Incorrect allowance of depreciation on vehicles used in contract business for supply of stones at the higher rate of 40 per cent treating them as having been used in the business of running them on hire instead of the correct admissible rate of 30 per cent	1,07,401 (P)
30	S 1985-86	Incorrect allowance of depreciation on earth moving machinery like tippers and and dumpers and computers at the rate of 40 per cent and 30 per cent respectively instead of correct rate of 30 per cent and 20 per cent.	1,97,598
31	T 1984-85, 1985-86 and 1987-88	Erroneous allowance of depreciation on certain machineries such as recording equipment and reproducing equipment etc., at 30 per cent instead of 20 per cent admissible.	1,34,549
32	S 1984-85	Incorrect allowance of depreciation on cinematographic films machinery at the rate of 30 per cent instead of the correct rate of 20 per cent.	2,43,498
33	S 1987-88	Incorrect allowance of depreciation at the rate of 30 per cent on a solvent coating machine instead of general rate of 15 per cent.	2,78,515 (P)
34	U 1985-86	Erroneous allowance of normal depreciation on generators and triple extra shift depreciation at the rate of 30 per cent and additional depreciation at 15 per cent instead of admissible general rate of 15 per cent and 7.5 per cent respectively.	1,37,509

Twenty of the thirty four companies were assessed by the Inspecting Assistant Commissioner (Assessment)/Deputy Commissioner of Income-tax.

The paragraphs were referred to the Ministry of Finance for comments during January 1989 and August 1989. The Ministry of Finance have accepted the objection in 16 cases. The reply from the Government has not so far been received in the remaining cases (October 1989). However, the department has accepted the objection in 4 other cases.

2. As per Income-tax Rules, 1962, depreciation is admissible only on tangible assets such as buildings, plant or machinery, furniture and fittings and not on 'mining rights', even though expenditure incurred on acquiring such rights is treated as capital expenditure.

In the assessment of a Government company for the assessment year 1985-86 completed by the Deputy Commissioner (Assessment) in January 1988, the assessing officer incorrectly allowed depreciation amounting to Rs. 6,42,786 on mining rights. The mistake resulted in excess computation of loss by Rs. 6,42,786 involving notional tax effect of Rs. 3,71,209.

The Ministry of Finance have accepted the objection.

3. In the assessments of a private company for the assessment years 1983-84, 1984-85 and 1985-86 completed in March 1986, March 1987 and December 1987 respectively, the assessing officer allowed depreciation of Rs. 1,61,495, Rs. 1,45,346 and Rs. 1,30,811 on a godown as claimed by the assessee. Scrutiny of the assessment records, however, revealed that in terms of an agreement dated 1 November 1981 with the owner of premises the assessee company constructed a godown on the said premises at a cost of Rs. 16,14,958. Further the assessee was allowed to use this godown subject to the payment of licence fee or godown charges at the rate of Rs. 10,000 only per month for a period of eighteen years. After that period all the rights of the licensee (being the assessee) to hold the said godown shall cease and the licensee shall not have any interest or claim whatsoever any longer. As the assessee in this case is neither the owner nor the lessee of the asset the grant of depreciation allowance on godown to the assessee by the assessing officer was not in order. The mistake resulted in excess allowance of depreciation of Rs. 1,61,495, Rs. 1,45,346 and Rs. 1,30,811 in the assessment years 1983-84, 1984-85 and 1985-86 involving short levy of tax of Rs. 2,96,070 in aggregate for the above three assessment years.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4. In the assessments of a Government undertaking for the assessment years 1983-84 and 1984-85 completed by the Inspecting Assistant Commissioner (Assessment) in December 1985 and August 1986, the assessing officer allowed to carry forward depreciation allowance of Rs. 3,36,654 and Rs. 3,64,067 respectively on leasehold land even though no depreciation allowance was admissible thereon. The incorrect allowance of depreciation resulted in excess computation of loss by Rs. 7,00,721 involving a potential tax effect of Rs. 4,04,665.

The Ministry of Finance have accepted the objection.

5. The assessment of a closely held company for the assessment year 1984-85 (previous year ending 30 September 1983) was completed in March 1987 after allowing on certain items of machinery, depreciation and extra shift allowance aggregating Rs. 1,19,656. Audit scrutiny revealed (January 1988), that the assessee, engaged in the business of equipment leasing, had purchased the machinery for a sum of Rs. 3,98,854 during the previous year relevant to assessment year 1984-85 and actually leased them out from October 1983 (i.e. during the previous year ending 30 September 1984 relevant to assessment year 1985-86). The asessee was, therefore, not entitled to any depreciation on this machinery for the assessment year 1984-85. The incorrect allowance of depreciation of Rs. 1,19,656 for the assessment year 1984-85 resulted in a short demand of Rs. 1,16,144 including interest.

The Ministry of Finance have accepted the objection·

6. Under the Income-tax Act, 1961, interest paid or payable in connection with the acquisition of an asset relatable to the period after the asset is first put to use is not to be included in determining the actual cost for the purposes of depreciation.

The assessment of a private limited company for assessment year 1985-86 was completed in March 1988. The cost of the assets included interest of Rs. 10,86,276 pertaining to the post commissioning period on which normal depreciation of Rs. 1,62,941 and additional depreciation of Rs. 81,471 was also incorrectly allowed. The mistake resulted in under-assessment of income of Rs. 2,44,412 involving potential tax effect of Rs. 1,53,979.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989).

7. It has been judicially held (169 ITR 334) that an assessee is not entitled to depreciation on the immovable property which has not been transferred to the assessee by the previous owner by registered deed of conveyance.

In the previous year relevant to the assessment year 1985-86, an assessee company purchased office premises at a cost of Rs. 31,08,000. The Inspecting Assistant Commissioner (Assessment), while completing the assessment in June 1986, allowed depreciation allowance of Rs. 1,55,400 at the rate of 5 per cent on the cost of the premises as claimed by the assessee. Since the registration of the deed of conveyance of the immovable property had not been made during the previous year relevant to the assessment year 1985-86, the assessee was not the owner of the office premises. The amount of depreciation allowed in the assessment, therefore, was not in order. The incorrect allowance of depreciation of Rs. 1,55,400 resulted in underassessment of income by like amount with consequent short levy of tax of Rs. 1,08,711, including short levy of interest of Rs. 2,650 for delay in filing the return for the assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989). However, the department has initiated rectificatory proceedings.

8. Under the provisions of Income-tax Act 1961 as made effective from 1 April 1975, no deduction on account of depreciation is to be allowed in respect of any motor car manufactured outside India where such motor car is acquired by the assessee after 28 February 1975 and is used otherwise than in the business of running it on hire for tourists.

In the assessment of a public limited company engaged in manufacture of textiles for the assessment year 1984-85 completed by the Inspecting Assistant Commissioner (Assessment) in March 1987 (revised in March 1988) depreciation of Rs. 87,011 was erroneously allowed on three motor cars manufactured outside India and acquired by the assessee after February 1975 which were used for the purpose of its business and were not used in the business of running them on hire for tourists The mistake resulted in short levy of tax of Rs. 71,459 inclusive of interest for belated filing of return and shortfall in payment of advance tax for the year.

The paragraph was referred to the Ministry of Finance for comments in August, 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection.

9. Under the rules framed under the Income-tax Act, 1961, in respect of building, the general rate of depreciation at 5 per cent is admissible. A higher rate of 10 per cent was prescribed in respect of factory buildings. It has been judicially held that hotel is mainly a trading concern and factory is always used in connection with the place where some kind of manufacturing process is carried out (1959, 15 AIR 1958 Bombay 370).

(i) In the case of a limited company for the assessment year 1985-86, assessment completed by the Inspecting Assistant Commissioner (Assessment) in January 1988, the assessing officer rejected the claim of the assessee for higher depreciation on the hotel building holding that hotel building was essentially not a tool of earning but a place where the business was carried on and decided to allow the depreciation on hotel buildings at the rates applicable to the non factory building. In the case of non-factory buildings, the admissible rate of depreciation for assessment year 1985-86 was 5 per cent and for factory building it was ten per cent. However, in actual computation, the depreciation on hotel buildings was erroneously allowed at the higher rate of 10 per cent instead of at 5 per cent correctly applicable to non factory buildings. The mistake resulted in the excess allowance of depreciation of Rs. 55,35,406 involving short levy of tax of Rs. 31,96,696.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not been received so far (October 1989).

(ii) In the case of a private limited company for assessment years 1984-85 and 1985-86, assessments completed in March 1987 and April 1987, the assessing officer allowed depreciation of Rs. 5,29,867 and Rs. 4,58,080 respectively on hotel building (including green gates) computed at 10 per cent of the written down value of the building as against the admissible general rate of 5 per cent. Further, additional depreciation of Rs. 18,743 which was not admissible on kitchen equipments was also allowed in assessment year 1984-85. These mistakes resulted in excess allowance of depreciation of Rs. 2,83,677 and Rs. 2,29,040 in assessment years 1984-85 and 1985-86 involving notional tax effect of Rs. 3,49,480 in aggregate for the two years.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection.

10. It has been judicially held that expression used for the purposes of business means that the assets must be used by the owner for purposes of carrying on the business and earning profit therefrom. If the assets have not at all been used for any part of the accounting year no depreciation allowance can be claimed.

In the case of eight companies under 6 different commissioners' charges for the assessment years 1982-83 to 1987-88 assessed between February 1986 and March 1988 depreciation was erroneously allowed on assets which were not used during any part of the previous years relevant to the assessment years concerned. The erroneous allowance of depreciation resulted in under assessment of income of Rs. 15,36,847 involving a short levy of tax of Rs. 12,21,716 in five cases and excess determination of loss of Rs.13,96,968 involving potential tax effect of Rs. 8,51,815 in the remaining 3 cases.

Of these, five companies were assessed by the inspecting Assistant Commissioner (Assessment)/Deputy Commissioner of Income-tax.

The paragraphs were referred to the Ministry of Finance for comments during April 1989 and August 1989. The Ministry of Finance have accpted the objection in 4 cases. The reply of the Government has not been received in the remaining cases (October 1989). However, the department has accepted the objection in one other case.

11. Where an assessee had acquired a capital asset out of loans taken in foreign currency and the repayment of loan results in an increase or decrease in the liability in terms of domestic currency for repayment of the whole or part of moneys borrowed due to change in the rate of exchange, the increase or decrease partakes the character of capital expenditure and has to be added to or reduced from the cost of the asset, and not accounted for as revenue expenditure or receipt in computing the income of business.

A limited company declared a gain of Rs. 6,18,334 on foreign exchange in the previous year relevant to the assessment year 1981-82. The gain was in respect of a loan in foreign currency for purchase of machinery. As the gain in foreign exchange reduced the liability of the company and as it was taken for purchase of machinery, the actual cost of the assets was required to be reduced correspondingly for working out the actual cost for purposes of grant of depreciation and investment allowance on such assets. It was, however, noticed in audit that, in the assessment for the assessment year 1981-82 completed in September 1984, the assessing officer while working out the depreciation and investment allowance, omitted to reduce from the actual cost the said gain of Rs.6,18,334 in foreign exchange for arriving at the actual cost of the asset. The omission resulted in excess grant of depreciation and investment allowance aggregating to Rs. 2,78,249, involving short levy of tax of Rs. 1,64,512.

The Ministry of Finance have accepted the objection.

12. Written down value has been defined in the Act to mean the actual cost of the assets to the assessee in the case of new assets acquired during the previous year and actual cost less depreciation (both normal and additional) allowed under the Act in case of an asset acquired in earlier years.

In the case of seven companies assessed in six different Commissioners' charges for the assessment years 1983-84 to 1987-88 assessed during February 1986 and March 1988, erroneous adoption of written down value of the plant and machinery, warehouses, godown, furniture and fixtures and office equipments resulted in under assessment of income of Rs.21,60,377 involving short levy of tax of Rs. 14,98,129 in three cases and excess carry forward of loss/unabsorbed depreciation of Rs. 15,46,439 involving potential tax effect of Rs. 9,18,556 in the remaining four cases.

Of these, three companies were assessed by the Inspecting Assistant Commissioner (Assessment).

The paragraphs were referred to the Ministry of Finance for comments during February 1989 and August 1989. The Ministry of Finance have accepted the objection in one case. The reply from the Government has not been received so far in the remaining cases (October 1989). The department has, however, accepted the objection in two other cases.

13. The Act further provides that from the assessment year 1984-85 the amount of initial depreciation will be deducted in determining the written down value of the building for the purpose of computing the amount of depreciation admissible in subsequent years.

An approved hotel company was allowed initial depreciation aggregating to Rs.3,54,36,950 at the rate of 25 per cent of the cost of construction of two hotel buildings during the assessment years 1973-74 to 1978-79 and 1982-83 to 1983-84 . In the assessment for the asessment year 1984-85 completed in March 1988, the Inspecting Assistant Commissioner (Assessment) allowed depreciation on the hotel buildings on their written down values arrived at without taking into account the initial depreciation allowed in earlier assessment years as required under the amended Act. The mistake resulted in excess grant of depreciation allowance of Rs. 17,71,847 involving short levy of tax of Rs. 16,55,067 including short levy of interest of Rs. 5,85,782 for short payment of advance tax and Rs. 46,044 for belated filing of return of income.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply form the Government has not been received so far (October 1989).

14. The term 'actual cost' as per the provisions of the Act means the actual cost of the assets to the assessee as reduced by that prortion of the cost thereof as has been met directly or indirectly by any other person or authority.

The assessment of a State Electricity Board for assessment year 1981-82 was revised in March 1988 to give effect to an appellate order requiring the deduction of the capital subsidy of Rs. 22,50,00,000 received from the State Government from the cost of plant and machinery for purpose of allowing depreciation and additional depreciation. Audit scrutiny revealed (July 1988) that while working out the disallowance, the excess depreciation and additional depreciation was computed incorrectly as Rs. 3,14,18,482 as against the correct disallowance of Rs. 3,37,50,000. The mistake resulted in the allowance of excess depreciation and additional depreciation amounting to Rs. 23,31,518 involving a potential undercharge of tax of Rs. 12,24,089.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not been received so far (October 1989.) However, the department has accepted the objection.

15. In the regular assessment of a limited company for assessment year 1980-81 the assessing officer allowed depreciation of Rs. 53,54,929 for 12 months as against depreciation of Rs. 66,93,661 for 15 months claimed by the assessee company. In the subsequent assessments for the assessment years 1981-82 to 1985-86, the written down value of the machinery was worked out on the basis of the reduced depreciation allowed by the assessing officer in assessment year 1980-81 and depreciation accordingly allowed. The company preferred an appeal against the assessment for 1980-81 allowing reduced depreciation and succeeded in appeal. Thereupon the assessment for assessment year 1980-81 was revised allowing the difference in depreciation. Consequent to this allowance of difference in depreciation, simultaneous action should have been taken for revising the assessment for the assessment years 1981-82 to 1985-86 to withdraw the extra depreciation allowed on the old higher written down value. This was not done by the Inspecting Assistant Commissioner (Assessment) resulting in excess allowance of depreciation aggregating to Rs. 7,22,176 for the assessment years 1981-82 to 1985-86 involving tax of Rs. 4,12,845.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not been recieved so far (October 1989).

16. The Income-tax Act, 1961 provides for the grant of an initial depreciation at twenty per cent of the cost of the new machinery or plant installed between 1 June 1974 and 31 March 1976 and used for the purposes of business in addition to deduction for normal depreciation prescribed in the rules. Although the initial depreciation was not deductible in determining the written down value of the plant or machinery, the Act provides that the aggregate of all the deductions in respect of depreciation , viz., normal depreciation, extra shift allowance, initial depreciation, etc., should not exceed the actual cost of the asset in respect of which the depreciation was allowed.

In the case of 10 companies for the assessment years 1979-80 to 1985-86 assessed in five different Commissioners' charges between September 1983 and March 1988, the initial depreciation allowed on the cost of new machinery and plant was not considered for restricting the allowance of depreciation suitably so that the aggregate of all deductions in respect of depreciation allowed did not exceed the cost of the asset. This resulted in excess allowance of depreciation of Rs. 69,15,801 involving short levy of tax of Rs. 41,59,192 in 8 cases and excess carry forward of unabsorbed depreciation amounting to Rs. 12,22,222 involving potential tax effect of Rs. 6,67,121 in 3 cases.

Of these, 9 assessments were completed by the Inspecting Assistant Commissioner (Assessment)/Deputy Commissioner of Income-tax.

The paragraph was referred to the Ministry of Finance for comments between March 1989 and July 1989. The Ministry of Finance have accepted the objection in 7 cases. The reply from the Government has not so far been received in the remaining cases (October 1989).

17. Under the provisions of the Income-tax Act 1961, initial depreciation is allowable in respect of buildings newly erected after 31 March 1961 and used (i) solely for the purpose of residence of persons employed in the business and drawing salary of not more than Rs. 10,000 per year, or (ii) solely or mainly for the welfare activities such as hospital, creche, school, canteen, library, etc. The quantum of allowance is 40 per cent of the actual cost of the building to the assessee. The allowance is to be granted in respect of the previous year of erection of building.

In the assessment of a company engaged in the business of growing and manufacturing of tea in India for the assessment year 1984-85 (assessment made in December 1986), the assessing officer allowed initial depreciation of Rs. 22,13,591 at the rate of 40 per cent of Rs. 55,33,978 being the cost of additions to buildings made during the relevant previous year. It was, however noticed in audit that the said amount of Rs. 55,33,978 included a sum of Rs. 10,29,200 representing the cost of renovations of the buildings. As initial depreciation is allowable only on newly erected buildings its allowance on the renovations of the buildings was not in order. The mistake resulted in excess allowance of initial depreciation to the extent of Rs. 4,11,680 and under-assessment of income of Rs. 1,64,671 (being 40 per cent in the case of a tea company) and consequent excess computation of loss by the like sum involving potential tax effect of Rs. 95,097.

The Ministry of Finance have accepted the objection.

3.31 Incorrect grant of additional depreciation

Under the provisions of the Income-tax Act, 1961, as amended by the Finance (No. 2) Act, 1980, a deduction is allowed by way of additional depreciation in respect of new plant and machinery installed after 31 March 1980 but before 1 April 1985, the additional sum being equal to one half of the normal depreciation in respect of the previous year in which such plant and machinery is installed, or if the plant and machinery is first put to use in the immediately succeeding previous year, then in respect of that previous year. The additional depreciation is not admissible in respect of office appliances, machinery and plant installed in office premises, buildings and road transport vehicles.

1. In the assessment of a Government Corporation for the assessment year 1985-86 completed in January 1988, the assessing officer allowed additional depreciation on all the assets including old assets which were in existence on 1 April 1984. The mistake resulted in allowance of inadmissible additional depreciation of Rs. 37,48,88,193 and in excess computation of loss by the like amount involving notional tax effect of Rs. 21,64,97,930.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection.

2. In the assessment of a Government corporation for the assessment year 1985-86 completed by the Deputy Commissioner (Assessment) in January 1988 additional depreciation of Rs. 11,69,269 on open drains which were parts of buildings was incorrectly allowed as claimed by the assessee. The mistake resulted in excess computation of loss by Rs. 11,69,269 involving notional tax effect of Rs. 6,75,253.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989).

However, the department has accepted the objection.

3. In the assessments of a closely held company for assessment years 1984-85 and 1985-86, completed in September 1986 and February 1988 respectively, additional depreciation in respect of TATA 320 cranes at Rs. 4,67,506 for assessment year 1984-85 and Hydraulic mobile cranes at Rs. 1,39,800 for assessment year 1985-86 were allowed as claimed. Audit scrutiny revealed (September 1988) that the Commissioner of Income-tax while dealing with similar claims for assessment year 1983-84, had held in his proceedings of March 1988 that the cranes are transport vehicles and are not eligible for additional depreciation. In view of (i) the proceedings of the Commissioner of Income-tax and (ii) the clarification of the Board no additional depreciation was admissible in respect of cranes mounted on mobile vehicles and as such the claim for additional depreciation allowed by the department was not in order. Omission to do so resulted in under assessment of income by Rs. 4,67,506 and Rs. 1,39,800 for the two assessment years 1984-85 and 1985-86 involving an aggregate short levy of tax of Rs. 6,57,566 for the two assessment years including interest for belated filing of return and short payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in March 1989; the reply from the Government has not been received so far (October 1989). However the department has accepted the objection.

4. In the assessment of a company for the assessment year 1985-86 (completed by the Deputy Commissioner (Assessment) in February 1988) the assessing officer disallowed investment allowance on Tata-tripper truck, Movewell trailors and Mahendra tractors as being road transport vehicles but erroneously allowed additional depreciation of Rs. 2,42,405 on these items. The mistake resulted in under-assessment of income by Rs. 2,42,405 involving short levy of tax of Rs. 1,99,453 including interest for short payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in March 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection.

5. The assessment of a widely held company for the assessment year 1984-85 was completed in March 1987 (revised in February 1988) allowing additional depreciation of Rs. 3,21,525 in respect of DAP II Train Road tankers and trailors costing Rs. 42,87,000. Audit scrutiny (October 1988) revealed that the assessee company in its return had excluded DAP II Train Road tankers and trailors from the list of plant and machinery qualifying for investment allowance treating it as road transport vehicle. Since additional depreciation is also not allowable in respect of road transport vehicles, the incorrect grant of additional depreciation in respect of the tankers and trailors ibid, resulted in under-assessment of income by Rs. 3,21,525 involving short levy of tax of Rs. 1,85,680 for assessment year 1984-85.

The Ministry of Finance have accepted the objection.

6. In the assessment of a company for the assessment year 1985-86 completed by the Inspecting Assistant Commissioner (Assessment) in January 1988 (revised in May 1988), additional depreciation of Rs. 2,99,891 at the rate of 7½ per cent on plant and machinery valuing Rs. 39,98,547 and installed in the new project on transfer from a completed old project, on which the assessing officer had earlier disallowed investment allowance as being used and old plant and machinery which cannot be treated as new machineries but erroneously allowed the same as claimed by the assessee. The mistake resulted in under-assessment of income of Rs. 2,99,891 involving short levy of tax of Rs. 1,73,187.

The paragraph was referred to the Ministry of Finance for comments in August 1988; the reply from the Government has not been received so far (October 1989).

7. In the assessment of a pharmaceutical company, for the assessment year 1985-86, completed in February 1988, additional depreciation of Rs. 5,04,187 was allowed on additions to plant and machinery costing Rs. 32,53,468. It was, however, noticed in audit that additional depreciation at seven and half per cent of plant worth Rs. 32,53,468 worked out to Rs. 2,44,010 and not to Rs. 5,04,187 as allowed by the Inspecting Assistant Commissioner (Assessment). This resulted in excess allowance of additional depreciation of Rs. 2,60,177 involving short levy of tax of Rs. 1,66,351 (inclusive of interest on refund of tax).

The Ministry of Finance have accepted the objection.

3.32 Mistake in excess set off of the unabsorbed depreciation

Under the provisions of Income-tax Act, 1961, when for any assessment year, unabsorbed depreciation under the head 'Profits and gains of business or profession', cannot be set off against any other income in the relevant year, such unabsorbed depreciation shall be carried forward to the following assessment year and shall be set off against the profits and gains of business or profession of that year and if there is no positive income in that year also it can be carried forward to the subsequent year for set off.

1. In the assessment of a private limited company for the assessment year 1984-85, completed in March 1987, the assessing officer set off an amount of Rs. 25,46,821 towards the balance of unabsorbed depreciation relating to the assessment year 1981-82. Audit scrutiny, however, revealed that according to revised order of October 1986, giving effect to the orders of March 1985 of Commissioner of Income-tax (Appeals) for the assessment year 1981-82, the unabsorbed depreciation to be carried forward for set off was Rs. 24,58,430 only and Rs. 21,26,589 was set off in the assessment for the assessment year 1983-84 completed in March 1986 as unabsorbed depreciation pertaining to the assessment year 1981-82. Thus the unabsorbed depreciation for assessment year 1981-82 to be adjusted in the assessment year 1984-85 was Rs. 3,31,841 only and not Rs. 25,46,821 as set off by the department. The mistake resulted in excess set off of unabsorbed depreciation of Rs. 22,14,980 involving a potential tax effect of Rs. 15,11,725 in the assessment for the assessment year 1984-85.

The Ministry of Finance have accepted the objection.

2. In the regular assessment of a company for the assessment year 1984-85, completed by the Inspecting Assistant Commissioner (Assessment) in January 1987, unabsorbed depreciation of Rs. 7,35,886 was allowed to be carried forward for set off, in the subsequent assessment years. The assessment for assessment year 1984-85, was subsequently revised in August 1987 and the unabsorbed depreciation to be carried forward for set off in subsequent years was reduced to Rs. 4,44,580. It was, however, noticed in audit that while completing the assessment for assessment year 1985-86 in February 1988, the assessing officer adjusted unabsorbed depreciation of Rs. 7,35,886 instead of the revised figure of Rs. 4,44,580. The excess set off of unabsorbed depreciation of Rs. 2,91,306 resulted in income escaping assessment to the same extent involving short levy of tax of Rs. 2,70,684, inclusive of interest for late filing of return of income and short payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection.

3. The assessment of an industrial company for the assessment year 1982-83 was completed in February 1986 determining an unabsorbed depreciation of Rs. 21,65,777 and the same was revised in November 1986 reducing unabsorbed depreciation ibid to Rs. 17,98,837. It was, however, noticed in audit that while completing the assessments for the assessment years 1986-87 and 1987-88 in February 1988, the assessing officer omitted to consider the reduced amount of brought forward unabsorbed depreciation for setting off against the income of assessment years 1986-87 and 1987-88. The mistake resulted in excess carry forward and set off of unabsorbed depreciation of Rs. 3,66,940 involving short levy of tax of Rs. 68,107 (including interest of Rs. 7,562 for non filing of estimate of advance tax in the assessment year 1987-88) and also excess carry forward of unabsorbed investment allowance of Rs. 2,56,856 relating to assessment year 1982-83 involving potential tax effect of Rs. 1,41,273.

The Ministry of Finance have accepted the objection.

4. In the assessment of a company for the assessment year 1984-85 completed by the Inspecting Assistant Commissioner (Assessment) in February 1987 depreciation of Rs. 3,36,738 and Rs. 70,48,951 was allowed on the written down value of residential quarters and plant and machinery respectively. Further unabsorbed depreciation of Rs. 4,52,22,197 for the assessment years 1978-79 to 1981-82 was also carried forward for set off in the assessment year 1984-85. It was, however, noticed in audit (October 1988) that as a result of revision of the assessment for the assessment year 1983-84 in August 1987, the figures of the written down value of the assets and the unabsorbed depreciation were reduced and for the assessment year 1984-85 the assessee company became entitled to only the depreciation of Rs. 3,08,811 and Rs.69,60,666 on the two assets and set off of the unabsorbed depreciation of Rs. 4,51,21,127. The assessment for the assessment year 1984-85 was not, however, so revised. The mistake resulted in excess carry forward of unabsorbed depreciation of Rs. 2,17,282 involving potential tax effect of Rs. 1,25,479.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not been received so far (October 1989).

3.33 Incorrect set off of losses

Under the provisions of the Income-tax Act, 1961 where a company has been allowed to carry forward unabsorbed depreciation and unabsorbed investment allowance for adjustment against its income of subsequent year(s), the unabsorbed depreciation, gets precedence over unabsorbed investment allowance during set off in subsequent assessments.

The assessment of a company for the assessment year 1983-84 was completed in October 1983 determining the total income as 'nil' after adjustment of unabsorbed investment allowance of Rs. 8,59,229, with carry forward of unabsorbed depreciation allowance of Rs. 16,60,999 and unabsorbed investment allowance of Rs. 8,43,737 relating to earlier years. The assessment for the assessment year 1984-85 was completed in September 1985 on 'nil' income after setting off unabsorbed depreciation allowance of Rs. 15,23,175 and the assessment for the assessment year 1985-86 was completed in October 1986 after set off of the balance unabsorbed depreciation allowance of Rs. 1,37,824. The department was, however, required to set off unabsorbed depreciation allowance at the first instance to the tune of Rs. 8,59,229 in the assessment year1983-84 and Rs. 8,01,770 in assessment year 1984-85. The erroneous setting off of unabsorbed investment allowance prior to adjustment of unabsorbed depreciation allowance in the assessment year 1983-84 resulted in under assessment of income of Rs. 2,57,771 in the assessment years 1984-85 and 1985-86 involving short levy of tax of Rs. 1,55,130 including short levy of interest of Rs. 6,267 for delayed submission of return and short payment of advance tax.

Further, in the assessment year 1985-86 unabsorbed deductions aggregating to Rs. 2,85,823 on account of tax holiday relief (Rs. 1,03,007) deduction on export turnover (Rs. 1,14,234) and deduction in respect of the assessee company's new industrial unit established after 31 March 1981 (Rs 68,582) were incorrectly allowed to be carried forward. These deductions which were not available to the assessee company as unabsorbed tax holiday relief could not be carried forward beyond the seventh assessment year reckoned from the initial assessment year 1978-79 and in the absence of sufficient gross total income there was no scope for carry forward of other unabsorbed deductions for future set off. The incorrect carry forward of unabsorbed deductions of Rs. 2,35,823 resulted in a potential tax under charge of Rs. 1,65,062.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection.

3.34 Incorrect allowance of depreciation on capital expenditure on scientific research

Under the provisions of the Income-tax Act, 1961, expenditure of a Capital nature incurred by an assessee on scientific research during the relevant previous year is deductible in computing the taxable income for that year. In such a case the assessee will not be entitled to depreciation in respect of the capital expenditure on scientfic research represented by any asset either in the same or in any subsequent previous year.

During the previous year relevant to the assessment year 1985-86 an assessee company carrying on the business of mining, extraction and sale of copper and other metals, maintained a scientific research and development unit which was run with Government's grant-in-aid. Fixed assets installed in this unit were also acquired fully out of funds provided by the Government. As such capital expenditure incurred by the company on scientific research was neither charged in its relevant accounts nor claimed separately as deduction in the assessment. Tax Audit Report annexed to the accounts for the assessment year 1985-86 revealed that an amount of Rs. 52.42 lakhs being the revenue expenditure on scientific research was incurred by the company during the relevant previous year. While computing the assessment for the assessment year 1985-86, in March 1988 the assessing officer allowed the entire expenditure as deduction. It was, however, noticed from the details of revenue expenditure on scientific research furnished in the annexure to the said tax Audit Report that the amount of Rs. 52.42 lakhs included a sum of Rs. 12.28 lakhs representing depreciation on fixed assets. As the entire cost of the fixed assets on account of scientific research and developmnt was met out of Government grant in aid, the actual cost of these assets to the assesse was nil and hence no depreciation allowance thereon was admissible. The incorrect allowance thereon resulted in under-assessment of income of Rs. 12.28 lakhs leading to excess computation and carry forward of loss by the like sum in the assessment year 1985-86 involving a potential tax effect of Rs. 7,09,170.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989).

3.35. Incorrect grant of extra depreciation to hotels.

1. Under the Income-tax Act, 1961, Indian Companies engaged in hotel business were entitled to deduction from their business income on account of development rebate a percentage of the cost of plant and machinery installed in

premises used by it as a hotel, provided such hotel is for the time being approved by the Central Government. However, the provisions relating, to development rebate were abolished (except in certain cases) with effect from 1 June 1974 and after 1 June 1977 development rebate is not admissible. The provisions in the Income-tax Act relating to development rebate have thus become otiose.

The Income-tax Rules, 1962, provided for an extra allowance of depreciation of an amount equal to one half of the normal allowance in the case of plant and machinery installed by an assessee, being an Indian company in premises used by it as hotel where such hotel is for the time being approved by the Central Government for the purpose of grant of development rebate.

With the withdrawal of the deduction on account of development rebate (except on certain cases) with effect from 1 June 1974 and the total withdrawal of the same with effect from 1 June 1977, there could be no approval by the Central Government to hotels for the purpose. As there cannot be any approval under provisions which are non existent and in the absence of amendment to the Rules suitably, the extra allowance of depreciation in repsect of plant and machinery installed in the premises of hotels will not be admissible.

(i) While completing the income-tax assessment of a company engaged in hotel business for the assessment year 1983-84 assessment made and revised by the Inspecting Assistant Commissioner (Assessment) in March 1987, the assessee company was allowed a sum of Rs. 38,67,141 being extra allowance of depreciation inrespect of plant and machinery installed during the relevant previous year. As the provisions relating to grant of development rebate (except in certain cases) had been abolished from 1 June 1974, the grant of extra depreciation of Rs. 38,67,141 in respect of approved hotels for the assessment year 1983-84 was not in order. The incorrect allowance resulted in under assessment of income of Rs. 38,67,141 with consequent tax under charge of Rs. 21,80,100 and short levy of interest of Rs. 87,204 and Rs. 11,82,704 for late filing of return and short payment of advance-tax respectively.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

(ii) In the assessment of a hotel company for the assessment year 1984-85 completed by the Inspecting Assistant Commissioner (Assessment) in March 1988 (revised in May 1988) extra depreciation amounting to Rs. 56,32,791 for the installation of plant and machinery was erroneously allowed. The mistake resulted in under charge of tax of Rs. 52,61,600 including interest of Rs. 1,46,380 for belated filing of return of income and Rs. 18,62,285 for short payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not been received so far (October 1989.

3.36 Incorrect allowance of extra shift depreciation

1. Under the Income-tax Rules, 1962, extra-shift depreciation allowance shall be allowed upto a maximum of one half of the normal depraciation allowance where the concern had worked double shift and upto a maximum of an anount equal to the normal allowance where the concern had worked triple shift.

In the assessment of a public limited company for the assessment year 1985-86 completed by Inspecting Assistant Commissioner (Assessment) in January 1988 (revised in March 1988) extra-shift depreciation of Rs. 6,28,520 and Rs.8,12,593 on plant and machinery for double shift and triple shift working respectively was allowed with reference to normal and additional depreciation taken together instead of with reference to normal depreciation only, as claimed by the company. The mistake resulted in excess allowance of extra shift depreciation of Rs.2,78,023. Further, due to a totalling mistake, there was also an under assessment of income of Rs.2,000. These mistakes resulted in under assessment of Income of Rs.2,80,023 involving under-charge of tax of Rs.2,09,039 in aggregate including short levy of surtax of Rs.47,324 for the assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. The Income-tax Rules, 1962, further prescribe that extra shift depreciation on plant and machineries of a non—seasonal factory is to be allowed at such proportion of normal depreciation as number of days for which the concern actually works extra shift bears to the normal number of working days of the concern during the previous year. The normal number of working days in a previous year is deemed to be actual number of days the factory works or 240 days, which ever is greater.

(i) In the assessment of a company for the assessment year 1985-86 completed in December 1987 extra shift depreciation of Rs.5,63,135 was allowed for double shift(19 days) and triple shift (102 days) working of the concern. Audit scrutiny (December 1988) revealed that the extra-shift depreciation allowance of Rs. 5,63,135 has been worked out taking the normal number of days of working of the concern as 125 days (for which the concern had actually worked during the previous year) instead of 240 days as provided in the Rules. The mistake resulted in excess allowance of extra-shift depreciation of Rs. 2,69,835 involving a potential tax effect of Rs.1,69,996.

The Ministry of Finance have accepted the objection.

(ii) In the assessment of a company engaged in manufacture of sugar for the assessment year 1985-86 completed by the Deputy Commissioner (Assessment) in December 1987 extra shift depreciation allowance in respect of plant and machinery equal to normal depreciation allowance was allowed. It was, however, noticed in audit that during the previous year relevant to assessment year 1985-86 the factory had actually worked for 143 days only. As such extra shift allowance should have been granted in the proportion of 143 days to the normal working of 180 days.The mistake resulted in excess carry forward of depreciation of Rs.6,13,491 involving a potential tax effect of Rs. 3,54,290

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(iii) In the assessment for the assessment year 1987-88 of a company completed in March 1988, the assessing officer allowed extra shift depreciation allowance of Rs.4,13,634, equal to the normal depreciation allowance. It was, however, noticed in audit that the assessee company commenced production on 15 December 1986 and worked for 107 days during the previous year ending on 31 March 1987, relevant to the assessment year 1987-88. As such, the triple extra shift depreciation allowance admissible was equal to the fraction of the normal depreciation in the proportion of 107 days to the normal working days of 240. Omission to do so resulted in excess allowance of extra shift depreciation allowance of Rs.2,29,233 involving notional short levy of tax of Rs.1,26,072.

The Ministry of Finance have accepted the objection.

(iv) The assessment of a closely held company, for assessment year 1985-86 was completed by the Deputy Commissioner (Assessment) in January 1988 determining a loss of Rs.16,93,184 after allowing a sum of Rs.9,10,613 towards extra shift depreciation being 100 per cent of the normal depreciation towards double and multiple shifts as claimed by the assessee. Scrutiny of records (August 1988), however, revealed that the assessee had been allowed to change the previous year from 31 December to 30 June and as such,the previous year relevant to assessment year 1985-86 was restricted to six months from 1 January 1984 to 30 June 1984. The factory, therefore, actually worked triple shift only for 177 days during this previous year and as such the extra shift depreciation should have been calculated in the proportion of 177 days to the normal working of 240 days. The department, however, took the normal number of days as 182 days and allowed the extra shift allowance accordingly. The action of the department was not in conformity with the provisions of the Act. The mistake resulted in the allowance of excess extra shift depreciation of Rs. 2,36,673 involving a notional short levy of tax of Rs. 1,30,170.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3. No extra shift depreciation allowance is admissible in respect of certain machinery and plant which have been specifically excepted in the depreciation Schedule duly marked NESA.

(i) In the assessment of a public limited company for the assessment year 1984-85 made in March 1987, extra shift depreciation of Rs. 44,27,366 equal to normal depreciation was allowed on barrage and barrage gates, as claimed by the company. Extra shift allowance on hydraulic works, pipe lines and sluices is not admissible as these machineries have been specifically excluded in the depreciation schedule. As hydraulic works include barrage and barrage gates extra shift depreciation is not admissible on them. The mistake resulted in under assessment of pre-incentive total income of Rs.44,27,366 in the assessment year 1984-85 with consequent tax under charge of Rs.29,15,375 including short levy of interest of Rs.34,515 and Rs. 3,24,057 for late filing of return and non-submision of estimate of advance tax respectively.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

(ii) The Act further provides for a deduction by way of additional depreciation in respect of new plant and machinery installed after 31 March 1980, but before 1 April 1985, the additional sum being equal to one-half of the normal depreciation in respect of the previous year in which such plant and machinery is installed or if the plant and machinery is first put to use in the immediately succeeding previous year, then in respect of that previous year. Electrical fittings are not eligible for extra shift depreciation allowance and also to additional depreciation allowance.

In the assessment of a limited company running a large textile complex for the assessment year 1984-85 completed in March 1987, the assessing officer erroneously allowed additional depreciation and extra shift depreciation aggregating to Rs.8,48,400 on electrical fittings. The mistake resulted in under assesssment of income by Rs.8,48,400 involving short levy of tax of Rs.4,89,951.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

(iii) In the assessment of a closely held company for assessment year 1985-86 completed by the Inspecting Assistant Commissioner (Assessment) in September 1987 depreciation on plant and machinery at 15 per cent and extra shift allowance 100 per cent of depreciation was allowed. Scrutiny of records revealed (October 1988) that extra shift allowance aggregating to Rs.3,09,543 has been allowed at 15 per cent of the total value of weighing machine and electrical fittings etc., amounting to Rs.20,63,625 including the additions made during the previous year. As extra shift allowance is specifically prohibited in respect of such items of machinery the deduction allowed was not in order. Further, depreciation allowed for assessment year 1985-86 also included Rs. 41,186 representing depreciation and extra shift allowance on the expenditure for card conversion. As the expenditure for card conversion was required to be treated revenue expenditure for assessment year 1984-85 by an appellate order, the grant of depreciation and extra shift allowance of Rs.41,186 should have been withdrawn. The mistakes resulted in short computation of income by Rs.3,50,729 involving an aggregate short levy of tax of Rs. 3,06,579 including interest for belated filing of return and short payment of advance-tax.

The Ministry of Finance have accepted the objection.

(iv) In the assessment of Government company for the assessment year 1985-86 completed by the Inspecting Assistant Commissioner (Assessment) in February 1988, the assessing officer disallowed extra shift allowance claimed on D.G. sets in respect of two units but omitted to disallow and add back to taxable income, the extra shift allowance amounting to Rs. 4,62,167 in respect of third unit. This resulted in excess computation of loss by Rs. 4,62,167 involving notional tax effect of Rs. 2,66,904.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989. However, the department has accepted the objection.

(v) In the assessment of a private limited industrial company for the assessment year 1985-86 completed by the Deputy Commissioner (Assessment) in January 1988, the assessing officer after examining the claim of the assessee for investment allowance decided to disallow investment allowance on computer but erroneously allowed additional depreciation and extra shift allowance on it. The mistake resulted in under assessment of income by Rs.1,82,950 involving short levy of tax of Rs.1,62,779 including interest for under estimate of advance tax.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October1989). However, the department has accepted the objection.

4. No extra shift allowance is admissible in respect of air conditioning machinery and refrigeration plant.

In the assessment of a company for the assessment year 1983-84 and 1984-85 made in November 1986 and March 1987 triple shift allowance of Rs. 1,49,985 and Rs. 93,740 was incorrectly allowed on air-conditioning machinery and refrigerator. The mistake resulted in excess allowance of extra shift depreciation by Rs. 2,21,227 in aggregate leading to short levy of tax of Rs.2,24,478 in the assessment years 1983-84 and 1984-85 including interest of Rs.75,927 for short payment of advance tax and delay in filing the return.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

5. In the assessment of a Government company for the assessment year 1985-86 completed by the Inspecting Assistant Commissioner (Assessment) in February 1988 the assessing officer disallowed triple shift allowace of Rs. 26,42,271 claimed by the assessee on plant and machinery. However, while computing taxable income, extra shift allowance of Rs. 20,74,280 only was actually disallowed. The mistake resulted in excess computation of loss by Rs. 5,67,991 involving potential tax effect of Rs.3,28,015.

The Ministry of Finance have accepted the objection.

6. It has been held by the Supreme Court (98 ITR 167) that the interest paid or payable on borrowed funds, in connection with the acquisition of an asset relating to a period after the asset is first put to use shall not form part of the 'actual cost'. The Central Board of Direct Taxes issued instructions in September 1985 directing that no investment allowance/depreciation should be allowed on capitalised portion of future interest. To give statutory recognition to these instructions the Income-tax Act, 1961, was amended by the Finance Act, 1986, retrospectively from the assessment year 1974-75.

In the assessment of a limited company for the assessment year 1985-86, completed by the Deputy Commissioner(Assessment) in March 1988, depreciation including extra shift depreciation allowance of Rs.2,30,716 was incorrectly allowed on interest liability payable in future. The mistake resulted in excess grant of deduction of Rs.2,30,716 involving short levy of tax of Rs.1,33,237.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

7. In the assessment for the assessment year 1984-85 of an assessee company, the assessing officer reduced the cost of asset acquired by the assessee from the country outside India by Rs.12,59,924 received by the assessee on account of variation in exchange rate for the purpose of grant of depreciation and investment allowance. It was, however, noticed in audit (August 1988) that in the assessment for the assessment year 1985-86 completed in March 1988, the cost of the asset was not reduced by the assessing officer by an amount of Rs. 6,28,834 similarly received by the assessee on account of exchange rate variation during the relevant previous year. The mistake resulted in grant of excess extra shift allowance by Rs.1,88,650 and excess investment allowance by Rs.1,57,208 involving short levy of tax of Rs.2,15,819 in aggregate (including interest for belated filing of return and short payment of advance tax).

The Ministry of Finance have accepted the mistake.

8. Under the Income-tax Act, 1961, where an assessee incurs any expenditure by way of payment of any sum to an association or institution, which has as its object, the undertaking of any programme of rural development to be used for carrying out any programme of rural development approved by the prescribed authority and the training of persons for implementing programmes of rural development, the same will be allowed as deduction. The deduction shall not be allowed unless such association or institution is approved in this behalf by the prescribed authority. As per guidelines issued by the Government in September 1977 particulars of rural areas which qualify as rural area should be given by the association, based on which approval for specific programme are to be given by the competent committee constituted for the purpose.

In the assessments of a public limited company for the assessment years 1984-85 and 1985-86 made in February 1987 (revised in March 1988) and March 1988 respectively, expenditure of Rs. 3,99,307 and Rs. 4,57,073 incurred by it on rural development programme in the respective previous years was disallowed by the assessing officer on the ground that the programme was not approved by the competent authority. It was, however, noticed that depreciation of Rs. 85,309 on two mobile medical vans was allowed in the assessment year 1985-86, as claimed by the company. Depreciation on these vans claimed and allowed in the assessment year 1984-85 was not separately shown. On the basis of depreciation allowed in the assessment year 1985-86 depreciation on the medical vans as allowed in the assessment year 1984-85, worked out to Rs. 1,21,870. As, however, the entire expenditure on rural development programme was disallowed in the assessment years 1984-85 and 1985-86, allowance of depreciation on medical vans used for the purpose of the aforesaid programme was not in order. The mistake resulted in the incorrect grant of depreciation aggregating to Rs. 2,07,179 in the assessment years 1984-85 and 1985-86.

Further, depreciation at the rate of 100 per cent on addition to electric fittings valued at Rs. 1,12,190 was allowed in the assessment year 1985-86 on the ground that individual cost of items was less than Rs. 750, as claimed by the company. As the cost of electric fittings of the electric line did not represent the cost of individual item of plant and machinery depreciation at the general rate of 15 per cent only (instead of 100 per cent) was allowable on them as allowed in the assessment for the assessment year 1984-85 (revised in March 1988). The mistake resulted in excess allowance of depreciation of Rs. 95,255 in the assessment year 1985-86.

The above mistakes led to under assessment of income aggregating to Rs. 3,02,434 with consequent tax undercharge of Rs. 1,69,941 (including interest of Rs. 1,928 for late filing of returns) for the assessment years 1984-85 and 1985-86.

The Ministry of Finance have accepted the objection.

3.37. Incorrect grant of investment allowance

1. Under the Income-tax Act, 1961, in respect of machinery owned by the assessee and used for the purpose of business carried on by him a deduction shall be allowed in the previous year of installation or in the previous year of first usage of a sum by way of investment allowance equal to 25 per cent of the actual cost of the machinery to the assessee. No investment allowance is admissible on machinery or plant which are not used in the industrial undertaking for the purpose of business of manufacture or production of any article or thing. Deduction on account of investment allowance is calculated on the basis of the actual cost of the plant or machinery installed and used for the purpose of his business.

In the assessment of five companies for the assessment years 1983-84 to 1985-86 assessed in five different Commissioners' charges between October 1985 and December 1987, due to incorrect grant of investment allowance there was an aggregate excess investment allowance of Rs. 14,65,949 resulting in short levy of tax of Rs. 10,09,311. In 2 cases, carry forward of unabsorbed investment allowance/over-computation of loss amounting to Rs. 3,71,197 involved potential tax effect of Rs. 2,50,684.

The Inspecting Assistant Commissioner (Assessment) has completed the assessment in 3 cases.

The paragraph was referred to the Ministry of Finance for comments between February 1989 and August 1989. The Ministry of Finance have accepted the objection in one case; the reply from the Government has not so far been received in the remaining cases (October 1989). However, the department has accepted the objection in two cases.

The particulars of these cases are as under :

Sl. No.	CIT/Assessment year	Nature of mistake	Tax effect (Rs.)
1	A 1983-84	Incorrect grant of investment allowance on X-ray equipment used in processing of raw X-ray film not involving any manufacturing activity.	1,30,515 and 1,08,906(P)
2	B 1985-86	Incorrect grant of investment allowance on seed processing work involving no manufacturing or production of any article or thing resulting in excess refund of Rs. 2,27,243.	1,62,325
3	C 1984-85	Incorrect grant of investment allowance on electrical fittings fitted in the factory.	5,38,615
4	D 1983-84	Incorrect grant of investment allowance to non industrial undertaking engaged in the business of construction of residential premises.	1,77,856
5	E 1985-86	Incorrect grant of investment allowance to an assessee engaged in doing job works for others in their computers.	1,41,778 [P]

2. It has been judicially held by Bombay High Court (126 I T R 377) that the term industrial company covers construction of ships only and by implication excludes companies engaged mainly or otherwise in the construction of anything other than ships. Accordingly investment allowance in respect of plant and machinery installed therein would not be admissible.

A private limited company engaged in the business of executing civil contract work in respect of 'Earth excavation and bed lining work' was allowed investment allowance of Rs. 16,17,562 for installation of plant and machinery worth Rs. 64,70,161 for the assessment year 1986-87 (assessment completed in March 1988). As the assessee was not engaged in the business of construction of ship or in the manufacture or processing of goods or in mining, the grant of investment allowance was not in order. The incorrect grant of investment allowance resulted in excess carry forward of unabsorbed investment allowance of Rs. 16,17,562 with potential tax effect of Rs. 9,34,141.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

3. It has been judicially held that metal printing and lacquering do not involve the manufacture of a tube from a metal slug.

In the assessment of a private limited company for the assessment year 1987-88 completed in January 1988 investment allowance of Rs. 4,31,238 was granted by the assessing officer on a metal printing machine. It was seen in Audit that the metal printing machine was used for extrusion of aluminium tubes by the assessee company. As metal printing is only a process and does not involve manufacture of any article or thing, grant of investment allowance on the metal printing machine was not in order. The mistake resulted in under assessment of income of Rs. 4,31,238 involving short levy of tax of Rs. 2,37,180.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

4. No investment allowance is admissible on office appliances, plant and machinery installed in office premises, road transport vehicles and any residential accommodation, including any accommodation in the nature of guest house.

(i) In the assessment of a closely held company for assessment years 1984-85 and 1985-86 completed by the Inspecting Assistant Commissioner (Assessment) in September 1986 and February 1988 respectively investment allowance of Rs. 7,84,626 in respect of TATA cranes for assessment year 1984-85 and Rs. 1,26,475 in respect of mobile cranes for assessment year 1985-86 were determined as admissible. Out of Rs. 7,84,626, a sum of Rs. 2,56,775 was adjusted against the income for assessment year 1984-85 and the balance carried over and adjusted against the income for assessment year 1985-86. Audit scrutiny revealed (September 1988) that the Commissioner of Income-tax in his orders of March 1988, dealing with the assessment for assessment year 1983-84, had held that the cranes are Road Transport Vehicles and as such not entitled to additional depreciation. The grant of investment allowance in respect of cranes was not therefore in order. The mistake resulted in short computation of income by Rs. 2,56,775 and Rs. 6,54,326 for the assessment years 1984-85 and 1985-86 respectively involving an aggregate short levy of tax of Rs. 9,62,235 including interest for belated filing of return and short payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in March 1989; the reply from the Government has not so far been received (October 1989).

(ii) In the assessment of a Government company for the assessment year 1983-84 completed by the Inspecting Assistant Commissioner (Assessment) in February 1986, the assessing officer allowed an investment allowance of Rs. 4,10,200 on computers installed in the office premises. The incorrect grant of investment allowance of Rs. 4,10,200 resulted in under assessment of income by the same amount involving short levy of tax of Rs. 2,45,124 including interest.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(iii) In the assessment of a company, for the assessment year 1984-85 completed by the Inspecting Assistant Commissioner of Income-tax (Assessment) in March 1986 a deduction of Rs. 1,51,315 by way of investment allowance was allowed on Electric Data Processing Machine brought into use by the company. As the Electric data processing machine was installed in office premises the assessee company was not entitled to investment allowance. The mistake led to under-assessment of income by Rs. 1,51,315 involving short levy of tax of Rs. 95,328.

The paragraph was referred to the Ministry of Finance for comments in January 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

5. The Income-tax Act, 1961, stipulates that investment allowance shall be allowed on any new machinery or plant installed after 31 March 1976 in any industrial undertaking for the purpose of construction, manufacture or production of any article or thing except those listed in the Eleventh Schedule to the Act. In case of small scale industry, the allowance is admissible even in respect of machinery utilised for the manufacture of any article or thing specified in the Schedule.

(i) In the assessment of a company, which was not a small scale manufacturing concern for the assessment year 1983-84 completed by the Inspecting Assistant Commissioner (Assessment) in December 1985 (revised in November 1986) unabsorbed investment allowance of Rs. 26,86,981 (against assessee's claim of Rs. 27,28,335) pertaining to the assessment year 1979-80 which was not allowed in that assessment due to non-creation of required reserve and in the assessments for the assessment years 1981-82 to 1982-83 due to there being no positive income (due to change in the accounting year there was no assessment in the assessment year 1980-81) was erroneously allowed on plant and machinery used in the production of domestic electrical appliances, like electric bulbs and tubes listed in the Eleventh Schedule to the Act, before its deletion from 1 April 1982. The irregular grant of investment allowance for the assessment year 1979-80 resulted in under-assessment of income of Rs. 26,86,981 involving short levy of tax of Rs. 20,52,503 including short levy of interest of Rs. 5,37,718 for short payment of advance tax in the assessment year 1983-84.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(ii) In the assessment of a company engaged in the business of converting wheat into flour and wheat products for the assessment year 1985-86 completed in February 1988 the assessing officer allowed investment allowance of Rs. 4,55,332 to the assessee company. As the assessee company was not an industrial undertaking engaged in the business of manufacturing of any article or thing, the investment allowance of Rs. 4,55,332 allowed by the department was not in order. The incorrect grant of investment allowance of Rs. 4,55,332 resulted in excess carry forward of unabsorbed investment allowance to the same extent involving a potential tax effect of Rs. 2,62,955 for the assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

(iii) An assessee company engaged in the business of poultry farming claimed investment allowance aggregating to Rs. 2,02,067 on machinery used for processing of eggs, for the assessment years 1983-84 to 1985-86. While completing the assessments for the three assessment years in February/March 1986, the assessing officer allowed the deduction claimed by the assessee company. As the assessee company was not engaged in the manufacture or production of a thing or an article but was engaged merely in processing of eggs, the machinery used for such processing was not entitled to investment allowance. The erroneous grant of investment allowance aggregating to Rs. 2,02,067 resulted in potential short levy of tax aggregating to Rs. 1,35,709 for the three assessment years.

The Ministry of Finance have accepted the objection.

(iv) A private limited company engaged in the business of boring of tube wells claimed investment allowance of Rs. 1,93,788 for the assessment year 1987-88 on the cost of air compressor and drilling rigs which was allowed by the assessing officer in the assessment completed in December 1987. As the assessee company was a small scale industrial undertaking and was not engaged in the manufacture or production of any article or thing it was not entitled to the benefit of investment allowance. The incorrect grant of investment allowance of Rs. 1,93,788 retsulted in a potential tax effect of Rs. 1,06,590.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply fom the Government has not so far been received (October 1989).

(v) In the assessment of a private company engaged in the business of leasing of 'generator sets and tractors' for the assessment year 1986-87 completed in March 1988, the assessing officer allowed investment allowance of Rs. 10,23,616 on generator sets and tractors valuing Rs. 40,94,463. Audit scrutiny, however, revealed that the machineries were delivered direct from seller's shop to different estates to whom the same were leased out by the assessee company. As the assessee company was not engaged in any manufacturing activity and its plant and machinery had been leased and hence not 'wholly' used in the business of the assessee, the grant of investment allowance of Rs. 10,23,616 was not in order. The incorrect grant of investment allowance resulted in under assessment of income of Rs. 10,23,616 and consequently excess carry forward of unabsorbed investment allowance by like amount involving potential tax effect of Rs. 6,44,877.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(vi) In the case of a private limited company engaged in the business of bottling aerated water in the assessment for the assessment year 1983-84 completed in March 1986, the assessing officer while computing the income chargeable to tax, allowed investment allowance of Rs.2,56,092 on machinery and plant worth Rs.10,24,371. It was observed in audit that one of the said machinery and plant worth Rs.9,96,639 had been installed by the assesse in the previous year relavant to assessment year 1980-81 and assessee had claimed depreciation allowance threron for assessment year 1980-81, confirming that the machinery was actually used in the previous year relevant to the assessment year 1980-81. Further, the cost of machinery including the cost of generator purchased in the previous year relevant to the assessment year 1980-81 had exceeded Rs.10 lakhs with the result that the company ceased to qualify as a small scale industrial undertaking. Thus company was not entitled to investment allowance of Rs.2,49,159 on plant and machinery worth Rs. 9,96,636 allowed during the assessment year 1983-84. The incorrect allowance of investment allowance of Rs.2,49,159 resulted in short computation of income to that extent involving tax effect of Rs. 2,12,482 including interest.

The Ministry of Finance have accepted the objection.

6. The Act further provides that where the plant or machinery on which investment allowance allowed in any assessment year is sold or otherwise transferred before the expiry of eight years from the end of the previous year in which it was instilled, the investment allownace as granted should be withdrawn treating it to have been wrongly allowed and the assesing officer should recompute the income of the assessee for the relevant previous year and make necessary adjustment.

(i) In the assessment of a private limited company for the assessment years 1980-81 and 1981-82 completed by the Inspecting Assistant Commissioner (Assessment) in February 1981 and February 1982 respectively, investment allownace of Rs.1,63,217 was allowed on machineries installed in the relevant previous years. These machineries were sold during the previous year relevant to the assessment year 1985-86 i.e. within the prescribed period of eight years. It was, however, noticed in audit that no action was taken by the assessing officer to withdraw the investment allowance already allowed in the assessment years 1980-81 and 1981-82. The mistake resulted in an aggregare under charge of tax Rs. 1,05,276 in the two assessment years.

The Ministry of Finance have accepted the objection.

(ii) A private limited company was allowed investment allowance of Rs.2,82,695 on an Oxygen Plant worth Rs. 11,30,781 during the previous year relevant to the assessment year 1982-83. The said machinery was sold in the previous year relevant to the assessment year 1987-88 before the expiry of the prescribed period of eight years. No action was, however, taken by the department to with-draw the investment allowance of Rs. 2,82,695 already allowed. The omission resulted in potential short levy of tax of Rs.1,73,857.

The Ministry of Finance have accepted the objection

(iii) In the assessments of a widely held company for the assessment years 1980-81, 1983-84 and 1984-85 made by the Inspecting Assistant Commissioner (Assessment) in September 1983, January 1986 and February 1987 respectively, investment allowance of Rs. 19,009, Rs. 3,86,475 and Rs. 1,85,784 respectively was allowed on machinery installed in the relevant previous years. Audit scrutiny revealed (June 1988) that though the assessee company had sold these machineries during the previous years relevant to the assessment years 1982-83 and 1986-87 i.e. within the stipulated period of eight years, yet no action was taken to withdraw the investment allowarce already allowed. The mistake resulted in short levy of tax of Rs. 3,24,546 in aggregate for the three assessment years.

The Ministry of Finance have accepted the objection.

7. Under the provisions of the Income-tax Act, 1961, if a machinery on which investment allowance is granted is sold at any time before the expiry of eight years from the end of the previous year in which it was installed. the investment allowance originally granted has to be withdrawn. The allowance so granted is, however, not required to be withdrawn where in a scheme of amalgamation, the amalgamating company sells or otherwise transfers to the amalgamated company, any machinery or plant in respect of which investment allowance had been allowed to the amalgamating company. An amalgamating company is defined in the Act as a company which merges into another company so as to lose its separate existence by being dissolved without being wound up. An amalgmated company is one in which one or more existing companies merges or merge. Amalgamation in relation to companies means the merger of one or more companies with another company or the merger of two or more comanies to form one company. Thus the expression amalgamation contemplates essentially the dissolution on one or more existing companies without being wound up and their merger into one company.

The assessments of a closely held company for the assessment years 1976-77 to 1980-81 were completed during the period November 1978 to June 1983 after allowing an aggregate investment allowance of Rs.35,34,277 in respect of machineries installed during the relevant previous years. Scrutiny of the assessment records relating to the assessment year 1983-84 revealed (while checking the assessment for the assessment year 1981-82) (July 1987), that the assessee company was dissolved in October 1982 under a scheme of amalgamation/reconstruction as approved on 3 May 1983 by the High Court whereby three wholly owned subsidiaries were promoted and the assets and liabilities of the assessee company transferred to these subsidiaries. As this arrangement did not result in the merger of one or more companies with another company or in the merger of two or more companies to form a new company it was not a case of amalgamation, but amounted to a transfer as contemplated under the Act and the investment allowance for assessment year 1981-82 was found inadmissible as the transfer of assets took place within the specified peroid of eight years. On this being pointed out in audit in July 1985, the department revised the assessment for assessment year 1981-82 in December 1986 to withdraw the investment allowance.

Audit scrutiny of the assessments for assessment years 1976-77 to 1980-81 in July 1987, however, revealed that similar action to withdraw the investment allowance of Rs. 35,34,277 relating to these assessment years was not taken by the department. The omission resulted in an aggregate under charge of tax of Rs. 21,40,284 for the assessment year 1976-77 to 1980-81.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989). However the department has accepted the objection.

8. The Act also provides that when the gross total income of an assessee includes any profits and gains from a new industrial undertaking, which is a small scale industrial undertaking there shall be allowed in computing the total income of the assessee a deduction from such profits and gains of an amount equal to twenty per cent thereof, subject to the condition that the assessee begins to manufacture or produce any article or thing within a period of nine years from 1 April 1981.

Effective from assessment year 1985-86, a small scale industrial undertaking has been defined in the Act for the purpose of relief under the sections, as one in which the aggregate value of plant or machinery other than tools, jigs and moulds installed as on the last day of the relevant previous year does not exceed rupees thirty five lakhs.

The assessment of a closely held company for assessment year 1987-88 was completed in February 1988 after allowing a deduction of Rs. 2,75,345 towards investment allowance (as claimed) and Rs. 1,39,096 as deduction towards profits and gains in respect of new industrial undertaking. Scrutiny of records (December 1988) revealed that cost of plant and machinery installed by the assessee as on the last day of the previous year exceeded rupees thirty five lakhs and by the definition in the Act, the concern was not a small scale industrial undertaking. The assessee was, thus, not eligible for the deductions claimed and allowed. The omission to disallow the deductions claimed resulted in an under assessment of income by Rs. 4,14,441 involving short levy of tax of Rs. 2,27,943.

The Ministry of Finance have accepted the objection.

9. The Act permits the deduction being allowed in th immediately succeeding year in which it is first put to use but not at any time later on if the machineries cannot be used in the year in which it is installed.

A private limited company installed machineries worth Rs. 50,12,607 in the previous year ended 31 March 1984 relevant to assessment year 1984-85. The machineries were not put to use either in the year of installation or in the immediately succeeding previous year. The machines worth Rs. 48,75,269 out of Rs. 50,12,607 were used in the third succeeding previous year (ended 31 March 1986) relevant to the assessment year 1986-87. It was, however, noticed in audit that in the assessment for the assessment year 1986-87 completed in August 1986 the assessee claimed and was incorrectly allowed investment allowance of Rs. 12,18,817 on the aforesaid machines worth Rs. 48,75,269 which was also carried forward for adjustment in later years. The mistakes resulted in incorrect carry forward of unabsorbed investment allowance of Rs. 12,18,817 involving potential tax under charge of Rs. 7,03,867 in assessment year 1986-87.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

10. The term actual cost for the purpose of grant of investment allowance means the actual cost of the assets to the assessee reduced by that portion of the cost thereof as has been met directly or indirectly by any other person or authority.

During the previous year relevant to the assessment year 1984-85 a State Electricity Board received a grant of Rs. 26 crores from the State Government for meeting its capital expenditure on acquisition of assets. Out of this grant, a sum of Rs. 16,14,36,808 was spent for the purchase of plant and machinery costing Rs. 23,66,36,101. In the assessment for assessment year 1984-85 completed in February 1988 determining a loss, the claim of the assessee, inter alia, for investment allowance of Rs. 14,08,43,474 at 25 per cent of the cost of plant and machinery of Rs. 56,33,73,898 which included the cost of new plant and machinery of Rs. 23,66,36,101 was admitted and allowed to be carried forward on the fulfilment of certain conditions. As the cost of the new machinery was partly met by the grant of Rs. 16,14,36,808 from the State Government, this amount should have been reduced from the cost of mahcinery for calculating the investment alolwance admissible. Omission to do so resulted in the grant of excess investment allowance amounting to Rs. 4,03,59,202 involving a potential undercharge of tax of Rs. 2,11,88,581.

The Ministry of Finance have accepted the objection in principle.

11. It has been judicially held that the plant and machinery must be used for the purpose of enabling the owner to carry on the business and earn profit in the business. When the plant and machinery is put to trial runs, it does not amount to commencement of commercial production. Trial run does not, therefore, mean, used for the purpose of business.

An assessee company installed in the previous year relevant to the assessment year 1983-84 plant and machinery costing Rs. 77,74,609 and Rs. 88,19,654 in its two newly established industrial units. In the assessment for the assessment year 1983-84 completed by the Inspecting Assistant Commissioner (Assessment) in February 1986 investment allowance of Rs. 41,48,566 in respect of the plant and machinery installed in the two newly established industrial units were allowed. Audit scrutiny, however, revealed that these plant and machinery were put to use only from the previous year relevant to the assessment year 1985-86 when commercial production commenced. Till then they were on trial runs. Thus, in view of judicial decisons no investment allowance was admissible on these plants and machineries. The incorrect grant of investment allowance of Rs. 41,48,566 resulted in under assessment of income by like amount involving under charge of tax of Rs. 23,38,754 in the assessment year 1983-84.

The assessee also installed plant and machinery worth Rs. 1,23,16,385 in the previous year relevant to assessment year 1984-85 in another newly established industrial unit. In the assessment for the assessment year 1984-85, completed in March 1986, investment allowance to the extent of Rs. 30,79,096 in respect of the plant and machinery was granted. But his new unit was on trial runs in the previous years relevant to assessment year 1984-85 and 1985-86 and started commercial production only in the previous year relevant to assessment year 1986-87. The grant of investment allowance of Rs. 30,79,096 was again in admissible. This resulted in under assessment of income by an identical amount with consequent tax under charge of Rs. 17,78,178 in the assessment year 1984-85.

The assessee was further granted investment allowance of Rs. 26,37,548 in the assessment for the assessment year 1985-86 (assessment completed in March 1987) on installation of plant and machinery costing Rs. 1,05,50,193 in the previous year relevant to assessment year 1985-86 in one of its newly established industrial units which started commercial production in the previous year relevant to the assessment year 1986-87. The grant of investment allowance of Rs. 26,37,548 in the assessment year 1985-86 was inadmissible and resulted in under assessment of income by identical amount with under charge of tax of Rs. 15,23,183 and short levy of interest of Rs. 4,37,891 for non payment of advance tax in the assessment year 1985-86.

The aggregate short levy of tax together with interest for the above mistakes worked out to Rs. 60,78,006 in the three assessment years.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

12. The Act further provides that where the assessee had acquired any capital asset from a country outside India for the purpose of his business or profession on deferred payment terms or against a foreign loan and there was increase or decrease in the rupee liability incurred by him in meeting the cost of asset or instalment payment as a consequence of fluctuation in the rate of exchange between Indian rupee and foreign currency, such variation in liability is allowed to be added or deducted against the original cost of the asset for the purpose of calculating depreciation allowance in computing the business profits.

(i) In the case of a public limited company for the assessment year 1983-84, assessment completed in March 1987, investment allowance of Rs. 10,46,19,022 instead of Rs. 9,91,29,378 in aggregate was claimed and allowed on two ships on their original costs of Rs. 21,84,69,146 and Rs. 20,00,06,940 instead on their actual costs of Rs.19,87,00,409 and Rs. 19,78,17,100 as worked out after taking into account the fluctuation in rate of exchange of currency of Rs. 1,97,68,737 and Rs. 21,89,840 respectively, as was done for allowing depreciation allowance. The mistake resulted in excessive grant of investment allowance of Rs. 54,89,644 involving notional short levy of tax of Rs. 30,94,786.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(ii) The Act provides that in respect of assets acquired from abroad, liabilities reduced due to fluctuations in foreign exchange would go to reduce the actual cost for the purposes of investment allowance and depreciation.

In the assessment of a company for the assessment year 1981-82 completed in August 1984, investment allowance and additional depreciation was allowed on the new machinery costing Rs. 29,27,014 overlooking the fact that the actual cost of the machinery was reduced by Rs. 3,25,176 due to fluctuation in foreign exchange. The mistake resulted in short computation of income by Rs. 1,05,682 involving short levy of tax of Rs. 87,479 including interest for short deposit of advance tax.

The Ministry of Finance have accepted the objection.

13. Under the Income-tax Act, 1961, in computing business income of an assessee, a deduction is allowed by way of investment allowance at the rate of twenty five per cent of the actual cost of new machinery or plant installed during the previous year provided that seventy five per cent of the allowance to be made is debited to the profit and loss account and credited to a reserve account.

(i) In the assessment of a company for the assessment years 1981-82 and 1982-83 completecd in March 1984 and March 1985 losses of Rs. 3,62,50,232 and Rs. 18,33,70,914 were determined by the assessing officer after allowing investment allowance of Rs. 78,59,833 and Rs. 1,11,59,932 respectively. It was, however, noticed in audit that the company had not created any investment allowance reserve in the accounts for these years and as such the grant of investment allowance was not in order. The mistake resulted in excess computation of losses of Rs. 78,59,833 and Rs. 1,11,59,932 for the assessment years 1981-82 and 1982-83 respectively involving a potential tax effect of Rs. 1,09,38,540 in aggregate.

The Ministry of Finance have accepted the objection in principle.

(ii) In the case of a Government undertaking for the assessment year 1984-85, assessment completed by the Inspecting Assistant Commissioner (Assessment) in February 1987, the assessing officer allowed the claim of the assessee for investment allowance of Rs. 1,40,10,230 even though the required reserve had not been created by the assessee during the relevant previous year. The incorrect grant of investment allowance of Rs.1,40,10,230 resulted in excess computation of loss of the same extent involving notional tax effect of Rs. 80,90,907.

The Ministry of Finance have accepted the objection.

(iii) The assessments of a public limited company for assessment years 1984-85, 1985-86 and 1986-87, were completed by the Inspecting Assistant Commissioner (Assessment) in February 1987, July 1987 and Novermber 1987 respectively. In computing the income, the assessing officer allowed deduction of Rs. 46,38,981 as investment allowance for assessment year 1984-85 and for assessment year 1985-86 and 1986-87 determined the quantum of investment allowance admissible as Rs. 71,90,359 and Rs. 9,35,557 respectively and allowed it to be carried forward though no investment allowance reserve was created in the previous years relevant to the respective assessment years. The incorrect grant of investment allowance resulted in under assessment of income of Rs. 46,38,981 in assessment year 1984-85, Rs. 71,90,359 in assessment year 1985-86 and Rs. 9,35,557 in assessment year 1986-87 involving potential tax effect aggregating to Rs. 73,22,606 for the three years.

The paragrap was referred to the Ministry of Finance for comments in June 1989; the reply from the Govenment has not so far been received (October 1989).

(iv) In the assessment of a public limited industrial company, for the assessment year 1982-83, completed in March 1985, the assessing officer allowed an investment allownace of Rs. 23,23,145 though the assessee company did not create the necessary reserve equal to seventy five per cent of the sum so allowed by debit to the profit and loss account of the relevant previous year. This resulted in excess computation of business loss by Rs. 23,23,145 involving potential tax under charge of Rs. 13,09,673.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

(v) In the accounts for the previous year relevant to the assessement year 1985-86, an assessee company withdrew investment allowance reserve of Rs. 10,47,306 created in the earlier years on the ground that there were no taxable profits in the years in which the allowance was claimed. On the basis of the reserve of Rs.. 10,47,306 the assessee company had been allowed investment allowance of Rs. 11,27,042 in the assessment years 1982-83 to 1984-85. As the assessee company contravened the provisions of the Act by drawing the reserve, the investment allowance of Rs. 11,27,042 allowed in the assessment years 1982-83 to 1984-85 should have been treated as wrongly allowed and it should have been accordingly withdrawn. This was not done by the department. The mistake resulted in incorrect allowance of investment allowance of Rs. 11,27,042 involving potential tax effect of Rs. 6,37,834 for the assessment years 1982-83 to 1984-85.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989). The department has accepted the objection.

(vi) In the assessment of a private limited company for the assessment year 1985-86 (assessment completed in March 1988), investment allowance of Rs. 1,29,208 pertaining to the assessment year 1984-85 and Rs. 89,423 relating to the assessment year 1985-86 were allowed as deductions. It was, however, noticed in audit that the statutory requirement regarding creation of the necessary reserve was not satisfied by the assessee company either in assessment year 1984-85 or in 1985-86 and as such no investment allowance was admissible to the assessee company. However, the assessing officer allowed investment allowance of Rs. 1,48,310 in assessment year 1985-86 resulting in short levy of tax of Rs. 1,35,447. Further, due to incorrect carry forward of investment allowance of Rs. 70,321 there was potential tax effect of Rs. 44,302.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

(vii) An industrial company in which the public were not substantially interested, claimed investment allowance of Rs. 3,93,660 in the original return for the assessment year 1985-86 filed in August 1985. In the revised return filed in February 1988 it claimed investment allowance of Rs. 2,25,660 but actually debited a sum of Rs. 1,62,600 in the relevant profit and loss account as Investment Allowance Reserve. While completing assessment in March 1988, the Inspecting Assistant Commissioner (Assessment) allowed investment allowance of Rs. 3.93,660 as per original claim of the assessee instead of Rs. 2,16,800 correctly allowable on the basis of reserve of Rs. 1,62,600 actually created in the relevant previous year. The excess allowance of investment allowance of Rs. 1,76,860 led to under-assessment of income by the like sum involving short levy of tax of Rs. 1,61,553 including interest for late submission of return and short payment of advance tax for the assessment year 1985-86.

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The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(viii) In the assessment of a company for the assessment year 1984-85 completed by the Inspecting Assistant Commissioner (Assessment) in August 1987, the assessing officer while computing the business income allowed investment allowance of Rs. 16,14,730 on machinery valued at Rs. 64,58,923. It was, however, noticed in audit that the assessee company had created investment allowance reserve of Rs. 11,14,204 only as against the required reserve of Rs. 12,11,046 in the accounts of the previous year relevant to the assessment year 1984-85 on the basis of which the assessee company, was entitled to the investment allowance of Rs. 14,85,604 only instead of Rs. 16,14,730 as allowed by the assessing officer. The mistake resulted in excess grant of investment allowance of Rs. 1,29,126 involving short levy of tax of Rs. 1,52,688 including short levy of interest of Rs. 31,910 and Rs. 39,430 for late filing of return and non furnishing of estimate of advance tax respectively.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

3.38 Mistake in set off of unabsorbed investment allowance

Under the Income-tax Act, 1961, where for any assessment year unabsorbed investment allowance under the head 'Profits and gains of business or profession' cannot be set off against any other income in the relevant year such unabsorbed investment allowance shall be carried forward to the following assessment year and shall be set off against profits and gains of business or profession of that year and if there is no positive income in that year also, it can be carried forward to the subsequent year for set off upto a maximum of eight assessment years, immediately succeeding the assessment year for which loss was first computed.

1. In the assessment of a limited company running a large texitle complex for the assessment year 1984-85, completed by the Inspecting Assistant Commissioner (Assessment) in March 1987 (revised in December 1987) an amount of Rs. 5,37,72,939 which included unabsorbed investment allowance of Rs. 45,66,915 pertaining to the assessment year 1981-82, was allowed as set off. The audit scrutiny however, revealed that the investment allowance of Rs. 45,66,915 had already been set off in the assessment for the assessment year 1983-84. The irregular set off of investment allowance of Rs. 45,66,915 again in the assessment year 1984-85, resulted in under assessment of income to the same extent involving short levy of tax of Rs. 37,51,695 (inclusive of interest of Rs. 11,14,302 for short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

2. In the assessment of a company for the assessment year 1977-78 completed in March 1981, net loss of Rs. 1,35,09,938 representing unabsorbed depreciation and unabsorbed investment allowance of Rs. 13,27,847 and Rs. 1,21,82,091 respectively was allowed to be carried forward for adjustment against future profit. This assessment was revised in April 1987 computing the loss at Rs.1,14,60,454 representing unabsorbed investment allowance only. It was however noticed in audit that assessment for the assessment year 1978-79, completed in May 1987 (revised in January 1988) the toal income was determind at Nil taking carried forward loss of assessment year 1977-78 as Rs.1,35,09,938 instead of Rs.1,14,60,454. The mistake resulted in excess carry forward of unabsorbed investment allowance of Rs. 20,49,484 involving potential tax effect of Rs. 11,83,576.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

3. In the assessment of a company for the assessment year 1982-83 completed in March 1985 (revised in December 1986) unabsorbed investment allowance pertaining to the assessment years 1976-77 to 1981-82 amounting to Rs. 9,34,277 was set off as claimed by the assessee. It was, however, noticed in audit that the investment allowance admissible to the assessee company for the assessment years 1976-77 to 1978-79 and 1980-81 amounting to Rs. 2,42,190 and Rs. 4,89,882 respectively was neither quantified nor allowed to be carried forward in the assessments made in September 1980 and March 1983 respectively. Thus set off of investment allowance of Rs. 2,42,190 and Rs. 4,89,882 pertaining to the assessment years 1976-77 to 1978-79 and 1980-81 respectively in the assessment year 1982-83 was not in order. The mistake resulted in under-assessment of income of Rs. 7,32,072 involving a tax under charge of Rs. 4,59,228 including short levy of interest of Rs. 9,004 for late filing of return in the assessment year 1982-83.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

4. In the assessment of a company for the assessment year 1985-86, completed in July 1987, the assessing officer computed the income as 'Nil' after allowing a deduction of Rs. 3,67,387 towards current year's investment allowance and adjusting earlier year's losses, though the carried forward losses of the earlier assessment years were required to be first adjusted against the business income of the assessment year 1985-86 and current year's investment allowance was to be allowed, if any income remained after such adjustment. In the case of assessee, after adjusting the carried forward business losses for earlier assessment year 1985-86, no amounts had remained for adjustment of the investment allowance. The grant of investment allowance of Rs. 3,67,387 resulted in excess carried forward of business loss involving potential tax effect of Rs. 2,31,454.

The Ministry of Finance have accepted the objection.

5. The assessment of a closely held company for the assessment year 1979-80 was completed by Deputy Commissioner (Assessment) in September 1982 on taxable income of Rs. 10,61,251. The assessment was revised in March 1988 to give effect to appellate orders and a loss of Rs. 2,00,235 was determined which included business loss of Rs. 1,05,632 and unabsorbed depreciation of Rs. 94,603. It was, however, noticed in audit (September 1988) that while carrying forward the loss for

adjustment against the profits for assessment year 1982-83 in the assessment completed in March 1988, another sum of Rs. 2,00,235 towards unabsorbed investment allowance which was neither claimed by the assessee company nor due to it (as per the records) was also carried forward and adjusted. The mistake resulted in short levy of tax of Rs. 1,23,144 for the assessment year 1982-83.

The Ministry of Finance have accepted the objection·

3.39 Mistake in excess set off of unabsorbed development rebate and depreciation.

1. Under the Income-tax Act, 1961, where for any assessment year, the development rebate/depreciation cannot be set off or is not wholly set off against income under any head of income in accordance with the provisions of the Act, such development rebate/depreciation is carried forward to the following assessment years, upto a maximum of eight assessment years immediately succeeding the assessment year for which the loss was first computed and is set off against the profits and gains of business or profession of these years.

(i) The assessment of a widely held company for the assessment year 1980-81 completed in September 1983 was revised in March 1988 to give effect to the appellate orders, determining the taxable income as Rs. 28,37,820 after setting off a sum of Rs. 13,85,106 towards unabsorbed development rebate relating to assesment years 1975-76 and 1976-77 and unabsorbed depreciation relating to assessment years 1976-77 and 1977-78 aggregating to Rs. 3,69,563. Audit scrutiny (November 1988), however, revealed that out of the sum of Rs. 13,85,106 set off, a sum of Rs. 3,40,344 representing the unabsorbed development rebate relating to assessment year 1975-76 and Rs. 6,46,252 being unabsorbed development rebate and depreciation relating to assessment year 1976-77 were already adjusted in the original assessment of assessment year 1977-78 completed in September 1980 in which a positive income of Rs. 16,25,892 was initially determined. Futher, as per the revision made in August 1986, the correct amount of loss relating to assessment year 1977-78 was Rs. 3,57,434 as against Rs. 3,62,721 adjusted in the assessment for the assessment year 1980-81. The mistakes resulted in excess carry over and set off of unabsorbed depreciation and business loss amounting to Rs. 9,91,883 involving short levy of tax of Rs. 5,86,451 for assessment year 1980-81.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(ii) In the case of an assessee company unabsorbed development rebate of Rs. 2,15,727 relating to assessment year 1974-75, was allowed to be carried forward in the assessment for the assesment year 1983-84, assessed in February 1987, even after the eighth assessment year. The mistake resulted in excess carry forward of unabsorbed development rebate by Rs. 2,15,727 involving potential tax under charge of Rs. 1,21,616.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection.

3.40 Incorrect computation of capital gains

1. Under the provisions of the Income-tax Act, 1961, any profit and gains arising from the transfer of a capital asset are chargeable to tax under the head 'Capital gains' except in cretain specified cases and is deemed to be the income of the previous year in which the transfer takes place. While, computing income from 'Capital gains' the Act provides for certain deductions in the case of assessees other than companies. In the case of companies such deduction is, however, not allowed but the income is taxed at certain concessional rates of tax.

In the assessment of a closely held company for the assessment year 1985-86 completed in February 1988, long term capital gains relating to sale proceeds of structural materials and building materials was computed at Rs. 5,66,451 after allowing a deduction of Rs. 3,77,634. But this deduction is admissible only in the case of non-company assessees and the assessee being a company, the incorrect allowance of the deduction resulted in under assessment of income by Rs. 3,77,634 and an under charge of tax of Rs. 1,98,257 including short levy of interest of Rs. 9,440 for late submission of return of income.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. Under the Income-tax Act, 1961, the income chargeable under the head 'Capital gains' shall be computed by deducting from the full value of the consideration, the cost of acquisition of the asset including the cost of any improvements thereto and the expenditure incurred wholly and exclusively in connection with the transfer. The cost of acquisition shall be the cost of the acquisition of the asset to the assessee or the fair market value of the asset as on 1 January 1964. It has been judicially held that when the entire shareholding including bonus shares are transferred by an assessee, question of determining cost of acquisition of bonus shares separately would not arise.

A foreign company sold during the previous year relevant to assessment year 1985-86, 13,598 shares comprising of 6,799 equity shares and equal number of bonus shares of Rs. 100 each held in another company at the rate of Rs. 350 per share. While computing the capital gain in the assessment for assessment year 1985-86 completed in Decermber 1987, the assessing officer determined the cost of acquistion for 6,375 shares purchased before 1 January 1964 at the rate of Rs. 116.34 per share (being the market value as on 1.1.1964) and for the remaining 7,223 shares at the average cost of Rs. 50 per share which was arrived at by dividing the total cost of Rs. 6,79,900 by the total number of shares, namely 13,598. As the assessee had sold its entire share holding including 6,799 bonus shares, the bonus shares were not required to be considered separately while determining the cost of acquisition in the light of the judicial decision mentioned above. The mistake resulted in excess computation of cost of acquisition by Rs. 3,18,750 which in turn led to under assessment of capital gains by an identical amount resulting in short levy of tax of Rs. 1,32,281 including interest of Rs. 4,781 for late filing of the return.

The paragraph was refered to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (Octover 1989).

3. During the previous year relevant to the assessment year 1984-85, a closely held company sold a piece of land admeasuring 1,842 square yard with a building thereon for Rs.5,00,000 and returned a capital gain of Rs. 1,97,120 after deduction from sale consideration a sum of Rs.3,02,800 towards cost of the assets. This was accepted in the assessment for the assessment year 1984-85 completed in December 1986. Audit scrutiny revealed in June 1987 that the property sold was a part of a property consisting of a factory building, store room godowns, out house and vacant land measuring 8,550 square yards purchased years' back for Rs. 68,000 and the assessee had already sold two pieces of the land during the previous years relevant to the assessment years 1968-69 and 1979-80. The gains arising from these two sales were charged to tax as capital gains by the assessing officers fixing the cost of acquisition of the vacant land at Re. 1 per square yard and that of the building at Rs. 25,000. These assessments had been confirmed by the Commissioner of Income-tax (Appeals) in April 1984. Adopting the same rate of valuation for land and building in the absence of details of buildings' cost, the cost of acquisition of land and building sold in the previous year relevant to the assessment year 1984-85 was only Rs. 26,842. The correct amount of capital gains assessable to tax was, therefore, Rs.4,73,158 as against Rs. 1,97,120 computed. The mistake resulted in short computation of capital gains of Rs. 2,76,038 with consequential short levy of tax of Rs. 1,21,885 for assessment year 1984-85

The Ministry of Finance have accepted the objection.

3.41 Income escaping assessment

1. It has been judicially held (97 ITR 615 S.C.) that the amount of Sales-tax collected by a trader in the course of business constitutes his trading receipts and is to be included in his total income. If and when the assessee paid the amount so collected to the Government or refunded any part thereof to the purchaser unless specifically exempted from tax by the provisions of the Act, the assessee would be entitled to claim deduction of the sum so paid or refunded. Further, under the provisions of the Income-tax Act, 1961, as amended by the Finance Act, 1983, with effect from the assessment year 1984-85, in computing the business income of an assessee liabilities for any sum payable by way of tax or duty under any law for the time being in force will be allowed out of the income of the previous year in which such sum is actually paid irrespective of the method of accounting employed by the assessee. In other words these deductions are admissible only on actual payment and not on accrual basis.

In the assessment of twelve assessee companies for the assessment years 1984-85, 1985-86 and 1987-88 completed between September 1986 and March 1988 it was noticed from the accounts of the relevant previous years that liabilities on account of State/Central Sales tax and excise duty collected during the years but not paid to the Government/refunded to the parties were allowed as deduction while computing the business income for the relevant assessment years. Failure to disallow the unpaid liabilities resulted in under-assessment of income amounting to Rs. 273.14 lakhs involving undercharge of tax of Rs. 189.43 lakhs including interest for late filing of return/short payment of advance-tax/excess-carry forward of unabsorbed investment allowance.

The details of the cases are as under :

Sl. No.	Name of the assessee	Assessment year	Unpaid sales tax/ Excise duty liability	Tax effect
1	A	1985-86	1,28,90,604	74,44,323 (Potential)
2	B	1984-85	17,36,142	17,77,288
				2,93,408 (Surtax)
3	C	1984-85	10,05,207	6,86,054
		1985-86	10,15,741	8,83,879
4	D	1985-86	4,06,606	3,68,206
5	E	1985-86	1,85,649	1,86,888
6	A	1985-86	39,54,166	22,83,530
7	B	1985-86	23,23,000	19,27,479
8	C	1985-86	8,57,442	7,11,817
9	D	1985-86	6,31,650	5,35,286
10	E	1987-88	9,45,742	5,20,158
11	A	1984-85	10,67,773	10,78,527
12	A	1985-86	2,94,147	2,46,186
	Total		2,73,13,869	1,89,43,029

The paragraphs were referred to the Ministry of Finance for comments between May 1989 and August 1989; the reply from the Government has not so far been received (October 1989.) However, the Ministry of Finance/department have/has accepted the objections in two three cases each.

2. Under the provisions of the Income-tax Act, 1961, the total income of the previous year of a person includes all income from whatever source derived which is received or deemed to be received in India each year or accrues or arises or is deemed to accrue or arise to him in India during such year unless specifically exempted from tax by the provisions of the Act. Further, any expenditure or trading liability incurred for the purpose of business carried on by an assessee is allowed as a deduction in the computation of his income. Where, on a subsequent date, the assessee obtained any benefit in respect of such expenditure or trading liability allowed earlier, by way of remission or cessation thereof the benefit that accrues thereby, shall be deemed to be profits and gains of business or profession to be charged to income-tax as income of the previous year in which such remission or cessation takes place. Under the Act, amalgamation of two or more companies is recognised provided, inter alia, all the liabilities of amalgamating company or companies immediately before the amalgamation become the liability of the amalgamated company by virtue of the amalgamation.

A company 'A' owning an industrial undertaking and running under loss was amalgamated with another company 'B' with effect from 1 April 1978, after approval (February 1982) by the High Courts of Bombay and Madras. During the previous years relevant to the assessment years 1982-83, 1983-84 and 1984-85 financial institutions and banks who were creditors of the amalgamating company agreed to the remission of overdue interest of Rs. 1,44,12,329 due to the above creditors, in accordance with the scheme of amalgamation. The amount so waived was credited to the general reserve account of the amalgamated company. Obviously the interest liability being revenue expenditure, had already been charged to accounts in the earlier years and had been allowed as deduction by the department in the hands of the amalgamating company. As such, the amount of Rs. 1,44,12,329 remitted during the previous years relevant to assessment years 1982-83 to 1984-85 should have been treated as income and brought to tax in the assessments of the amalgamated company for the respective years. The benefit accruing on account of remission of the overdue interest was nevertheless not brought to tax in the assessment of the amalgamated company for assessment years 1982-83, 1983-84 and 1984-85 (completed in March 1985, December 1986 and February 1987 respectively). This was not also considered when the assessments were revised subsequently between March 1987 and January 1988. This led to under assessment of income of Rs. 1,44,12,329 and corresponding under charge of Rs. 82,38,649 (including excess interest on advance tax amounting to Rs. 1,07,461 to be withdrawn for assessment year 1984-85). The consequent under charge of surtax for assessment year 1982-83 was Rs. 22,77,309. The surtax assessments for the remaining two assessment years were still pending.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3. A widely held company in the previous year relevant to the assessment year 1985-86 credited in the profit and loss account, an amount of Rs. 51,79,067 towards excess provision/relating to earlier years. The details on record revealed that the provision had been allowed as expenditure in the earlier assessment years. As this amount of Rs. 51,79,067 was already charged to accounts of the earlier years and was allowed as deduction, the amount when written back during the year should have been treated as income. However, while completing the assessment for the assessment year 1985-86 in February 1988, the amount of Rs. 51,79,067 was not treated as income of that year. The omission resulted in under assessment of income of a like amount involving notional short levy of tax of Rs. 29,90,911.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4. In the case of a company, provision of expenses and liabilities no longer required was written back to the extent of Rs. 9,15,443 in its accounts for the previous year relevant to assessment year 1984-85. As the provision in question had been allowed as deduction in earlier years, it was chargeable to tax when written back under the specific provision in the Act mentioned above. In the assessment completed in January 1988, for the assessment year 1984-85, the assessing officer did not include the amount in question while computing the business income of the assessee. Omission to do so resulted in excess determination of loss by Rs. 9,15,443 leading to potential short levy of tax of Rs. 5,76,729.

The Ministry of Finance have accepted the objection.

5. In the case of a company provisions for excise duty and sales tax amounting to Rs. 2,09,517 and Rs. 6,55,679 respectively were written back in the accounts of the year relevant to assessment year 1984-85. These provisions were allowed as deduction by the department in earlier assessment years. In the assessment for the assessment year 1984-85 completed in January 1987 and revised in November 1987, the assessing officer included a sum of Rs. 1,05,774 only out of excise duty of Rs. 2,09,517 while computing the assessable income. Neither the amount of Rs. 6,55,679 relating to sales tax nor the balance of Rs. 1,03,743 relating to excise duty written back was considered in the computation of total income. As the aforesaid amount written back represented benefit received by the assessee by way of remission of trading liabilities allowed in earlier years, the entire provision written back is chargeable to tax. Omission to include them resulted in under assessment of income by Rs. 7,59,422 leading to short levy of tax of Rs. 4,67,039.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

6. The assessment of an assessee company for the assessment years 1983-84 and 1984-85 (assessments completed in November 1985 and January 1987 respectively) was computed at a loss in each of the said assessment years. It was, however, seen that the assessee company credited its profit and loss appropriation accounts in the previous years relevant to the assessment years 1983-84 and 1984-85 with the sums of Rs. 2,71,466 and Rs. 3,69,767 respectively. This was shown as adjustment relating to previous years (net). These sums represented credit notes received from a coal

supplying agency in return for delivering defective coal in earlier years and other items which were also written back. Since the expenses for purchase of coal and the other relevant items had already been debited in earlier years accounts and had consequently been allowed in respect of assessments, the sums of Rs. 2,71,466 and Rs. 3,69,767 were required to be treated as income in the previous years relevant to the assessment years 1983-84 and 1984-85. Omission to do so resulted in excess computation and carry forward of business loss and unabsorbed depreciation aggregating to Rs. 6,41,237 involving a potential tax effect of Rs. 4,33,230 for the assessment years 1983-84 and 1984-85.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October1989).

7. The note annexed to the accounts of an assessee company for the previous year relevant to assessment year 1987-88 showed that the company received a refund of Rs. 4,55,662, being rebate of excise duty on production of sugar for the season 1974-75 as per decision of Customs, Excise and Gold (Control) Appellate Tribunal. The Excise department had subsequently preferred an appeal before Supreme Court against the said decision of the Tribunal. Perusal of records disclosed that the assessee instead of crediting the amount to the profit and loss account as trading receipt provided the same in the Balance Sheet as current liability pending decision of appeal before the Court by the department. In the assessment for the assessment year 1987-88 completed in September 1987 and subsequently revised in June 1988, the assessing officer did not include the amount of Rs. 4,55,662 as income. As the liability for excise duty had already been allowed by the department in the earlier assessments, the rebate of excise duty should have been added back and treated as income of the previous year in which such refund was received in accordance with the above mentioned provisions of the Income-tax Act, 1961, since the order of the Tribunal is a valid order so long as it is not over ruled by the Supreme Court. The omission to do so resulted in under assessment of income of Rs. 4,55,662 involving tax under charge of Rs.2,42,068 (including interest of Rs.14,237 for short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

8. An assessee company had written back in the accounts for the previous year relevant to assessment year 1985-86 a sum of Rs. 52,000 which had been incurred in the earlier years towards 'salaries and rent'. This amount should have been credited to the profit and loss account and included in the total income. Similarly, during the same accounting period the assessee received a remission of Rs.3,93,988 from unsecured creditors. Both these amounts were required to be included in the computation of total income of the assessee. Failure to include the aggregate amount of Rs. 4,45,988 in the income chargeable to tax resulted in the total income being computed wrongly at a loss of Rs.1,52,860, against a positive income of Rs. 2,93,128. This involved short levy of tax of Rs. 2,34,880 (including interest of Rs. 65,600 for non payment of advance tax).

The departmet has accepted the objection.

The paragraph was referred of the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

9. Under the Income-tax Act, 1961, any expenditure laid out or expended wholly and exclusively for the purpose of business is allowable as deduction in computing the business income of an assessee provided the expenditure is not in the nature of capital or personal expenses of the assessee.

A nationalised bank had made investment in securities. The investments were valued by the bank at cost or market price whichever is lower at the end of the year and the resultant loss due to revaluation was claimed as deficiency in the market value. In the previous year ending 31 December 1979 relevant to assessment year 1980-81, the assessee claimed a deduction of Rs.2,88,21,031 towards deficiency in the market value of securities. This was not allowed by the assessing officer in the original assessment made in September 1983 but was allowed in the revision order made in February 1984 to give effect to an appellate order allowing the deduction subject to verifying the correctness of computation. Scrutiny of records (February 1987) revealed that for assessment year 1981-82, the appellate authority had held while allowing similar deduction that the appreciation or depreciation in the value of securities should be ascertained and the amount added or deducted from the returned income according as there was appreciation or depreciation. It was noticed from the details filed by the assessee for assessment year 1980-81 that while the deficiency in the market value was Rs. 2,88,21,031 there was also surplus in respect of some securities amounting to Rs.1,17,77,172 but this surplus was not taken into account while computing the total income. It was pointed out in audit (February 1987) that the omission to take into account the surplus arising out of revaluation of securities resulted in escapement of income by Rs.1,17,77,172 involving an undercharge of tax of Rs. 69,63,252.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

10. In the assessment of a Government company for the assessment year 1983-84 completed in March 1987 the assessing officer adopted the value of closing stock as on 31 March 1983 at Rs. 5,92,07,459 instead of the correct value of the stock at Rs.6,75,22,808. The difference of Rs.83,15,349 was due to an omission on the part of the department to take into account the stock with the disposal officers and in the show rooms. The mistake resulted in excess computation of loss by Rs. 83,15,349 involving a potential tax effect of Rs.46,87,778.

The Ministry of Finance have accepted the objection.

11. Under the provisions of the Income-tax Act, 1961, as applicable from the assessment year 1976-77 profits of a non resident assessee engaged in the business of operation of ship shall be calculated at seven and half per cent of the aggregate amount (i) paid or payable in India or out of India for carriage of passengers, live-stock, mail or goods shipped at any port in India (ii) received or deemed to be received in India for carriage of passengers, livestock, mail or goods shipped at any port outside India.

In the assessment of a non-resident shipping company for the assessment year 1983-84 assessed in February 1986, container detention charges of Rs. 16,72,544 recovered from the consignees in India was assessed at the rate of seven and half per cent. The concessional rate of seven and half per cent was applicable only for freight receipt from carriage of passengers, live-stock, mail or goods. As carriage charges did not include demaurrage received for container detention, it was required to be assessed at the rate of 100 per cent instead of seven and half per cent. The mistake resuted in under assessment of income of Rs.15,47,103 with consequent under charge of tax of Rs.12,99,043 including short levy of surtax of Rs.1,88,997.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

12. Under the provisions of the Income-tax Act, 1961, where in respect of any assessment year the net result of computation under "Capital gains" relating to short term capital asset is a loss and the assessee has income assessable under any head of income other than 'Capital Gains', the assessee shall be entitled to have such loss set off against income under other head of income It has been judicially held that tax planning may be legitimate provided it is within the frame work of law but it is wrong to avoid the payment of tax by dubious methods.

A private limited company acquired in February 1982, 19,300 shares of another private limited company by way of gift and an additional 10,000 shares of the same company at a nominal price of rupee one each. All these 29,300 shares were sold within a few days of acquisition for Rs. 29,300. The cost of acquisition of the gifted shares was determined at Rs.19,40,000 at Rs. 100 per share under the provisions of the Income-tax Act. On the sale of the shares the assessee claimed a short term capital loss of Rs. 19.10 lakhs which was allowed by the assessing officer in the assessments completed in November 1984 and February 1986. It was seen in audit that the company whose shares were acquired was taken over by the Government in May 1979 and there was no material change in the balance sheets of the company for the years 1979, 1980, 1981 and 1982. The assessing officer himself had stated in the assessment order that even after adjustment of debit balance of the accumulated losses and the loans there were investment value of the shares. As such the value of the share could not be below its face value viz. Rs. 100 and the sale of the shares at Re. 1 each and consequent claim for a short term capital loss of Rs. 19.10 lakhs was only a device to avoid tax and deserved to be disallowed in the light of the Supreme Court decision cited above. The comission resulted in under assessment of income of Rs.19.10 lakhs involving a tax effect of Rs.11,75,055.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

13. Under the Income-tax Act, 1961, income chargeable under the head 'Profits and gains of business or profession is computed in accordance with the method of accounting regularly employed by the assessee. Where an assessee follows mercantile system of accounting the net profit or loss is calculated after taking into account all the income actually received as well as accrued or deemed to accure as well as all expenditure and the liability incurred relating to the period regardless of their actual receipt or payment.

During the previous years relevant to the assessment years 1983-84 and 1984-85, a company engaged in the manufacture of tea produced 8,96,232 Kgs and 1,83,650 Kgs. of tea includng 3,53,349 Kgs. and 24,508 Kgs of tea manufactured for its sister concerns. The profit and loss account of these two years was debited with the full manufacturing cost. However, it was credited with the realisable cost of 5,42,883 Kgs and 1,59,142 Kgs of tea, leaving the balance of 3,53,349 Kgs and 24,508 Kgs of tea produced for its sister concerns out of account. As the company was following the mercantile system of accounting and had debited the profit and loss with the full cost of manufacture, the realisable cost of tea manufactured to the sister concerns aggregating to Rs.9,89,974 was required to be assessed in the assessment years 1983-84 and 1984-85. The omission resulted in under assessment of income of Rs.9,89,974 and short levy of tax of Rs. 6,09,796.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

14. A tea company following mercantile system of accounting credited in its accounts for the previous year relevant to the assessment year 1984-85, accrued interest of Rs. 5,21,946 receivable from another company. This accrued income although taxable in the hands of the assessee company was not considered by the department while computing business income of the company for the assessment year 1984-85 in January 1987. As interest income of a tea company is treated as non agricultural income, the amount of Rs. 5,21,946 was wholly taxable. Omission to include interest income resulted in under-assessment of income of Rs. 5,21,946 with consequent undercharge of tax of Rs. 3,01,423.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

15. While completing the assessment of a private limited company for the assessment year 1984-85 in March 1987, the assessing officer did not disallow and add back to the income of the relevant previous year, expenses in respect of liquidated damages amounting to Rs. 2,77,668 relating to an earlier previous year, already claimed in the relevant assessment year. The omision to do so resulted in income escaping assessment to the extent of Rs. 2,77,668 having tax effect of Rs. 2,35,519 (including interest of Rs. 60,587 for short payment of advance-tax).

The paragraph was referred to the Ministry of Finance for comments in August 1989, the reply from the Government has not so far been received (October 1989).

16. A company following mercantile system of accounting credited in its accounts for the year ended 31 March 1983 relevant to the assessment year 1983-84 a sum of Rs.2,47,259 towards interest accrued on loan of Rs.32,53,500 advanced from time to time to another company. But a correlation of assessment records revealed that the borrowing company (having identical previous years) debited a sum of Rs.5,75,334 in its

accounts as interest payable to the assessee company for the period 1 April 1982 to 31 March 1983. The interest accrued on the aforesaid loan was thus credited short by Rs.3,28,075 in the books of the assessee company. This led to excess computation of loss by the identical amount involving a potential tax effect of Rs. 1,89,463.

The Ministry of Finance have accepted the objection.

17. It has also been judicially held that the mere fact that an amount due to the assessee has been carried to a suspense account cannot be held to mean that income had not accrued to the assessee.

(i) The Income-tax assessment of a private limited investment company for assessment year 1985-86 was completed in November 1987. From the notes on accounts for the previous year ending 31 December 1984 relevant to assessment year 1985-86, it was seen that interest of Rs. 6,20,017 receivable on the loans given to certain parties were not accounted for on the ground that the recovery was doubtful. As the company was following mercantile system of accounting the interest due on the loans was required to be brought to tax. Failure to do so resulted in under assessment of income of Rs. 6,20,017 involving potential short levy of tax of Rs. 4,23,162.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) In the assessment of a non resident banking company completed in February 1988 for the assessment year 1987-88, an amount of Rs. 2,63,072 being interest credited to a 'Interest Suspense Reserve Account' was not assessed to tax. The omission of income by the like sum and under-charge of tax of Rs. 1,77,405 including interest for short payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Govenment has not so far been received (October 1989).

18. A widely held company, follwing the mercantile system of accounting, did not bring to account the interest of Rs. 5,59,578 accrued during the previous year relevant to the assessment year 1986-87 and the assessing officer also omitted to assess the accrued interest in the assessment for 1986-87. The omission resulted in short levy of of tax Rs. 3,34,120 including interest for late filing of returns and non-submission of estimate of income.

The Ministry of Finance have accepted the objection.

19. An assessee company was allowed interest by Government on the excess payment of advance tax for the assessment year 1978-79, the assesment for which was completed in September 1981. Since the interest of Rs.2,65,802 was quantified in the previous year relevant to the assessment year 1982-83 the same should have been taken as income of the assessee for the assessment year 1982-83 completed in February 1986. The omission led to escapement of income of Rs. 2,65,802 with consequent short levy of tax of Rs. 2,24,745 inclusive of interest of Rs. 74,900 for short payment of advance tax in assessment year 1982-83.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

20. The Income-tax assessments of a closely held company for the assessment years 1983-84 and 1984-85 were completed in March 1986 and February 1987 determining a loss of Rs. 7,81,452 and a total income of Rs. 7,47,680 respectively. Audit scrutiny in March 1988 revealed that the assessee company was paid on interest of Rs. 1,22,303 and Rs. 1,76,267 on account of excess advance tax paid for the assessment years 1979-80 and 1980-81 as determined in the assessment completed in September 1982 and December 1983 respectively. Though the interest was rightly assessable in the assessment for the assessment years 1983-84 and 1984-85, yet it was neither returned by the assessee company nor was it brought to tax by the department. The omission resulted in excess determination of loss by Rs. 1,22,303, and under assessment of income by Rs. 1,76,267 involving potential tax demand of Rs.1,88,097.

The departmnet has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

21. The assessment of a private limited company deriving income from cold storage business for the assessment year 1977-78 was reopened on the basis of a search conducted in the premises of the company as well as those of its Managing Director. Documents seized disclosed, inter alia, that potatoes sold through trucks worth Rs.85,905 were kept out of the account furnished with the return of income. While completing the re-assessment in October 1987, the assessing officer omitted to include this sale proceeds in the total income of the assessee. The mistake resulted in sort computation of income by Rs.85,905 with consequent under charge of tax of Rs. 1,24,517 (inclusive of interest for delay in filing of return and non payment of advance-tax).

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

3.42 Incorrect set off and carry forward of losses

1. As during the previous years, during test check a large number of cases of 'incorrect set-off and carry forward of losses' were noticed during 1988-89 also. A few major instances are detailed below:

The assessment of a company for the assessment year 1982-83 completed in February 1985 was revised in January 1987 determining the income as 'NIL' after set off of a part of unabsorbed depreciation of Rs.5,69,450 relating to assessment year 1966-67. The unabsorbed depreciation, business loss and unabsorbed development rebate for assessment years 1966-67 to 1973-74 and 1978-79 amounting to Rs.29,91,832 was allowed to be carried forward for set off in subsequent years. It was noticed in audit that a sum of Rs.12,25,994 representing unabsorbed depreciation and business loss for assessment years 1966-67 to 1970-71 was already set off against the revised positive income for assessment year 1976-77 as computed in January 1985. This set off of Rs.12,25,994 in the assessment year 1976-77 was lost sight of at the time of assessing the income for assessment year 1982-83 on a later date. This led to excess carry forward of business loss, unabsorbed depreciation and unabsorbed development rebate by Rs.12,25,994 in the assessment year 1982-83 involving potential tax effect of Rs.7,53,987.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in January 1989; the reply from the Government has no so far been received (October 1989).

2. The assessment of a widely held company for the assessment year 1981-82 originally completed in August 1984 was revised in December 1984 computing a business loss of Rs.6,42,733 and unabsorbed investment allowance of Rs.5,51,491 which were allowed to be carried forward and set off against the business income for assessment year 1982-83 in the assessment completed in January 1985. The assessment for assessment year 1981-82 was revised in January 1987 and the business loss of Rs.6,42,733 was converted into profit and the investment allowance of Rs.5,51,491 was also allowed as deduction from the positive business income. To give effect to appellate orders allowing certain reliefs, the assessment for assessment year 1982-83 was also revised in January 1987 and the total income determined as a loss. However, the business loss and unabsorbed investment allowance aggregating to Rs.11,94,224 originally set off in January 1985 was omitted to be withdrawn consequent on the revision of assessment for the assessment year 1981-82 and this amount was allowed to be carried forward for adjustment against the income of subsequent assessment years. The mistake resulted in irregular carry forward of business loss and unabsorbed investment allowance aggregating to Rs.11,94,224 with a consequetial potential undercharge of tax of Rs.6,73,243.

The Ministry of Finance have accepted the objection.

3. In the assessment of an assessee company for the assessment years 1980-81,1981-82 and 1982-83, the taxable income was computed at a loss aggregating to Rs.24,39,903 which was allowed to be carried forward. The assessee had positive income for the assessment years 1983-84 and 1984-85 against which loss amounting to Rs. 19,56,616 (Rs 10,19,501 in assessment year 1983-84 and Rs.9,37,115 in assessment year 1984-85) was adjusted leaving a balance of loss of Rs.4,83,287. However, a sum of Rs.10,47,713 (Rs.8,62,616 for the assessment year 1981-82 and Rs.1,85,097 for the assessment year 1982-83) instead of the correct amount of Rs.4,83.287 was allowed to be carried forward in the assessment order for the assessment year 1984-85 passed in January 1987. The mistake resulted in excess amount of loss of Rs.5,64,426 being carried forward in the subsequent years with consequent potential tax effect of Rs.3,55,590.

The Ministry of Finance have accepted the objection in principle.

4. In the assessment of a tea company for the assessment year 1985-86 completed in March 1988, the assessing officer adjusted the business loss of Rs.5,93,999 for the assessment year 1983-84 as claimed by the assessee. However, verification in audit of the assessment records for the assessment year 1983-84 revealed that the business loss as assessed by the department was Rs.4,00,720 only. The incorrect adjustment of business loss of Rs.5,93,999 instead of the correct amount of Rs. 4,00,720 resulted in under-assessment of income of Rs.1,93,279 involving undercharge of tax of Rs. 1,92,914 (including short levy of interest of Rs.61,003 for late filing of return and short payment of advance tax).

Further due to mistake in calculation of interest, there was also a short levy of interest of Rs.94,465 for short payment of advance tax. The above mistakes resulted in short levy of tax aggregating to Rs.2,87,379 for the assessment year 1985-86.

The Ministry of Finance have accepted the objection.

5. Unabsorbed losses can be set off only if the business or profession for which the loss was originally computed continued to be carried on in the previous year relevant to that assessment year.

A proprietory concern of an assessee company which had not carried on any fibre manufacturing activity since the previous year ending July 1981 was allowed to carry forward and set off of business losses of the concern relating to assessment years 1982-83, 1983-84 and 1984-85 amounting to Rs. 2,57,740, Rs. 2,63,665 and Rs.2,03,948 respectively against the income of the main company. The incorrect carry forward and set off of these losses relating to the closed concern resulted in under assessment of income by Rs.3,93,290 for the assessment year 1984-85 (income in assessment years 1982-83 and 1983-84 being below taxable limit) involving short levy of tax of Rs.2,71,922 (including interest of Rs.24,150 for short payment of advance tax).

The Ministry of Finance have accepted the objection for the assessment years 1983-84 and 1984-85. For the assessment year 1982-83, the Ministry have stated that the rectfiicatory action has become time barred.

6. The total income of a private limited company for the assessment year 1985-86 was computed at Rs. 3,35,763 which comprised of house property income of Rs.2,56,446 and business income of Rs.79,317. The assessing officer while completing the assessment in November 1987 allowed set off unabsorbed business loss of Rs.3,35,763 relating to the assessment years 1977-78, 1979-80, 1980-81, and 1982-83 against this income and reduced the taxable income to nil. As the unabsorbed business loss of earlier eassessment years could be set off only against the business income of Rs.79,317 and not against the income from house property, the erroneous adjustment resulted in under assessment of income by Rs.2,56,446 for the assessment year 1985-86 involving short levy of tax amounting to Rs.2,47,216 (including interest).

The Ministry of Finance have accepted the objection.

7. In the case of a public limited company, the assessment for the assessment year 1982-83 was completed in March 1985 allowing set off of business loss of Rs. 4,05,352 pertaining to the assessment year 1981-82. The assessment for the assessment year 1981-82 was completed in September 1984 computing the loss at Rs. 7,96,775. The assessment was revised in June 1987 for giving effect to appellate orders and a taxable income at Rs. 21,64,689 was computed. Thus no business loss existed to be carried forward for the following assessment year 1982-83. However, the assessment for the assessment year 1982-83, was not rectified simultaneously withdrawing the business loss of Rs. 4,05,352 allowed in March 1985. The omission to rectify the assessment of assessment year 1982-83 resulted in under assessment of income of Rs. 4,05,352 involving short levy of tax of Rs. 2,28,517.

The Ministry of Finance have eccepted the objection.

8. The total income of a company for the assessment year 1984-85 was originally computed in February 1985 at Rs. 3,96,346 which comprised of income from other sources of Rs. 3,91,318 and business income of Rs. 5,028. The assessment was subsequently revised in July 1987 in which the assessing officer allowed set off of unabsorbed business loss of Rs. 2,73,840 in aggregate for the assessment years 1980-81 and 1983-84 against the income of Rs. 3,96,346 and reduced the total income to Rs. 1,22,506. As the unabsorbed business loss of the eariler years could be set off only against the business income of Rs. 5,028 and not against the income from other sources of the assessment year 1984-85, there was an under-assessment of income of Rs. 2,68,812 leading to under charge of tax of Rs.1,93,475 (including short levy of interest of Rs. 24,125 for late submission of return and short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

9. The assessments of a closely held company for the assessment years 1984-85 and 1985-86 were completed in June 1986 and October 1987 on taxable incomes of Rs. 17,350 and Rs. 17,435 after adjusting Rs. 1,03,424 and Rs. 1,30,264 respectively towards unabsorbed business loss relating to the assessment year 1981-82. It was however, noticed that based on the orders of the Commissioner of Income tax issued in Feburary 1988, the assessment for the assessment year 1981-82 (for which the business loss of Rs.2,39,832 was determind in January 1986) was revised in March 1988 computing taxable income of Rs. 3,90,650. However, the assessments for the assessment years 1984-85 and 1985-86 were not correspondingly revised to withdraw the carried forward business loss of the assessment year 1981-82 which was adjusted earlier. The omission to do so resulted in under assessment of income of Rs.2,33,688 in the assessment years 1984-85 and 1985-86 involving short levy of tax of Rs. 1,59,490.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

10. In the assessment of a private limited company for the assessment year 1983-84 completed in September 1986 a loss of Rs. 1,44,406 pertaining to assessment year 1982-83 was adjusted. The assessment for assessment year 1982-83 was revised in October 1986 and loss was recomputed at Rs. 1,68,044. The balance of unabsorbed loss of Rs. 23,638, was to be set off, while giving effect to appellate orders dated 3.12.1986, for assessment year 1983-84. However, as against Rs.23,638, the assessing officer set off the entire unabsorbed loss of Rs. 1,68,044. The incorrect set off of loss resulted in excess adjustment of loss of Rs. 1,44,406 and consequent short levy of tax of Rs. 1,68,878 (including interest for late filing of return and short payment of advance tax).

The Ministry of Finance have acepted the objection.

11. The assessment of a widely held company for the assessment year 1982-83 was competed in December 1984 determining the income as 'NIL' and allowing a sum of Rs. 2,72,989 as unabsorbed investment allowance which was carried forward and set off in the assessment for the assessment year 1983-84 completed in October 1985. The assessment for the assessment year 1982-83 was revised in January 1987 to give effect to the orders of Commissioner of Income-tax (Appeals) which resulted in enhancement of the unabsorbed investment allowance to be carried forward to Rs. 3,29,936. Accordingly, the assessment for the assessment year 1983-84 was also revised on the same date in which the sum of Rs.3,29,936 was again set off as unabsorbed investment allowance over looking the fact that the set off of a sum of Rs. 2,72,989 had already been allowed on this account in the original assessment made in October 1985. The mistake resulted in excess set off of unabsorbed investment allowance by Rs. 2,72,989 with a consequent short levy of tax of Rs. 1,53,899 in the assessment year 1983-84.

The Ministry of Finance have accepted the objection.

12. The assessment of a company for the assessment year 1983-84 was completed in February 1987 computing a positive income of Rs. 4,89,402 against which unabsorbed business losses of Rs. 2,21,257 and Rs. 2,68,145 for the assessment years 1974-75 and 1975-76 respectively were set off. As unabsorbed business loss for the assessment year 1974-75 could not be carried forward beyond the assessment year 1982-83, the set off of unabsorbed loss to the tune of Rs. 2,21,257 of the assessment year 1974-75 against the income of the assessment year 1983-84 was not in order. The mistake led to under assessment of income by Rs.2,21,257 leading to excess carry forward of loss by the same amount involving potential tax effect of Rs. 1,24,733 for the assessment year 1983-84.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

13. The assessments of a private construction company for the assessment years 1984-85, 1985-86 and 1986-87 were completed in October 1986/November 1986 and 'NIL' income was assessed after adjusting the loss pertaining to the assessment years 1979-80 to 1983-84. During the previous years relevant to assessment years 1984-85 to 1986-87 the company was engaged in the business of technical consultancy, while the losses incurred in assessment years 1979-80 and 1983-84, were on account of construction activity outside India. As the business in which loss was incurred in 1979-80 and 1983-84 was not continued in the assessment years 1984-85 to 1986-87, the business losses could not be set off against the positive income in assessment years 1984-85 to 1986-87 of a newly started business. The incorrect set off of losses resulted in under assessment of income aggregating to Rs. 5,03,969 involving under charge of tax of Rs. 2,48,356.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

14. A company deriving income from manufacture and sale of sugar started a new industrial undertaking namely 'Solvent Plant Unit' in backward area, which went into production during the previous year relevant to assessment year 1976-77. In the assessment of the

company for the assessment year 1980-81 completed in September 1984, the entire profit of Rs. 9,81,009 in the new undertaking was adjusted against relief for establishing the industry in backward area and tax holiday relief relating to the assessment years 1976-77 to 1980-81. The assessments for the assessment years 1978-79 to 1980-81 were revised by the Inspecting Assistant Commissioner (Assessment) in September 1987, to give effect to the relief granted by the Commissioner of Income-tax (Appeals) on account of export markets development allowance, etc., and to rectify certain mistakes. In the revised assessments, business loss for the assessment years 1978-79 and 1979-80 were determined at Rs. 9,90,356 and Rs. 3,76,321 respectively and the income for the assessment year 1980-81 after set off of the business losses for these two years was determined at Rs. 'NIL' and the balance loss of Rs. 2,25,783 was allowed to be carried forward. Audit scrutiny (December 1988) revealed that while computing the 'NIL' income for the assessment year 1980-81, the profit of Rs. 9,81,009 (before tax reliefs of new industrial undertaking) of the new undertaking was not taken into consideration and the business losses for the assessment years 1978-79 and 1979-80 which pertained to the new undertaking, were adjusted against the profits of the old unit of sugar. Had the profit of Rs. 9,81,009 been included first and the correct order of priority for adjustment of losses been observed, there would have been positive income of Rs. 5,59,246 for the assessment year 1980-81 and the business loss of Rs. 2,25,783 would not have arisen. The mistake resulted in under assessment of income of Rs. 5,59,246 with aconsequent short levy of tax of Rs. 3,30,650 for the assessment year 1980-81. Besides, there was potential tax effect of Rs. 1,33,490 on business loss of Rs. 2,25,783 which was wrongly allowed to be carried forward.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

15. The hotel business of a company was taken over by a State Government in July 1980. The management was handed over to an authority to look after the affairs of the hotel. The new body had no share capital and the department treated it as a company in which public were not substantially interested. The assessment of the new company for the assessment year 1984-85 was made in March 1985 and revised in December 1985 determining a total income of Rs. 17,30,490 after adjusting carried forward business loss of Rs. 6,98,553 of the erstwhile company relating to the assessment years 1977-78 and 1978-79. The new company had no one shareholders of the erstwhile company as its shareholder as on the last day of the previous year relevant to the assessment year 1982-83 in which the unabsorbed business loss of the erstwhile company was set off against the business income of the new company. The incorrect set off of loss resulted in under assessment of income of Rs. 6.98,553 with consequent undercharge of tax of Rs. 6,52,733 (including short levy of interest for late filing of return and short payment of advance tax) for the assessment year 1982-83.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

16. In the previous years relevant to assessment years 1985-86 and 1986-87, an assessee company derived more than 51 per cent of its total income from trading activities as commission received and also sustained losses of Rs. 8,02,265 and Rs. 7,80,068 in the business of share dealings. The aforesaid losses were charged to the profit and loss account of the company and were allowed as deductions by the assessing officer while completing assessments in July 1987. As the company derived more than 51 per cent of its total income from a source other than that of a investment company as defined in the Act, the losses sustained in share dealings should be taken to have arisen out of speculation business and this loss could be set off only against speculation profit. The allowance of such deduction were, therefore, not in order.

The incorrect set off of speculation loss against income from sources other than speculation business thus resulted in under assessment of income of Rs. 15,82,333 leading to total undercharge of tax of Rs. 13,55,174 for the assessment years 1985-86 and 1986-87 (including interest of Rs. 3,16,181 for late submission of return and short payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

17. A trading company deriving income mainly from agency commission was also carrying on business in share dealings in the previous years relevant to the assessment years 1985-86, 1986-87 and 1987-88. The company sustained losses of Rs. 2,28,712 in the assessment year 1985-86, Rs. 6,67,124 in the assessment year 1986-87 and Rs. 2,85,266 in the assessment year 1987-88 in share dealings and charged the losses to its profits and loss account. The losses were allowed by the assessing officer while completing the assessment in summary manner in October 1985. July 1987 and July 1987 respectively. The losses being from speculation business which could be set off only against speculation profit, the deduction of the same from the profits of the company was not in order. The omission to disallow the same resulted in underassessment of income of Rs. 2,28,712, Rs. 6,67,124 and Rs. 2,85,266 in the assessment years 1985-86, 1986-87 and 1987-88 respectively leading to undercharge of tax aggregating to Rs. 9,13,323 (including interest of Rs. 68,880 and Rs. 96,904 for late filing of return and non furnishing of estimate of advance-tax) for the three assessment years 1985-86 to 1987-88.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

18. In the case of a private limited company engaged in trading activities in the assessment for the assessment year 1984-85 completed in March 1988 the assessing officer had adjusted the brought forward loss of Rs. 6,47,979 on the sale of shares against the current year's capital gains on sale of land. As the company was not an investment company, the loss arising on the sale of shares was a speculation loss and was adjustable only against the speculation profits. Incorrect adjustment of the loss against the capital gains resulted in under-assessment of income of Rs. 6,47,979 involving short levy of tax of Rs. 3,23,989.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

19. A trading company engaged mainly in the business of commission agency was also carrying on business in share dealings in the previous years relevant to the assessment years 1985-86 and 1986-87. The company sustained losses of Rs. 92,650 in the assessment year 1985-86 and Rs. 1,48,206 in the assessment year 1986-87 in share dealings. While computing the business income of the company for the assessment years 1985-86 and 1986-87 in August 1987 and February 1988 respectively in a summary manner, the assessing officer allowed these losses as deductions. The loss being from speculation business, could be set off only against speculation profits and the deduction of the same from the profits of the company was not in order. The omission to disallow the losses resulted in under assessment of income of Rs. 2,40,856 leading to undercharge of tax aggregating to Rs. 1,92,232 (including non levy of interest of Rs. 21,988 and Rs. 32,127 for late filing of returns and non furnishing of estimates of advance tax) in the two assessment years.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

20. In the case of a private limited company for the assessment year 1984-85, the aggregate loss on sale of fixed assets included an amount of Rs. 4,43,636 being loss on sale of plant and machinery under erection. While completing the assessment for assessment year 1984-85 in January 1987, the assessing officer set off the loss of Rs. 4,43,636 against business income and computed the net loss at Rs. 1,25,947. As the plant and machinery was not installed and was not used for business and as no depreciation was admissible, the loss of Rs. 4,43,636 on sale of the plant and machinery was a capital loss which could be set off only against capital gains. The incorrect set off resulted in underassessment of income of Rs. 4,43,636 involving short levy of tax of Rs. 3,02,781.

The paragraph was referred to the Ministry of Finance for comments in February 1989; the reply from the Government has not so far been received (October 1989).

21. In the previous year relevant to the assessment year 1980-81, a tea company suffered long term capital loss of Rs.2,57,000 on sale of long term capital assets and claimed deduction for the same against other income for the year. While completing assessment for the assessment year 1980-81 in December 1982 (subsequently revised in March 1987) the same was allowed by the Inspecting Assistant commissioner (Assessment) as claimed. As the long term capital loss can be adjusted only against long term capital gain the allowance made by the assessing officer for such adjustment against other income was therefore irregular. The irregular deduction thus resulted in under-assessment of income of Rs.2,57,000 involving tax undercharge of Rs.1,51,951.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

22 While computing the income of a tea company for the assessment year 1985-86 in March 1988 the Inspecting Assistant Commissioner (Assessment) determined the total income at Rs. 19,46,360 after adjustment of long term capital loss of Rs. 1,23,449 relating to assessment year 1977-78. Audit scrutiny revealed (September 1988) that in the assessment year 1985-86 long term capital gains was determined at Rs. 1,23,449 and the entire amount was incorrectly set off against the long term capital losses carried forward for more than four assessment years. Erroneous carry forward and set off of long term capital loss resulted in under assessment of income of Rs. 1,23,449 leading to under charge of tax of Rs. 70,993 (including interest of Rs. 21,613 for short payment of advance tax).

The Ministry of Finance have accepted the objection.

23. An assessee company filed its return of income for the assessment year 1985-86 showing loss of Rs. 12,44,685 on 30 September 1985 against the due date of 30 June 1985, without seeking any extention of time. The assessing officer assessed the loss at Rs. 7,13,128 in December 1987and also allowed it to be carried forward. As the return of loss was filed beyond the stipulated date, the benefit of carry forward of the loss was not available to the assessee. The mistake resulted in incorrect carry forward of loss by Rs. 7,13,128 with consequent potential tax effect of Rs. 4,49,271.

The Ministry of Finance have accepted theobjection.

24. An assessee company, having calender year as previous year and who was required by law to file the return by 30 June every year had filed its return for the assessment year 1985-86 on 31 July 1985 claiming carry forward of loss of Rs. 3,71,786. No application for the extension of filling of return for the assessment year 1985-86 was filed by the assessee. The assessee was, therefore, not entitled to carry forward of business loss of Rs. 3,71,786 for assessment year 1985-86. Failure of disallow the claim to carry forward the loss for the assessment year 1985-86 resulted in notional short levy of tax of Rs. 2,34,224.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.43 Mistake in assessment while giving effect to appellate orders

1. Under the Income-tax Act, 1961, an assessee who is aggrieved can appeal to the Commissioner of Income-tax (Appeals) against an order of assessment made by the Income-tax Officer and the latter shall comply with the direction given by the Commissioner of Income-tax (Appeals) in the appellate order.

The assessment of a State owned Electricity Board (Statutory corporation) for the assessment year 1982-83 was modified in February 1987 to give effect to an order of Commissioner of Income-tax (Appeals) and the loss was determined as Rs. 63,44,75,428. Audit scrutiny (conducted in January/February 1988) revealed that 'provision for doubtful debts on sale of energy' of Rs. 1,07,00,000 which was disallowed in original assessment (March 1985) and upheld in appeal was incorrectly allowed while finalising the revised assessment (February 1987). The omission led to excess computation of loss by Rs. 1,07,00,000 with notional tax effect of Rs. 60,32,125.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

2. While framing assessment of a Government company for the assessment year 1980-81 in November 1982, the assessing officer disallowed a sum of Rs. 68,82,529 on various counts. On appeal by the assessees, the Commissioner of Income-tax (Appeals) ordered full relief in respect of these disallowances. After giving appeal effect on 27 May 1983 the department went in appeal to the Income-tax Appellate Tribunal. The appeal was dismissed by the Tribunal. Thereupon, the assessing officer again revised the assessment in October 1985 allowing a further deduction of Rs. 68,82,529 from the assessed income determined after giving appeal effect to Commissioner of Income-tax (Appeal's) orders. This led to under charge of income to that extent resulting in short levy of tax of Rs. 40,69,295.

The Ministry of Finance have accepted the objection.

3. In the assessment of a widely held company for the assessment year 1980-81, completed in August 1983 (revised in April 1984 and March 1986), the assessing officer disallowed deductions towards ex-gratia payments in excess of the statutory bonus to the extent of Rs. 19,35,242 claimed on payment basis and of Rs. 24,12,769 claimed as a provision. In appeal, the Commissioner of Income-tax (Appeals), deleted the disallowance of Rs. 19,35,242 but upheld the disallowance of Rs. 24,12,769. Audit scrutiny in June 1988 revealed that while giving effect to the Commissioner of Income-tax (Appeals) order in April 1984, the assessing officer allowed deductions for the sum of Rs. 19,35,242, as well as the sum of Rs. 24,12,769. This mistake resulted in excess carry forward of unabsorbed depreciation by Rs. 24,12,769 with a potential tax effect of Rs. 13,93,375.

The Ministry of Finance have accepted the objection.

4. In the original assessment of a widely held company for the assessment year 1980-81 made in August 1983, the assessee's claim for a deduction of Rs. 7,15,435 in respect of profits and gains from a newly established undertaking, was allowed to be carried forward and adjusted against the income for the assessment year 1983-84 in the assessment completed in January 1986. By an order passed in July 1985, the Commissioner of Income-tax set aside the assessment for assessment year 1980-81 holding that the deduction in respect of the newly established undertaking was inadmissible. The assessment for assessment year 1980-81 was accordingly revised in September 1987 withdrawing the relief of Rs. 7,15,435 granted under Section 80J but the amount of Rs. 7,15,435 representing the unabsorbed relief of the said assessment year brought forward and allowed in the assessment for assessment year 1983-84 made in January 1986, was not correspondingly withdrawn resulting in a short levy of tax of Rs. 4,13,115 for assessment year 1983-84.

The Ministry of Finance have accepted the objection.

5. In the assessment of a State Financial Corporation for the assessment year 1983-84 concluded in January 1986, a deduction of Rs. 1,02,58,175 calculated at 2/7th of business income of Rs. 3,59,03,608 was allowed by the assessing officer. The Commissioner (Appeals) in his orders issued in March 1987 gave a relief of Rs. 23,88,080 from the taxable income. While giving effect to the appeal order, the relief of Rs. 23,88,080 was straight away deducted from the total income determined in the original assessment order without recalculating the special deduction admissible with reference to the income after revision. Omission to reduce the amount of special deduction resulted in under-assessment of income of Rs. 6,82,308 (2/7th of Rs. 23,88,080) leading to a short levy of tax of Rs. 3,84,651.

The Ministry of Finance have accepted the objection.

6. The assessment of a widely held company engaged in the business of distribution of electricity for assessment year 1974-75 was originally completed in September 1985 on a taxable income of Rs. 8,45,170. The assessee went in appeal against the assessment contending among other things that a sum of Rs. 4,86,106 being business income earned by it upto 6 January 1974 when it was taken over by the Government of Tamil Nadu, is not exigible to tax. The appellate authority in its orders of July 1987 deleted the additions made by the assessing officer towards certain items of expenditure but there was no mention in its order about the deletion of the business income of Rs. 4,86,106. Audit scrutiny, however, revealed (July 1988) that the assessment for assessment year 1974-75 was revised to give effect to the appellate orders in December 1987 and again in March 1988 deleting the addition of Rs. 4,86,106. The irregular deletion of the income resulted in under charge of tax of Rs. 2,80,725.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Gobernment has not so far been received (October 1989).

7. Certain incentive deductions are admissible under the provisions of the Income tax Act, 1961, from the gross total income of an assessee. The overriding condition is that total deduction should not exceed the gross total income of the assessee.

The income of an assessee company for the assessment year 1983-84 was computed at nil in January 1985 after allowing incentive deduction of Rs. 2,57,778 from technical services fees received by the company. The assessment was subsequently revised in February 1988 computing a business loss of Rs. 13,82,952 after allowing relief of an identical amount of Rs. 13,82,952 by the Commissioner of Income tax (Appeals). As the company had no positive income for the assessment year 1983-84 after adjustment of relief allowed in appeal, the incentive deduction of Rs. 2,57,778 allowed in the original assessment was required to be withdrawn. This was not done in the revised assessment and thus, there was excess carry forward of loss of Rs. 2,57,778. The mistake resulted in under charge of tax of Rs. 2,31,014 including interest for short payment of advance-tax of Rs. 68,614 in the assessment year 1984-85 when the carried forward loss was fully set off.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

8. Under the Income-tax Rules, 1962, only 40 per cent of the income derived from the sale of tea grown and manufactured by a seller in India is deemed to be income derived from manufacturing and selling operations of the assessee and liable to income-tax.

In the previous year relevant to assessment year 1985-86, an assessee company derived income both from manufacturing and trading activities in tea business. The original assessment for the assessment year 1985-86 was completed in March 1988. The company preferred an appeal before the appellate authority against certain additions in the original assessment and the appellate authority allowed some reliefs which included a sum of Rs. 3,88,038 pertaining to tea manufacturing business. While giving effect to the appellate order in September 1988, the assessing officer allowed the entire relief of Rs. 3,88,038 instead of Rs. 1,55,215 being 40 per cent of Rs. 3,88,038 as admissible under the Act in the case of tea business. This resulted in under-assessment of income of Rs. 2,32,823 involving tax under charge of Rs. 2,25,527 (including interest of Rs. 78,849 for late submission of return and short payment of advance tax).

The Ministry of Finance have accepted the objection.

9. The assessment of a tea company for the assessment year 1985-86 was completed in March 1988 computing a net total income of Rs. 20,60,260 being 40 per cent of business income of Rs. 50,98,770 derived from growing, manufacture and sale of tea and income from other sources. On appeal preferred by the assessee against certain additions made in the above assessment, the Commissioner of Income-tax (Appeals) allowed relief to the extent of Rs. 5,55,715 towards additions made on valuation of stock and initial contribution to group gratuity. The assessing officer while giving effect to the appellate order in August 1988, started the computation with the net total income of Rs. 20,60,260 and deducted therefrom the entire sum of Rs. 5,55,715. As the relief of Rs. 5,55,715 actually related to tea manufacturing business of the company, only 40 per cent thereof amounting to Rs. 2,22,286 should have been deducted. The mistake resulted in under assessment of income by Rs. 3,33,429 with consequent under charge of tax of Rs. 1,92,554.

The Ministry of Finance have accepted the objection.

10. In the previous year relevant to assessment year 1985-86, an assessee company derived income from growing and manufacturing of tea and also from letting of a wherehouse. The original assessment for the assessment year 1985-86 was completed in March 1988. The assessee company preferred an appeal before the appellate authority against certain disallowances in the original assessment and the appellate authority allowed some reliefs which included a sum of Rs. 4,65,668 pertaining to tea business. While giving effect to the appellate order in August 1988, the assessing officer allowed the entire relief of Rs. 4,65,668 instead of Rs. 1,86,264 being 40 per cent of Rs. 4,65,668 as admissible. This resulted in underassessment of income of Rs. 2,79,404 involving tax undercharge of Rs. 1,67,642.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

11. The assessment for the assessment year 1984-85 of a company producing citronella oil apart from normal business of growing and manufacturing of tea in India, was completed in July 1986. The assessing officer instead of adding back, deducted the expenditure relating to the production of Citronella Oil of Rs. 4,99,681 from the consolidated net profit shown in the relevant profit and loss account. This led to under-statement of unallocated income from tea business by Rs. 9,99,362 with consequent under-assessment of income by Rs. 3,99,744 (40 per cent of Rs. 9,99,362 being tea business). The Commissioner of Income-tax (Appeals) while considering several grounds of appeal made by the assessee

company directed the assessing officer on 6 February 1987 to rectify this mistake. The assessing officer, accordingly, revised the assessment on 30 April 1987 but added back to income only Rs. 1,99,872 (40 per cent of Rs. 4,99,681) instead of Rs. 3,99,744. This led to underassessment of income of Rs. 1,99,872 with a short levy of tax of Rs. 1,54,950 (including interest for belated submission of return and short payment of advance tax) in the revisional assessment for the assessment year 1984-85.

The paragraph was referred to the Ministry of Finance for comments in June 1989 ; the reply from the Government has not so far been received (October 1989).

12. The regular assessment of a Government company for the assessment year 1981-82 was completed in January 1984 on a total income of Rs. 65,42,290 and interest of Rs. 12,76,473 was levied for non payment of advance tax by the assessee. In appeal, the total income was reduced to Rs. 6,14,862 by the Commissioner of Income-tax (Appeals). While revising the amount of tax payable by the assessee as a result of appeal, the department omitted to levy interest for non payment of advance tax amounting to Rs. 1,19,955.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

13. Under the provisions of the Income-tax Act, 1961, as applicable during the period 1 April 1984 to 31 March 1986, where the aggregate expenditure incurred by an assessee on advertisement, publicity and sales promotion, etc. exceeds Rs. one lakh, 20 per cent of such excess shall not be allowed as deduction in computing the income chargeable under the head profits and gains of business or profession.

In the original assessment of a company for the assessment year 1984-85 made by the Inspecting Assistant Commissioner (Assessment) in February 1987 on a taxable income of Rs. 4,91,480, out of the total expenditure of Rs. 6,26,967 incurred on advertisement, publicity, sales commission, etc., a sum of Rs. 1,05,393 was disallowed. In appeal, the Commissioner of Income-tax (Appeals) directed (October 1987) to exclude Rs. 2,55,254 towards sales commission and general expenses from the total amount of such expenditure of Rs. 6,26,967 for the purpose of making the disallowance. Accordingly, the amount of disallowance worked out to Rs. 54,343 as against Rs. 1,05,393 disallowed in the original assessment. While computing the taxable income in December, 1987 for giving effect to the appeal order, the amount of Rs. 1,05,393 disallowed earlier, was deducted and then, instead of adding the amount of Rs. 54,343 which was to be disallowed as per appeal order, a further deduction of Rs. 54,343 was made from the taxable income. The mistake resulted in under-assessment of income of Rs. 1,08,686 with consequent short levy of tax of Rs. 1,18,270 (including interest of Rs. 49,357 for short payment of advance-tax and non-payment of demand).

The paragraph was referred to Ministry of Finance for comments in August 1989 ; the reply from the Government has not so far been received (October 1989).

14. In computing the total income of a company for the assessment year 1985-86 in March 1988, the assessing officer deducted from the net profit as per profit and loss account, a sum of Rs. 9,05,123 admitted by the assessee company as speculation profit for separate consideration. Further, the assessing officer considered a sum of Rs. 2,00,000 (out of interest payment of Rs. 8,99,361 debited to accounts) as attributable to speculation business and disallowed the same against business profit. On an appeal preferred by the assessee on various points, the Commissioner of Income-tax (Appeals), inter alia, upheld the action of the assessing officer with regard to interest in June 1988. Accordingly, while revising the assessment pursuant to the appellate order in September 1988, the assessing officer started computation of income from the net profit as per profit and loss account and deducted from the net profit as per profit and loss account and deducted therefrom the admitted speculation profit of Rs. 9,05,123 for separate consideration and computed the business profit at Rs. 5,23,197 against which unabsorbed business loss of like amount (out of Rs. 8,23,200) for the assessment year 1983-84 was set off and the balance unabsorbed loss of Rs. 3,70,003 was allowed to be carried forward. The speculation profit of Rs. 9,05,123 was taken separately from which the interest attributable to speculation business amounting to Rs. 2,00,000 was deducted. However, in revising the assessment, the assessing officer failed to disallow interest payment of Rs. 2,00,000 against the business profit. The omission to add back the sum of Rs. 2,00,000 to the business profit resulted in short computation of business profit by a like amount. The business profit would thus, be increased by Rs. 2,00,000 against which further unabsorbed business loss of Rs. 2,00,000 would be set off and the balance unabsorbed loss of Rs. 1,70,003 only relating to the assessment year 1983-84 would remain to be carried forward against Rs. 3,70,003 actually allowed to be carried forward. The mistake resulted in excess carry forward of unabsorbed loss of Rs. 2,00,000 at the end of assessment year 1985-86 involving potential tax effect of Rs. 1,15,500.

The paragraph was referred to the Ministry of Finance for comments in July 1989 ; the reply from the Government has not so far been received (October 1989).

INCORRECT EXEMPTIONS AND EXCESS RELIEFS

3.44 Mistakes in allowing deduction under Chapter VIA

1. Under the provisions of Chapter VIA of the Income-tax Act, 1961, certain deductions are admissible from the gross total income of an assessee in arriving at the net income chargeable to tax. The overriding condition is that the total deduction should not exceed the gross total income of the assessee. 'Gross total income' has been defined in the Act as the total income computed in accordance with the provisions in the Act before making the deductions under Chapter VIA. Where the set off of unabsorbed loss, depreciation, investment allowance etc., of earlier years result in reducing the total income to 'Nil' or to a loss, no deduction under Chapter VIA is admissible.

Certain important representative cases of mistakes falling under the above category, selected from a large number of similar cases noticed in audit during test check, are given below :

In the assessment of a public limited company for the assessment year 1984-85 (completed in December 1987 and revised in January 1988) the Inspecting Assistant Commissioner (Assessment) allowed carry forward of deduction aggregating to Rs. 36,68,446 under Chapter VIA of the Act, towards donation, profits from newly established industrial undertaking in backward areas, export turnover, inter corporate dividends and royalties etc., from certain foreign enterprises, even though the total income of the company was determined at a loss of Rs. 1,67,14,783 alongwith unabsorbed depreciation of Rs. 7,53,01,087. As the gross total income of the assessee for the asssessment year 1984-85 before making the deduction unler Chapter VI-A resulted in a loss, no deduction was admissible. Further, as there was no pre-incentive total income of the company for the relevant assessment year, the question of restricting the deductions under the restrictive provisions of Chapter VI-B of the Act and carry forward of the unallowed portion of such deduction for further adjustment did not arise The mistake led to incorrect carry forward of deductions of Rs. 36,68,446 in the assessment year 1984-85 involving a potential tax effect of Rs. 21,18,527.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. The gross total income of Rs. 71,17,022 and Rs. 94,79,385 of a closely held Engineering Consultancy company for the assessment years 1982-83 and 1985-86 included dividend and interest on fixed deposit income of Rs. 13,41,221 and Rs. 31,83,471 and the balance of Rs. 57,75,801 and Rs. 62,95,914 respectively were business income. In the assessments completed in March 1985 and February 1986, the Inspecting Assistant Commissioner (Assessment) allowed deduction of Rs. 71,17,022 and Rs. 66,35,569 on account of technical service fees received from foreign enterprise from the gross total income of the assessee company for the assessment years 1982-83 and 1985-86 respectively instead of limiting it upto the amount of business income of Rs. 57,75,801 and Rs. 62,95,914 of the respective years. However, the assessee company would get a further deduction of Rs. 58,136 for inter corporate dividend and appellate expenses in the assessment year 1982-83 and Rs. 1,23,540 for inter corporate dividend in the assessment year 1985-86. Thus total deduction admissible to the assessee company for the assessment year 1982-83 would work out to Rs. 58,33,937 instead of Rs. 71,17,022 allowed in the assessment resulting in under-assessment of income of Rs. 12,83,085 and in the assessment year 1985-86 the admissible deduction works out to Rs. 64,19,454 instead of Rs. 66,35,569 resulting under-assessment of income of Rs. 2,16,115. This led to udercharge of tax of Rs. 11,73,674 for the assessment year 1982-83 and Rs. 1,51,180 for the assessment year 1985-86 (including short levy of interest of Rs. 31,684 for belated filing of return of income and Rs. 2,87,136 for short payment of advance-tax for the assessment year 1982-83 and Rs. 3,685 for belated filing of return of income for the assessment year 1985-86).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3. In the assessment of a private limited company for the assessment year 1985-86 completed in March 1988, the assessing officer computed the business income as Rs. 13,17,783 after allowing the deduction in respect of export turnover of Rs. 24,15,066 under Chapter VI-A of the Act. Part of the unabsorbed business losses carried forward from earlier years were then adjusted, to the extent of available business income of Rs. 13,17,783, and the business income was determined as nil. The balance unabsorbed business losses of earlier years amounting to Rs. 4,45,695 was allowed to be carried forward for future adjustment. The assessing officer finally computed the total income of the company aggregating to Rs. 1,87,900 arising out of other heads of income. It was, however, noticed in audit that while computing the business income of the assessee, the assessing officer had set off the entire unabsorbed business loss aggregating to Rs. 17,63,478 before allowing deduction under Chapter VI-A of the Act. Further, the assessee being a company, the total deductions were to be restricted to seventy per cent of the pre-incentive total income as per provisions of Chapter VI-B of the Act which was not done. After set off of the unabsorbed business loss of Rs. 17,63,478 relating to the earlier years, the pre-incentive total income of the company

for the assessment year 1985-86 worked out to Rs. 21,59,671 and the deduction for export turnover was available to the extent of Rs. 15,11,769 only limited to 70 per cent of the pre-incentive total income. The total income thus, worked out to Rs. 6,47,902 as against Rs. 1,87,900 only computed by the assessing officer. The mistake led to under-assessment of income of Rs. 4,60,002 with consequent short levy of tax of Rs. 4,23,833 (including non-levy of interest of Rs. 7,245 and Rs. 1,26,787 for late filing of return and short payment of advance tax respectively). Further, there also resulted excess carry forward of loss of Rs. 4,45,695 in the assessment year 1985-86 involving a potential tax effect of Rs. 2,80,788.

The paragraph was forwarded to the Ministry of Finance for comments in July 1989 ; the reply from the Government has not so far been received (October 1989).

4. In the assessment of a company for the assessment year 1983-84 completed in March 1987, the assessing officer computed the income as Rs. 1,54,72,316 after allowing deductions of Rs. 16,20,475 under Chapter VI-A of the Income-tax Act, 1961. Business losses of Rs. 1,54,72,316 carried forward from earlier years were then adjusted and the taxable income was determined as nil. The procedure adopted by the assessing officer was not in order. Under the provisions of the Act, business losses should have been adjusted before arriving at the amount of gross total income. On this basis, the gross total income of the assessee company after adjusting of losses would work out to Rs. 7,200 only. As such the deductions under Chapter VI-A should have been allowed to this extent. The incorrect allowance of deduction to an extent of Rs. 16,13,275 resulted in potential short levy of tax of Rs. 9,09,484 in the assessment year 1983-84.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in May 1989 ; the reply from the Government has not so far been received (October 1989).

5. In the assessment of a company for the assessment year 1984-85 completed in February 1987 and rectified in May 1987, the assessing officer allowed a relief of Rs. 31,89,787 with reference to the profit of Rs. 1,59,48,935 derived from a unit established in a backward area and carried forward the entire amount under the restrictive provisions of Chapter VI-B of the Income tax Act, 1961. The unit, however, had an unabsorbed investment allowance of Rs. 1,87,56,021 in respect of plants and machinery installed therein during the year relevant to assessment years 1980-81 to 1983-84. Had the profit of the unit been computed after adjusting the unabsorbed Investment allowance, the entire profit of Rs. 1,59,48,935 with reference to which the deduction of Rs. 31,89,787 was allowed, will be wiped out and consequently no deduction will be admissible. The omission resulted in excess carry forward of relief of Rs. 31,89,787 in the assessment year 1984-85 involving potential tax effect of Rs. 18,42,102.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

6. With effect from the assessment year 1984-85 when in the case of a company, the aggregate amount of deduction admissible under certain specified provisions of the Income-tax Act, 1961, exceeded 70 per cent of the amount of total income as computed before making any such deduction, that is, the 'pre-incentive total income', the amount to be deducted under these provisions is to be restricted to 70 per cent of the total income as computed before making such deduction. It was also provided that to the extent to which full deduction could not be allowed in an assessment year in respect of the specified deductions only by virtue of the limitation imposed and not by virtue of anything contained in any other section of the Act, the amount of deduction which could not be so allowed will be added to the amount, if any, in the succeeding assessment year and be deemed to be part of the deduction admissible for each such assessment year.

The assessment of a private limited company for the assessment year 1985-86 was revised in March 1988 to give effect to certain appellate orders. The pre-incentive total income was computed as Rs. 17,46,481. The assessee company was eligible for deduction of Rs. 31,85,073 on exports profits and also for rebate of Rs. 10,000 on donations made to charitable institutions. These deductions were limited to Rs. 12,22,537 being 70 per cent of the pre-incentive total income and the taxable income was computed at Rs. 5,23,944. The assessee company was also allowed to carry forward an amount of Rs. 19,72,536 on account of the balance of export profits incentives. In as much as the Chapter VI-A deductions are to be limited to the gross total income of Rs. 17,46,481 the maximum amount that could be allowed to be carried forward was Rs. 5,23,944 as against Rs. 19,72,536 allowed by the assessing officer. This resulted in excess carry forward of Rs. 14,48,592 involving potential tax of Rs. 9,88,670.

The paragraph was referred to the Ministry of Finance for comments in June 1989 ; the reply from the Government has not so far been received (October 1989).

7. The assessment of a closely held company for the assessment year 1985-86 was completed in March 1988 after allowing a deduction of Rs. 2,75,545 out of Rs. 10,88,719 claimed by the assessee on account of export turnover under the

provisions of the Act, allowing the balance of Rs. 8,13,174 to be carried forward for adjustment in succeeding assessment years. Scrutiny of assessment records (September 1988) revealed that the pre-incentive total income of the assessee for assessment year 1985-86 was Rs. 3,93,635 and as such deduction allowable was restricted to Rs. 2,75,545 (70 per cent of Rs. 3,93,635). However, the overall deduction admissible was only Rs. 3,93.635 being the pre-incentive total income. The balance amount eligible for carry forward to next year would, therefore, be Rs. 1,18,090 only as against Rs. 8,13,174 computed in the assessment order. The mistake resulted in excess carry forward of Rs. 6,95,084 involving a potential undercharge of tax of Rs. 4,37,850 in the year of adjustment.

The Ministry of Finance have accepted the objection.

3.45 Incorrect deduction in respect of donations

1. Under the Income-tax Act, 1961, an assessee is entitled to a deduction, in the computation of his total income, of an amount equal to fifty per cent of the aggregate of the sums paid by him in the previous year as donations to the funds specified therein. The aggregate of the donations qualifying for the deduction has, however, to be restricted to ten per cent of the gross total income or Rs. 5,00,000, whichever is less, before computing the quantum of deduction. This does not apply to the Prime Minister's National Relief Fund donations, which are allowable in full in computing the total income.

In the assessment of a closely held company for the assessment year 1985-86, completed in February 1988 and revised in March 1988, a deduction of Rs. 4,78,501 was allowed towards donations made in the previous year, including a sum of Rs. 11,001 to the Prime Minister's National Relief Fund. In computing the quantum of deduction, the aggregate of the qualifying amounts (excluding the amount donated to the Prime Minister's National Relief Fund, which was allowable in full) was not restricted to Rs. 5,00,000, ten per cent of the gross total income being in excess of this amount. The incorrect allowance of excess deduction resulted in under assessment of income of Rs. 2,17,500, with consequent undercharge of tax of Rs. 1,37,025.

The Ministry of Finance have accepted the objection.

2. In the assessment of a limited company for the assessment year 1983-84 (completed in March 1986 and revised in August 1986), a sum of Rs. 4,28,755 was allowed as deduction being 50 per cent of the amount of donation of Rs. 8,57,511. The assessment was again rectified for giving effect to certain appellate orders in November 1986. After allowing certain deductions the income assessable to tax was reduced to Nil. The amount qualifying for deduction limited to 10 per cent of the gross total income being 'nil', the assessee company was not entitled to the deduction towards donation in the assessment year 1983-84. The omission to withdraw the deduction of Rs. 4,28,755 allowed in the earlier assessment resulted in under-assessment of income to that extent involving short levy of tax of Rs. 2,41,710 in the assessment year 1983-84.

The Ministry of Finance have accepted the objection.

3. The assessment of a closely held company for the assessment year 1985-86 was completed in February 1988 after allowing a deduction of Rs. 5,08,375 on account of donation paid. Audit scrutiny revealed (September 1988) that the gross total income was computed as Rs. 57,19,780 and therefore the qualifying amount should have been restricted to Rs. 5,00,000 as per the provisions of the Act, thus entitling the assessee to a deduction of Rs. 2,50.000 only. The incorrect allowance of deduction of Rs. 2,58,375 resulted in under assessment of business income by the same amount with consequent undercharge of tax of Rs. 2,01,016 (including surtax of Rs. 38,240).

The Ministry of Finance have accepted the objection.

3.46 Incorrect deductions in respect of newly established industrial undertakings in back ward areas

1. Under the provisions of the Income-tax Act, 1961, where the gross total income of an assessee includes any profits and gains from an industrial undertaking established in a backward area, a deduction of twenty per cent of profits derived from such undertaking is allowed in computing the taxable income for a period of ten years. Under the Income-tax Rules, 1962, only 40 per cent of the income derived from the sale of tea grown and manufactured by a seller in India is liable to income-tax, the remaining 60 per cent being deemed to relate to the cultivation of tea, income from which is agricultural in nature and hence not liable to Income-tax.

In the assessment of a tea company for the assessment year 1985-86 the Inspecting Assistant Commissioner (Assessment) determined the profit earned by the assessee's new industrial unit in a backward area from growing and manufacturing of tea at Rs. 1,56,35,449. Since the unit was located in a backward area, a deduction of Rs. 31,27,090 computed at 20 per cent of the profit of the unit was allowed in the assessment made in March

1988. The deduction was, however, allowable at Rs. 12,50,836 computed at 20 per cent of Rs. 62,54,180 (40 per cent of Rs. 1,56,35,449) the sum actually included in the gross total income of the assessee as a tea company for the purpose of income-tax. The incorrect allowance of deduction led to under assessment of income by Rs. 18,76,254 involving undercharge of tax of Rs. 10,31,940 in assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. It has been judicially held in july 1967 that the sums claimed for allowance of rebate must be sums assessable in their nature as part of assessable income of the relative accounting year.

In the assessment of a tea company for the assessment year 1984-85 made in March 1987, 100 per cent deductions on account of relief in respect of an industrial undertaking estabilshed in a backward area and tax holiday relief in respect of the same newly established industrial undertaking aggregating to Rs. 24,24,335 was allowed. The amount of Rs. 24,24,335 also included Rs. 11,28,116, being the unabsorbed tax holiday relief in respect of the newly established industrial undertaking carried forward from earlier years which was fully set off against the positive income of the assessment year 1984-85. It was noticed that the green tea produced by the company in its gardens was converted into black tea at the new industrial undertaking. Since 40 per cent of the composite income inclusive of income derived from the new unit was treated as assessable income, the amount of relief in respect of the new unit should have been restricted to Rs. 9,69,733 only calculated at the rate of 40 per cent as against the entire relief of Rs. 24,24,335 actually allowed by the department. The mistake led to under assessment of income by Rs. 14,54,602 with consequent undercharge of tax of Rs. 8,56,832 (including short levy of interest of Rs. 16,800 for late filing of return for the assessment year 1984-85).

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

3. In computing the gross total income as defined in the Act, the unabsorbed business loss, depreciation or investment allowance should first be set off against the profits and gains. The relief in respect of profits and gains from new industrial undertaking established in rural areas/backward areas is to be set off against the balance of profits, if any. The relief is admissible only in relation to the income from the manufacture or production of articles and not from any other activity carried on by the assessee.

In the assessment of a private company for the assessment year 1981-82 and 1983-84 to 1986-87 completed during January 1984 to March 1988, deduction amounting to Rs. 1,06,472 was claimed and allowed for establishment of a new undertaking in rural area. In addition, deduction of Rs. 1,30,570 based on the capital employed was also allowed against the profits of the previous years relevant to the assessment years 1981-82 to 1984-85 for establishment of new undertaking before 31 March 1981. Audit scrutiny in September 1988 revealed that :

(i) There was no finding by the assessing officer that the industrial undertaking was situated in a rural area as defined in the Act. Even otherwise, the deduction for new undertaking in rural area or backward area was allowed without set off of brought forward business loss, unabsorbed depreciation and unabsorbed investment allowance of past years. Further, for the assessment year 1986-87, there was no positive income of the undertaking, as the income of Rs. 3,26,148 on sale of import entitlements was not to be treated as income of the undertaking from manufacturing activity.

(ii) The deduction under section 80-J of the Act was allowed without set off of unabsorbed depreciation/investment allowances of past years.

These mistakes resulted in excess allowance of the deductions aggregating to Rs. 1,27,845 with consequent short levy of tax of Rs. 1,02,800 (including interest for non-payment/short payment of advance tax) for the assessment years 1984-85 to 1986-87.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.47 Incorrect deduction in respect of profits and gains from projects outside India

Under the provisions of the Income-tax Act, 1961, where the gross income of an assessee, being an Indian company, includes any income from the execution of foreign project undertaken by the assessee in pursuance of a contract entered into by him and considration for such project is payable in convertible foreign exchange, the assessee is entitled to a deduction from such profits and gains of an amount equal to twenty five per cent thereof.

During the previous year relevant to the assessment year 1983-84, a company engaged in executing projects outside India was allowed a deduction of Rs. 69,01,621 being 25 per cent of the profits amounting to Rs. 2.76 crores on such projects in the assessment completed in November 1985. The assessment was rectified in January 1986 and August 1986 to allow set off of investment allowance of earlier years and certain other reliefs and consequently the gross total income was reduced to Rs. 75,76,879. Out of this amount profits from projects outside India were Rs. 70,14,957. As 25 per cent of such profits included in the gross total income only was to be allowed as deduction, the deduction allowable worked out to Rs. 17,53,739. Therefore, the deduction of Rs. 69,01,621 allowed earlier was to be reduced to Rs. 17,53,739. Failure to do so resulted in under-assessment of income by Rs. 51,47,882 involving under-charge of tax of Rs. 38,96,093 (including interest leviable for under estimate of advance-tax).

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.48 Incorrect allowance of relief in respect of export turnover

1. Under the provisions of the Income-tax Act, 1961, prior to its amendment by the Finance Act 1985, an assessee being Indian company or other assessee resident in India engaged in the business of export was entitled to a deduction in the computation of taxable income of an amount equal to 1 per cent of the export turnover plus a further amount equal to 5 per cent of the incremental export turnover of certain goods and merchandise if the sale proceeds thereof were receivable in convertible foreign exchange. The deduction was subject to the restriction that it shall not, in any case, exceed the gross total income of the assessee. The concession was not, however, available for export of mineral oil, minerals and ores. With a view to encouraging the establishment of export oriented industries in the Free Trade Zone, the Finance Act, 1981, inserted a new provision in the Income-tax Act, 1961, providing for a complete tax exemption in respect of the profits and gains derived from an industrial undertaking set up in a Free Trade Zone for a period of five assessment years.

The assessment of a multinational company for the assessment year 1985-86 was completed by the Inspecting Assistant Commissioner (Assessment) in March 1988. While computing income chargeable to tax a deduction of Rs. 36,93,410 on account of exports was allowed to the assessee company. An examination of accounts revealed that the total exports of Rs. 7,73,11,000 was inclusive of the exports of Rs. 3,36,60,000 pertaining to the company's unit situated in the Kandla Free Trade Zone. As per the provisions of Income-tax Act, 1961, there was complete tax exemption in respect of the profits of newly established industrial undertaking in Free Trade Zones. When the profits were completely exempt from taxation and thus did not form part of the total income, the free trade zone export turnover did not qualify for being considered in the total export turnover to determine the deduction allowable. Chapter VI-A deductions are allowable only from the gross total income and the gross total income in the instant case did not at all include the profits pertaining to export from the Kandla Free Trade Zone. Hence while determining the export incentive deduction allowable, the exports of Rs. 3,36,60,000 pertaining to the Kandla Free Trade Zone was required to be excluded from the total export and the allowable deduction worked out on the balance. On this basis the deduction allowable was Rs. 16,73,810 as against Rs. 36,93,410 given by the assessing officer. Thus there was under-assessment of income of Rs. 20,19,600 involving under-charge of tax of Rs. 16,76,575 (inclusive of interest of Rs. 5,10,256 for under estimate of advance tax).

The Ministry of Finance have accepted the objection.

2. In the assessment of a company for the assessment year 1984-85 completed in August 1986 and finally revised in March 1988, incentive deduction of Rs. 34,10,815 was allowed on export turnover of Rs. 10,32,20,067 at the rate of 1 per cent and 5 per cent on the incremental turnover of Rs. 4,75,72,294. The export turnover included seafood export of Rs. 4,76,47,571 not directly purchased or sold by the assessee company. The company acted only as an intermediary between suppliers in India and purchasers in foreign countries in the transactions relating to seafeed export. The sale proceeds of seafood were also received by the suppliers in India directly from buyers abroad in convertible foreign exchange. As such, the assessee company was not eligible for incentive deduction in respect of seafood export. For the subsequent assessment year 1985-86 the assessing officer had also disallowed incentive deduction on sea food export on similar grounds. Thus, incentive deduction of Rs. 5,55,725 only was allowable on assessee's actual export turnover of Rs.5,55,72,496. The mistake led to excess incentive deduction of Rs. 28,55,090 involving undercharge of tax of Rs. 19,48,597.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3. In the assessment of a company for the assessment year 1984-85 completed in March 1987, the Inspecting Assistant Commissioner (Assessment) allowed a deduction of Rs. 4,08,294 calculated at 5 per cent of the net export turnover of Rs. 81,65,872. It was noticed in audit in February 1988 that the company did not export any goods or merchandise during the earlier year, viz., assessment year 1983-84. Accordingly, the deduction for the assessment year 1984-85 was admissible at 1 per cent of the export turnover instead of at 5 per cent allowed by the assessing officer. The excess allowance of relief thus resulted in under assessment of income of Rs. 3,26,636 with consequent short levy of tax of Rs. 2,85,006 (including interest for short payment of advance tax) for the assessment year 1984-85.

The Ministry of Finance have accepted the objection.

4. In the assessment of a tea company for the assessment year 1984-85, completed in September, 1986 the Inspecting Assistant Commissioner (Assessment) allowed a deduction of Rs. 4,46,508 on export turnover, calculated at the prescribed percentage. It was, however, noticed in audit in September 1987 that relief on export turnover had been worked out with reference to the export turnover but the same had been deducted from the 40 per cent of business income liable to income-tax though under the rules 100 per cent of income should have been arrived at after allowing the above deduction and 40 per cent of the income thereof should have been taken as income liable to tax. The erroneous deduction of export turnover allowance resulted in under-assessment of income of Rs. 2,67,905 leading to under charge of tax of Rs. 1,68,783.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

5. The Central Board of Direct Taxes clarified in August 1986, that when the manufacturers export their goods or merchandise through export/trading houses, the tax benefit passed on by such export trading houses will be allowed as a deduction in the computation of income subject to certain restrictions and that the benefit received by the manufacturers will not be included in the total income of the manufacturers if such claim for non inclusion is supported by a certificate from the export/trading house.

An assessee, an Indian company, was engaged in the purchase and supply of fish and sea food to foreign buyers on commission basis, under an agreement with another Indian Company of Calcutta, which was an export house, registered and licenced by the Controller of Export and Import. Scrutiny of the assessment records in Audit disclosed that the claim for deduction in relation to exports/export profits had been claimed both by the assessee and the export house at Calcutta and that based on a communication of August 1987 from the Commissioner of Income-tax (Appeals), Calcutta, the deductions earlier allowed in the case of the assessee for assessment years 1983-84 and 1984-85 were withdrawn. However, the assessments for assessment year 1985-86 made in April 1986 and for assessment year 1986-87 made in January 1987 were not revised to withdraw the deduction incorrectly allowed in the assessments made. This resulted in under assessment of income of Rs. 50,469 in assessment year 1985-86 and Rs. 3,22,811 in assessment year 1986-87 involving aggregate short levy of tax of Rs. 2,01,754.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

6. The Act further provides that 'export turnover' means sale proceeds of any goods or merchandise exported but does not include freight or insurance attributable to the transport of the goods beyond the customs station as defined in the Customs Act.

In the assessment of a company for the assessment year 1985-86 completed in February 1989, the Inspecting Assistant Commissioner (Assessment) allowed a deduction of Rs. 44,98,373 in respect of export turnover without determining the export turnover as per provisions of the Act. Audit scrutiny in September 1988 revealed that the assessee debited sums of Rs. 86,62,933, Rs. 13,91,914 and Rs. 27,93,898 in its accounts as expenditure on ocean freight, shipping charges and marine insurance respectively which were required to be deducted from gross export turnover at the time of allowing percentage deduction in respect of export turnover. After deduction of these expenditure, allowable deduction on export turnover of Rs. 15,41,18,880 would work out to Rs. 37,27,448 instead of Rs. 44,98,373 allowed by the assessing officer. The mistake resulted in incorrect allowance of deduction of Rs. 7,70,925 on export turnover involving under assessment of income of Rs. 3,08,370 (being 40 per cent of Rs. 7,70,925 for tea company) with under charge of tax of Rs. 1,78,083.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.49 Incorrect deduction in respect of profits and gains from newly established industrial undertaking in backward areas/new industrial undertaking established after 31 March 1981

1. Under the provisions of the Income-tax Act, 1961, where the gross total income of a company includes any profits and gains derived from newly established industrial undertaking in backward areas, a deduction equal to twenty per cent of the profits is allowed while computing its business income. The Act also provides for a further deduction of twenty five per cent of such profits to a company, if the new industrial undertaking goes into production after 31 March 1981.

In the original assessments of a private company engaged in the business of manufacture of biris, for the assessment years 1982-83 to 1985-86, the claim of the assessee company for the aforesaid deductions was rejected but in appeal the Commissioner of Income tax (Appeals) admitted the claim and directed the Inspecting Assistant Commissioner (Assessment) to allow the deduction after verification of the quantum of the deduction. In the revised assessments for these four years made by the Inspecting Assistant Commissioner (Assessment) between August 1985 and December 1986 and further revisions made on 31 Decembee 1986, the aforesaid deductions were allowed at 45 per cent (20 per cent plus 25 per cent) of the total profits and gains for the respective years. Audit scrutiny (October 1988) revealed that the total profits and gains included interest income of Rs. 85,641, Rs. 3,77,046 Rs. 4,27,040 and Rs. 3,57,536 on the fixed deposits with banks for the four years and dividend income of Rs. 800 and Rs. 1,000 for the assessment years 1984-85 and 1985-86 respectively. These incomes (interest on fixed deposits and dividend) did not form part of the profits and gains of the manufacture and as such the assessee company was not entitled to the relief in respect of such income. The mistake in allowing the relief in respect of interest and dividend income resulted in under-assessment of income of Rs. 5,62,080 for the four years. Further, consequent on reduction in total income due to appeal effect, the deduction of Rs. 2,08,001 for donations allowed in the original assessment for the assessment year 1983-84 was required to be recomputed to limit the qualifying amount of donation to 10 per cent of the reduced income. This mistake resulted in excess grant of the deduction by Rs. 30,599.

The above mistakes resulted in total under-assessment of income of Rs. 5,92,679 (Rs. 5,62,080 + Rs. 30,599) with consequent short levy of tax of Rs. 4,81,503 (including interest for short payment of advance tax and surtax.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. In the case of an assessee, private limited company, while computing the income for the assessment year 1986-87, the aforesaid deduction in respect of a unit established during the previous year relevant to the assessment year 1984-85 was allowed to the extent of Rs. 6,68,727 (being 20 per cent of profits of Rs. 33,43,635) before adjusting the carried forward investment allowance of Rs. 16,40,931 and business loss of Rs. 2,39,572 pertaining to the assessment years 1984-85 and 1985-86 respectively. After adjustment of investment allowance and loss the company was actually entitled to a deduction of Rs. 3,65,783 instead of Rs. 6,68,727 allowed. The mistake resulted in under-assessment of income of Rs. 3,02,944 with consequent short levy of tax of Rs. 1,74,950.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.50 Incorrect relief in respect of profits from newly established industrial undertaking (prior to 31 March 1981)

1. Under the provisions of Income-tax Act, 1961, prior to its amendment by the Finance Act, 1980, with effect from the assessment year 1981-82, where the gross total income of an assessee included any profits and gains derived from a newly established undertaking which went into production before 1 April 1981, the assessee became entitled to tax relief in respect of such profits and gains upto 6 per cent per annum ($7\frac{1}{2}$ per cent from 1 April 1976) of the capital employed in the undertaking in the assessment year in which it began to manufacture or produce articles and also in each of the four succeeding assessment years.

The method of computing capital employed in the industrial undertaking was laid down in the Income-tax Rules, 1962, according to which the capital employed would be the value of assets as on the first day of the computation period of the undertaking as reduced by moneys and debts owed by the assessee on that day. In the computation of the value of capital employed, the value of depreciable assets should be taken at their written down value as on the first day of the computation period.

The capital employed was calculated on the basis of owned capital and reserves only, exclusive of borrowed capital. Under an amendment by the Finance Act 1980, to the Act, the provisions of the Rules were incorporated in the Act itself retrospectively from 1 April 1972.

In the assessments of nine companies for the assessment years 1977-78 to 1984-85 assessed between June 1980 to June 1985 in seven different

Commissioner's charges, due to erroneous determination of capital employed in the newly established industrial undertakings, there was excess computation of capital employed resulting in excess/irregular allowance of relief of Rs.2.22 crores involving short levy of tax of Rs. 1,22,93,065 in eight cases and potential tax effect of Rs. 14,12,515 in one case. The details of the cases are as under :—

Sl. No.	Name of assessee Commissioner's charge	Assessment year	Nature of mistake	Tax effect
				Rs.
1	A West Bengal II	1977-78	Debts allocable to the new unit were not deducted in the computation of capital employed.	1,08,573
2	B Bombay City V	1980-81	Tax holiday relief was calculated on gross value of assets without deducting the liabilities relating to the unit.	6,81,081
3	C Coimbatore Tamil Nadu	1981-82	Capital was computed without taking into account the liabilities on Rs. 14,25,999.	83,389
4	D West Bengal II	1982-83 to 1984-85	Value of depreciable assets taken at their book value instead of written down value.	3,87,818
5	E Tamil Nadu I	1981-82 and 1982-83	Incorrect allowance of relief on receipts amounting to Rs. 30,26,511 for assessment year 1981-82 and Rs. 16,65,762 for assessment year 1982-83, such as cash assistance and compensatory support, customs drawback, lease rent, sale of scrap, interest, etc., which could not be held as income derived from business activity of the newly established undertaking.	6,90,278
6	F West Bengal I	1980-81 1981-82	Relief allowed on the basis of ratio arrived at with reference to the value of assets at the close of respective previous years instead of on the first day of the respective previous year. Further, proposed dividends representing current liabilities and project loan was not deducted for the purpose of capital computation.	14,22,515 (Potential)
7	G Jabalpur	1979-80	Borrowings and Debts owned by the assessee company was not deducted from the capital employed.	1,09,605
8	H Coimbatore	1981-82	Unsecured loans of Rs. 32,76,188 and current liabilities and provisions of Rs. 2,44,04,569 not taken into account while computing the capital employed.	4,43,096 97,548 (surtax)
9	I West Bengal III	1979-80 1980-81	Value of depreciable assets was taken at their original cost instead of their written down value. Further average increase in the net assets from the first day of computation period to last day was considered in place of considering the value of assets as on the first day of the computation period. In addition, in computing the capital, liabilities and debts owed by the assessee company in respect of new unit was not reduced.	96,91,677

In three cases the assessments were completed by the Inspecting Assistant Commissioner (Assessment).

The paragraphs were referred to the Ministry of Finance for comments between January 1989 and August 1989. The Ministry of Finance have accepted the objection in one case. The reply from the Government has not so far been received in the remaining eight cases (October 1989). However, the department has accepted the objection in two cases.

2. In the assessment of 14 companies for the assessment years 1975-76 to 1987-88 completed between February 1978 to March 1988 in 12 Commissioners' charges owing to incorrect application of the provisions of the Act, erroneous deduction allowed to units engaged in manufacturing activities after the prescribed date and/or engaged in exempted items, irregular deduction of relief beyond the prescribed period, etc., tax holiday relief amounting to Rs. 2.50 crores was allowed in excess resulting in short levy of tax of Rs. 1,65,81,296 in eight cases and excess carry forward of losses etc. involving potential tax of Rs. 14,55,291 in the remaining cases. The details are as under :

Sl. No.	Name of the assessee/ Commissioner's charge	Assessment year	Nature of mistake	Tax effect
1	A Pune Bombay	1984-85	Since the assessee company had started its manufacturing activity in the previous year relevant to the assessment year 1979-80, it was eligible for tax holiday relief upto assessment year 1983-84 only.	2,83,845
2	B West Bengal III	1984-85	The assessee company started production in the assessment year 1974-75. As such unabsorbed relief not entitled to be carried forward beyond assessment year 1981-82.	3,63,149 (Potential)

	1	2	3	4	5
3	C C.C. Ludhiana	1982-83		The assessee company which was initially allowed relief in the assessment year 1973-74 was incorrectly allowed relief of Rs. 34,855 in the assessment year 1978-79 instead of restricting the relief to five assessment years only. Further deficiency of Rs. 4,11,245 was erroneously carried forward beyond seventh assessment year and set off against the profit in the assessment year 1982-83.	2,31,842
4	D West Bengal II	1984-85		Incorrect allowance of relief to new unit formed by the splitting up of a business already in existence.	5,71,221
5	E Tamil Nadu I	1980-81		Incorrect allowance of relief on receipts such as intrest, customs duty drawback, export incentive, profit on sale of assets and miscellaneous receipts which could not be held as income 'derived from' business activity of the newly established undertaking.	70,448
6	F Delhi II	1984-85		Incorrect allowance of relief to the assessee company which went into production after 1 April 1981 but where the article produced was one of the items specified in the Eleventh Schedule to the Act in which relief was not allowed.	91,980
7	G West Bengal I	1982-83 to 1984-85		The assessee company took over the entire business of a registered firm which had already enjoyed tax holiday relief for the fourth year counted from the initial assessment year 1978-79. Hence the assessee company was entitled to relief upto assessment year 1982-83 only.	1,01,176
8	H Bombay City VI	1984-85		Incorrect carry forward of relief of Rs. 6,67,036 instead of correct amount of Rs. 4,29,263	1,95,323
9	I Central I Calcutta	1983-84		Tax holiday relief of Rs. 25,55,368 allowed to the new unit was not restricted to the available profit of Rs. 21,40,000.	2,34,163
10	J Bombay City VI	1985-86		In determining the profits of the new unit the depreciation of Rs. 6,66,783 as per books of accounts was deducted instead of deducting depreciation of Rs. 10,40,762 as allowed in the income-tax assessment.	97,757
11	K Tamil Nadu II	1987-88		Incorrect allowance of relief in the asseessment year 1987-88 i.e., beyond the prescribed period as the assessee company was allowed relief first time in the assessment year 1982-83.	81,336
12	L Tamil Nadu II	1975-76 to 1979-80		Since the new unit was formed by the transfer of buildings and plant and machinery previously used the value of which exceeded the limit of 20 per cent of the total value of machinery and plant used in the business of the assessee, no relief was admissible.	1,15,97,379 33,93,465
13	M Andhra Pradesh I	1984-85		Incorrect carry forward of unabsorbed relief of Rs. 3,41,049 (pertaining to the assessment years 1977-78 to 1980-81) to the assessment year 1985-86 that is beyond the seventh year.	2,72,415 (Potential)
14	N West Bengal VI	1984-85		Incorrect carry forward of tax holiday deficiency of Rs. 1,31,078 and Rs. 5,84,935 to the assessment year 1984-85 in respect of two units of the assessee company which started production from assessment years 1973-74 and 1976-77 respectively.	4,51,088 (Potential)

The paragraphs were referred to the Ministry of Finance for comments between April 1989 and August 1989. The Ministry of Finance have accepted the objection in four cases. The reply from the Government has not so far been received in the remaining 10 cases (October 1989). However, the department has accepted the objection in four cases.

3.51 Incorrect deduction in respect of inter-corporate dividends

Under the Income-tax Act, 1961, in the case of a domestic company, where the gross total income includes any income by way of dividends from another domestic company, there shall be allowed in computing the total income, a deduction at specified percentage of such income. The Act was amended through Finance (No. 2) Act, 1980, with retrospective effect from April 1968, to provide that the deduction on account of inter-corporate devidends is to be allowed with reference to the net devidend income as computed in accordance with the provisions of the Act and not on the gross amount of the dividend.

1. In the assessment of a limited company for the assessment year 1985-86 completed in September 1987, the Inspecting Assistant Commissioner of Income-tax (Assessment) allowed a deduction of Rs. 1,08,54,494 on the net dividend of Rs. 1,80,90,824 after deducting interest and other expenses of Rs. 1,80,00,000 from the gross dividend of Rs. 3,60,90,824. It was, however, seen that the gross divided included an amount of Rs. 8,42,090 on account of foreign dividend and the assessee company had deducted it while claiming the deduction. As the assessing officer had not reduced the

gross dividends by the amount of the foreign dividends the mistake resulted in allowance of excess deduction of Rs. 5,05,254 with consequential short levy of tax of Rs. 4,78,445 (including interest for late filing of return and under estimate of advance tax).

The paragraph was referred to the Ministry of Finance for comments in March 1989; the reply from the Government has not so far been received (October 1989).

2. In the case of a private limited company for the assessment year 1984-85 (assessment completed in February 1987) the gross total income was computed at Rs. 3,82,860 after adjusting the dividend income of Rs. 8,73,946 against the loss under the head 'profits and gains of business or profession'. The deduction for inter-corporate dividend was worked out as Rs. 5,24,387 at sixty per cent of gross dividends of Rs. 8,73,946 and it was limited to the available income of Rs. 3,82,860. Thus the taxable income was computed as 'NIL'. It was pointed out in Audit that the deduction of sixty per cent was required to be worked out on the dividend amount of Rs. 3,82,860 included in the total income and not on the gross dividends of Rs. 8,73,946. Due to incorrect working of the deduction admissible, there was under-assessment of income of Rs. 1,53,144 involving short levy of tax of Rs. 1,04,520.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

3. In the assessments of a closely held company for the assessment years 1984-85 and 1985-86 (assessments completed in June 1986 and December, 1986 respectively) deductions amounting to Rs. 9,58,589 and Rs. 9,96,779 on account of inter-corporate dividends were allowed by the assessing officer on the basis of dividend income arrived at before setting off the losses under other heads of income. In accordance with the provisions of the Act, the assessee company was entitled to a deduction of Rs. 8,62,628 and Rs. 9,24,015 only on the basis of dividend income after setting off of the said losses. The excess deductions resulted in under-assessment of income aggregating to Rs. 1,68,725 involving under charge of tax of Rs. 1,28,065 (including interest of Rs. 513 in the assessment year 1984-85 for late submission of return and excess payment of interest of Rs. 12,400 by the Government in the assessment year 1985-86 for excess payment of advance tax).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4. Under the Income-tax Act, 1961, full deduction is granted in respect of income by way of dividends received by a domestic company from an Indian company formed and registered under the Companies Act, 1956 after the 28 February 1975 and engaged exclusively or almost exclusively in the manufacture or production of any one or more of the articles or things specified in Ninth Schedule to the Act, and at sixty per cent of such income in other cases.

In the assessment of a public sector ship building company, for the assessment year 1984-85, completed in March, 1987, the deduction for intercorporate dividends was allowed for the entire amount in respect of the dividend income of Rs. 6,16,914 received from another shipyard company. There was nothing on records to show that the conditions stipulated for the allowance of deduction in full of such dividends were fulfilled in this case. It was also seen in audit that the department had not allowed at any time in the earlier assessment years, the deduction of whole of the dividends received from the said shipping company. The deduction was, thus, allowable at sixty percent only. The mistake resulted in excess allowance of deduction by Rs. 2,46,766 involving short levy of tax of Rs. 2,05,563 (including interest leviable for late filing of return and under estimate of advance tax).

The Ministry of Finance have accepted the objection.

3.52 Incorrect deduction on income from technical service-fees received from an Indian concern

1. Under the Income-tax Act, 1961, where the gross total income of an assessee, being an Indian Company includes income by way of royalty, commission, fees or any other payment (excluding capital gain) received by the assessee from any person carrying on business in India in consideration for provision of technical know how or rendering services in connection with the provisions of such technical know how, under an approved agreement, there shall be allowed a deduction of forty per cent of such income. The relief is to be determined with reference to the net income derived in respect of these services and included in the gross total income.

During the previous year relevant to the assessment year 1982-83 an Indian Company received technical knowhow fees of Rs. 9,30,335 from three other Indian companies. In the revised assessment made in March 1987, the assessing officer computed the deduction in respect of such technical fees at Rs. 3,72,134 being 40 per cent of such receipts and limited the deduction to the amount of gross total income computed at Rs. 3,63,876. In accordance with the provisions of the Act, such deduction was to be allowed on income which stood included in the gross total income and consequently this net income could not be more than the amount of gross total income. Accordingly, a sum of Rs. 1,45,550 (40 per cent of gross total income of Rs. 3,63,876) was only allowable as deduction. The mistake led to under-assessment of income of Rs. 2,18,326 involving under-charge of tax of Rs. 1,50,382 (including excess payment of interest of Rs. 16,112).

The paragraph was referred to the Ministry of Finance for comments in April 1989 ; the reply from the Government has not so far been received (October 1989).

2. In the previous year relevant to the assessment year 1983-84 a closely held company received a sum of Rs. 9,00,000 being the receipt from sale of technical know-how. The assessing officer while completing the assessment in January 1987 allowed relief of Rs. 3,60,000 at the rate of forty per cent of the aforesaid gross receipts as claimed by the assessee. It was, however, noticed in Audit that the net income from the aforesaid services worked out to Rs. 6,27,606 after considering the direct expenditure of Rs. 2,18,128 on account of drawing and design and other expenditure on prorata basis and the relief allowable thereon at forty per cent worked out to Rs. 2,51,042 only as against relief of Rs. 3,60,000 allowed by the assessing officer. The incorrect allowance of relief on gross receipts instead of on net income as provided in the Act, resulted in under assessment of income of Rs. 1,08,958 with consequent under charge of tax of Rs. 1,01,686 (including interest of Rs. 34,677 for short payment of advance tax).

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989 ; the reply from tht Government has not so far been received (October 1989).

3.53 Incorrect deduction in respect of royalty, etc. from a foreign enterprise

Under the Income-tax Act, 1961, as applicable to assessment year 1984-85, where the gross total income of an assessee being an Indian Company includes any income by way of royalty, commission, fees or any similar payment received by the assessee from a foreign enterprise in consideration for use outside India of any patent, invention, model, design, secret formula or process or in consideration of technical services rendered or agreed to be rendered outside India to such enterprise by the assessee under an agreement entered into by the assessee with such person and approved by the Central Government/Central Board of Direct Taxes and such income is received in convertible foreign exchange in India, a deduction of the whole (50 per cent from the assessment year 1985-86) of the income so received shall be allowed in computing the total income of the assessee. It has been judicially held (155 ITR 120) that the deducation is to be computed with reference to the quantum of the income from profits and gains attributable to the specified business included in the gross total income.

1. The assessment of a public limited company for the assessment year 1984-85 originally completed in March 1986 was rectified in October 1986 to allow deduction of Rs. 3,13,69,518 on account of royalty income as against Rs. 1,06,61,199 allowed in the original assessment. It was seen in audit that the royalty income from foreign enterprises, as included in the gross total income, was only Rs. 2,74,05,037 (being the business income as computed under the Act) whose separate identity got merged with the business income computed and not Rs. 3,13,69,518. Hence, the deduction should have been restricted to Rs. 2,74,05,037. Omission to do so resulted in under assessment of income of Rs. 39,64,481 involving short levy of tax of Rs. 27,05,758.

The department has not accepted the objection stating that the figure of Rs. 2,74,05,037 is the income of the assessee company chargeable under the head 'profits and gains of business' and that this included not only the income of the company from contract receipts which are eligible for the benefit of section 80-O but also the income or loss from the other multifarious activities of the company. The department's reply is not acceptable. As per section 80-O of the Income-tax Act, 1961, the deduction is to be allowed on the royalty income included in the gross total income, and such income included in the gross total income cannot exceed the business income computed under the Act.

The paragraph was referred to the Ministry of Finance for comments in June 1989 ; the reply from tht Government has not so far been received (October 1989).

2. In the assessment of a public limited company for the assessment year 1983-84 completed in January 1986 and revised in February 1987, the total income was computed at 'Nil' and an aggregate amount of Rs. 1,39,537 being the unabsorbed relief in respect of newly established industrial undertakings relating to the earlier years, was allowed to be carried forward. The assessee company was allowed deduction of Rs. 4,56,458 representing estimated net income for technical services rendered outside India. It was, however, noticed from the Directors' report appended to the accounts relevant to the assessment year 1983-84 that due to political instability and foreign exchange crisis the payment from the foreign country was yet to be repatriated to India. As the income was not received in India in convertible foreign exchange, the company was not entitled to the deduction on such income in the assessment year 1983-84. The incorrect allowance of deduction of Rs. 4,56,458 resulted in net under-assessment of income of Rs. 3,16,921 (after

setting off of the whole of the carried forward deficiency of Rs. 1,39,537 relating to the earlier years) in the assessment year 1983-84 involving short levy of tax of Rs. 1,78,663 and non levy of interest of Rs. 51,347 and Rs. 67,868 for late filing of return and non-payment of advance tax respectively. As the carried forward relief deficiency to the extent of Rs. 72,095 (out of Rs. 1,39,537) was set off against the positive income assessed for the assessment year 1984-85 (made in March 1987 and revised in February 1988), there resulted tax under charge of Rs. 41,634 with consequent non levy of interest of Rs. 6,968 and Rs. 18,096 for late filing of return and non-payment of advance tax respectively for the assessment year 1984-85. Further, there was also a resultant excess carry forward of relief/ deficiency to the extent of Rs. 67,442 (Rs. 1,39,537-Rs. 72,095) at the end of the assessment year 1984-85 involving a potential tax effect of Rs. 38,947. These mistakes resulted in total undercharge of tax of Rs. 4,03,523 (including interest and potential tax effect).

3. In the assessment of a private limited company, for the assessment year 1984-85 (assessment completed in January 1987), a deduction of Rs. 6,18,177 out of the gross amount of foreign fees of Rs. 8,38,357 received by the assessee company was allowed after allowing the expenses of Rs. 2,20,180 incurred for earning the same. The foreign fees received were 11.54 per cent of the total fees received as against which the assessing officer incorrectly worked out the percentage of foreign fees to gross fees at 11.45 per cent. Further, it was also seen that all the expenses incurred for earning the fees were not considered by the assessing officer. As against the allocable expenses at Rs. 11.54 per cent of total expenses of Rs. 61,83,204 at Rs. 7,13,542, the expenses were considered at Rs. 2,20,180 only. The incorrect deduction allowable was, therefore, Rs. 1,24,815 only (Rs. 8,38,357 minus Rs. 7,13,542) as against Rs. 6,18,177 allowed by the department. The mistake resulted in excess allowance of deductions of Rs. 4,93,362 with consequent short levy of tax of Rs. 3,36,720.

The paragraph was referred to the Ministry of Finance for comments in February 1989; the reply from the Government has not so far been received (October 1989).

4. In the assessmtnt of a public sector corporation for assessment year 1985-86 (completed in February 1988) a deduction of Rs. 11,93,665 being 50 per cent of the earnings of Rs. 23,87,329 was allowed, without deducting the expenses incurred for earning the income. On the basis of information available on records the expenses attributable for realising the income of Rs. 23,87,329 worked out to Rs. 7,48,606. Hence the amount qualifying for deduction was Rs. 16,38,663 and deduction allowable thereon worked out to Rs. 8,19,332 only as against Rs. 11,93,665 allowed by the Department. The mistake resulted in under assessment of income of Rs. 3,74,333 involving short levy of tax of Rs. 2,21,574 (inclusive of interest of Rs. 10,810 for late filing of the income-tax return and Rs. 94,587 for under estimate for advance tax).

The Ministry of Finance have accepted the objection in principle.

5. An approved gross foreign income of Rs. 1,33,52,836 earned by an assessee company for rendering technical service outside India in the previous year relevant to assessment year 1985-86 (assessment completed in February 1988), included income of Rs. 68,72,051 derived from Nepal. Out of the above income from Nepal Rs. 54,47,820 was received in India in convertible foreign exchange and the balance Rs. 14,24,231 was received in Nepal in local currency and not brought to India. As technical services fee of Rs. 14,24,231 was not brought to India in convertible foreign exchange, the company was not entitled to get 50 per cent deduction therefrom. But while computing income in February 1988, the Inspecting Assistant Commissioner (Assessment) allowed 50 per cent deduction on Rs. 14,24,231 along with the total technical services fee of Rs. 1,33,52,836. The mistake resulted in under-assessment of income of Rs. 7,12,115. Besides, actual tax effect was required to be calculated on Rs. 3,31,612 being the difference between the assessee's business income of Rs. 62,95,915 and relief allowable for technical services fee of Rs. 59,64,303 as incentive deduction was to be made from the related business income only. This led to under charge of tax of Rs. 2,31,982 (including short levy of interest of Rs. 5,657 for belated filing of return).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.54 Incorrect deduction in respect of profits and gains from publication of books

Under the provisions of the Income-tax Act, 1961, where the gross total income of the previous year included any profits and gains derived from business carried on in India on the printing and publication of books, or publication of books, a deduction of 20 per cent of such profits and gains is allowable while computing the total income of an assessee.

In the assessment of a company for the assessment year 1985-86 completed in October 1986 by the Deputy Commissioner of Income-tax, a deduction of Rs. 18,62,866 was allowed at twenty per cent of the gross profit on the publication of books which included interest of Rs. 12,96,115 on fixed deposits. As the deduction is not allowable on interest on fixed deposits, the assessee company was incorrectly allowed a deduction of Rs. 2,59,223 i.e. 20 per cent of Rs. 12,96,115 being interest on fixed deposits.

The incorrect allowance of deduction resulted in under-assessment of income of Rs. 2,59,223 and short levy of tax of Rs. 1,90,529.

The Ministry of Financt have accepted the objection in principle.

3.55 Non-levy of minimum tax due to omission to restrict certain deductions in the case of companies

1. Under the Income-tax Act, 1961, as applicable to the assessment years 1984-85 to 1986-87 where in the case of a company, the aggregate amount of deduction admissible under certain specified provision of the income-tax Act exceeds seventy per cent of the amount of total as computed before making any such deduction that is the pre-incentive total income, the amount to be deducted under these provisions will be restricted to seventy per cent of the pre-incentive total income.

The assessments of a widely held company for the assessment years 1984-85 and 1985-86 were completed by the Deputy Commissioner of Income tax in March 1987 and March 1988 on 'NIL' income and a loss of Rs. 33,53,772 respectively after allowing a deduction of Rs. 83,04,121 and Rs. 66,63,986 for the two assessment years respectively being expenditure on agricultural development. It was noticed in audit (September 1988) that the deductions were allowed in full without applying the provisions regarding restriction of the deduction to seventy per cent of the pre-incentive total income. The omission resulted in short computation of income aggregating to Rs. 34,84,300 for the two assessment years, involving an aggregate under charge of tax of Rs. 20,12,182.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. In the assessment of a company, in which public are substantially interested for the assessment year 1985-86 completed by the Deputy Commissioner (Assessments) in October 1987, the pre-incentive total income was computed, at Rs. 1,18,48,713 after allowing a deduction of Rs. 86,32,403 in respect of foreign income, which is one of the specified deductions and the deduction towards the unabsorbed investment allowance was restricted to the extent of 70 per cent of pre-incentive income. The total income was determined at Rs. 35,54,614. The correct pre-incentive total income worked out to Rs. 2,04,81,116. From this the unabsorbed investment allowance had to be considered first and restricted to 70 per cent of the pre-incentive total income viz. Rs. 1,43,36,781. The total income thus worked out to Rs. 61,44,335 as against Rs. 35,54,614 determined. The short computation of total income by Rs. 25,89,721 resulted in under charge of tax of Rs. 14,95,564.

The Ministry of Finance have accepted the objection.

3. In the assessment of a private limited company for the assessment year 1985-86 completed by the Inspecting Assistant Commissioner(Assessment) in March 1988 the total taxable income was computed at Rs. 2,67,940 after adjusting fully the brought forward investment allowance and also the current year's investment allowance. Detailed examination revealed that the income was computed without taking into account the amendments brought about by the Finance Act 1983, for levy of minimum tax on companies. The 'pre-incentive' income computed was Rs. 41,55,302 and hence the brought forward investment allowance that could be adjusted was required to be limited to Rs. 29,08,711 being 70 per cent of the pre-incentive income, and an amount of Rs. 12,46,591 was required to be brought to tax. As the income computed was only Rs. 2,67,940 there was under-assessment of income of Rs. 9,78,650 involving short levy of tax of Rs. 9,09,388 (inclusive of interest of Rs. 23,119 for late filing of the return and Rs. 2,69,719 for under estimate of advance tax).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4. In cases where any of the specified deductions has not been allowed in the computation of the total income only because of the aforesaid restriction, the amount of deduction which could not be so allowed will be carried forward and will be deemed to be deduction admissible for the succeeding assessment year or years as the case may be.

In the assessment of a company for the assessment year 1985-86 completed by the Inspecting Assistant Commissioner (Assessment) originally in January 1988 and revised in May 1988, an aggregate amount of Rs. 21,29,987 being the unallowed deductions in respect of profits from projects outside India and export profits carried forward under the restrictive provisions of Chapter VI-B of the Act relating to the assessment year 1984-85, was set off against seventy per cent of the pre-incentive total income of the company. It was, however, noticed that the assessment for the assessment year 1984-85 was also revised in May 1988 and an aggregate amount of Rs. 7,31,890 only in respect of the aforesaid deductions, remaining un-allowed under the restrictive provisions of chapter VI-B of the Act, was allowed to be carried forward for set off against the positive income of the succeeding assessment years. Thus, carried forward unallowed deductions for Rs. 7,31,890 only relating to the assessment year 1984-85 was required to be set-off against the seventy per cent of the pre-incentive total income for the assessment year 1985-86 (revised in May 1988) instead of Rs. 21,29,987 actually set-off by the department. The mistake led to under-assessment of income of Rs. 13,98,097 with consequent under charge of tax of Rs. 8,07,400 in the assessment year 1985-86.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

5. In the assessment of a closely held company for assessment year 1985-86 completed in September 1987 the Assistant Commissioner determined the taxable income as 'NIL' after adjusting the unabsorbed investment allowance relating to assessment year 1982-83 to the extent of Rs. 14,35,737 without limiting it to Rs. 10,05,015 being seventy per cent of the pre-incentive total income of Rs. 14,35,737. The omission to do so resulted in the short computation of taxable income by Rs. 4,30,722 involving an aggregate short levy of tax of Rs. 3,76,503 (including penal interest for belated filing of return of income and short payment of advance tax).

The Ministry of Finance have accepted the objection.

6. The regular assessment of a private limited company for the assessment year 1984-85 was completed in March 1987. No investment allowance was allowed on the ground that the company was not an industrial company. In appeal the Appellate Commissioner directed that the company be treated as an industrial company and investment allowance be allowed. Accordingly the assessment was reviesd by the Inspecting Assistant Commissioner (Assessment) in March 1988. While giving effect to the appellate orders the allowable investment allowance was not restricted to 70 per cent of the pre-incentive total income. The omission resulted in under-assessment of income of Rs. 2,77,360 involving short levy of tax of Rs. 2,48,555 (inclusive of interest of Rs. 73,818 for under estimate of advance tax).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

7. The assessment of a private limited company for the assessment year 1985-86 was completed in May 1986. The assessment was, checked by the special Audit Party of the department in March 1988 and the gross total income of the company was recomputed by them at Rs. 6,68,986 and deduction aggregating to Rs. 10,21,078 towards donation, export turnover and inter corporate dividend for the assessment year 1985-86 was determined as admissible. Out of the total deduction of Rs. 10,21,078, an amount of Rs. 4,68,290 (being seventy per cent of the pre-incentive total income of Rs. 6,68,986) was determined as allowable in the current year in arriving at the taxable income of Rs. 2,00,696 under the restrictive provisions of Chapter VI-B of the Act and the balance amount of Rs. 5,52,788, being the portion of deduction remaining unallowed in the current year, was permitted to be carried forward for future adjustment. However, the gross total income of the company, before allowing deduction under Chapter VI-A of the Act having been computed at Rs. 6,68,986, the total deduction should not have exceeded that income. On this basis and after allowing deduction of Rs. 4,68,290 (being seventy per cent of the pre-incentive total income) only the balance amount of Rs. 2,00,696 should have been allowed to be carried forward for future adjustment as against Rs. 5,52,778 incorrectly allowed by the special audit party. The mistake resulted in excess allowance and carry forward of deduction to the extent of Rs. 3,52,092 in the assessment year 1985-86 involving a potential tax of Rs. 2,40,303.

The Ministry of Finance have accepted the objection.

8. While assessing the income of an assessee, a company, in which public are not substantially interested, in March 1986 and August 1987, the pre-incentive total income for the assessment years 1984-85, 1985-86 and 1986-87 was determined at Rs. 1,18,876, Rs. 2,76,603 and Rs. 3,34,172 respectively. The assessing officer allowed the deduction towards investment allowance of the year of assessment, unabsorbed investment allowance and profits and gains from newly established industrial undertaking, as the case may be, to the full extent of the pre-incentive total income without applying the ceiling limit of seventy per cent of such total income in each of the three assessment years. The mistake resulted in short computation of taxable income by Rs. 35,663, Rs. 82,981 and Rs. 1,00,252 for the assessment years 1984-85, 1985-86 and 1986-87 respectively leading to non-levy of tax of Rs. 1,60,906 for all the three assessment years (including interest for delayed filing of return of income and non-filing of estimate of income).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

9. In the assessment of a company for the assessment year 1984-85 completed in February 1987 by the Inspecting Assistant Commissioner (Assessment) the pre-incentive total income was computed at Rs. 29,68,790 and after restricting the deductions for investment allowance and export turnover to Rs. 22,26,592 the taxable income was worked out at Rs. 7,42,198. Thus the deductions allowed amounting to Rs. 22,26,592 were restricted to 75 per cent of pre-incentive total income instead of 70 per cent provided under the Act. The mistake resulted in under-assessment of income of

Rs. 1,48,437 with consequent non-levy of tax of Rs. 1,31,852 (including interest for non-payment of advance tax).

The Ministry of Finance have accepted the objection.

10. The assessment of a company for the assessment year 1985-86 was completed in March 1988 determining pre-incentive total income of Rs. 7,63,956. The company was entitled to deductions on account of investment allowance, donation and export profits aggregating to Rs. 9,42,332 in the relevant assessment year. Applying the restrictive provisions under Chapter VI-B of the Act, the assessing officer allowed deductions aggregating to Rs. 5,34,770 only being 70 per cent of pre-incentive total income of Rs. 7,63,956. However, the assessment order of March 1988 did not indicate the amount of unabsorbed deductions be carried forward. In the revised assessment made in April 1988, a sum of Rs. 4,07,562 being the amount of deductions not allowed in respect of donation and export profits was allowed to be carried forward for future adjustment. But the gross total income of the company worked out to Rs. 6,33,546 and hence deduction on account of donation and export profits was to be restricted to the gross total income i.e. Rs. 6,33,546. In the original assessment made in March 1988 the assessing officer had already allowed deduction in respect of donation and export profits to the extent of Rs. 4,04,360 (Rs. 5,34,770—Rs. 1,30,410). Hence. further deduction on these accounts amounting to only Rs. 2,29,186 (Rs. 6,33,546 - Rs. 4,04,360) was required to be carried forward in the assessment year 1985-86 as against Rs. 4,07,562 actually carried forward and allowed by the assessing officer. The mistake resulted in excess carry forward of deduction to the extent of Rs. 1,78,376 involving potential tax effect of Rs. 1,12,376.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

11. In the assessment of a private company for the assessment year 1986-87 completed in January 1988, the total income before deduction of current year's investment allowance was computed at Rs. 3,41,841 and after allowing deduction in respect of investment allowance to the extent of whole income of Rs. 3,41,841 the assessed income was reduced to Nil. However, under the aforesaid provisions of the Act, the assessee company could have been allowed deduction for investment allowance to the extent of only Rs. 2,39,289 being 70 per cent of Rs. 3,41,841 and the balance income of Rs. 1,02,552 was required to be brought to tax. Omission to do so resulted in under-assessment of income of Rs. 1,02,552 involving short levy of tax of Rs. 74,764 (including interest for non payment of advance tax).

The Ministry of Finance have accepted the objection.

3.56 Excess or irregular refund

Under the Income-tax Act, 1961, where the advance-tax paid by an assessee exceeds the amount of tax payable as determined on regular assessment, the Government is liable to pay interest on the amount of advance-tax paid in excess for the period from 1 April of the assessment year to the date of regular assessment. There is no provision in the Act to increase or decrease the interest payable to the assessee on the excess advance-tax paid as a result of variation in the income due to rectification as a result of appellate or revision proceedings upto 31 March 1985.

1. In the case of a public limited company, the regular assessment for the assessment year 1982-83 was completed in March 1985 and was modified in May 1985 and October 1986. In the modification order of October 1986, to give effect to the appellate orders, the excess advance-tax paid was increased with consequential increase of interest payable thereon by Rs. 3,35,494 and the same was refunded to the assessee. As the provisions for increase or decrease of interest payable by the Government were effective from assessment year 1985-86, the payment of interest of Rs. 3,35,494 to the assessee was not in order and resulted in an irregular refund.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. An assessee company was due to receive interest of Rs. 2,91,799 from the Government for excess payment of advance-tax for the assessment year 1975-76 as per regular assessment completed in March 1978. On revision of the assessment in November 1985, the amount of interest payable by the Government was increased to Rs. 3,09,640 and after adjustment of tax demand of Rs. 1,17,490 for the same year, a sum of Rs. 2,92,150 was refunded to the assessee company. The action of the assessing officer in increasing the amount of interest payable to the assessee by Rs. 17,841 on the basis of revisional assessment, was not in order. Further, after deducting Rs. 1,17,490 from Rs. 3,09,640 an amount of Rs. 2,92,150 was wrongly determined as payable to the assessee instead of the correct amount of Rs. 1,92,150. The arithmetical mistake of Rs. 1,00,000 along with excess payment of interest of Rs. 17,841 resulted in an excess refund of Rs. 1,17,841 for the assessment year 1975-76.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

3. In the case of a public limited company for the assessment year 1986-87, in the provisional assessment completed in December 1986, the total income was computed at Rs. 5,99,64,051 including long term capital gain of Rs. 3,803. The tax payable worked out to Rs. 2,99,81,644. After giving credit for deposit made in Industrial Development Bank of India in lieu of surcharge on Income-tax and advance payment of tax for Rs.3,14,69,100, a refund of Rs. 15,86,453 was made to the assessee company in February 1987. However, the correct amount of refund due to the assessee was only Rs. 14,87,456. This resulted in grant of excess refund of Rs. 98,997.

The Ministry of Finance have accepted the objection.

4. The assessments of two private limited companies for the assessment year 1976-77, were completed in the months of October 1978 and November 1978 by including a dividend income of Rs. 3,75,000 and granting credit of tax deducted there from amounting to Rs. 86,250 in each case. As the assessing officer noticed that the dividend was declared on the last day of the previous year relevant to assessment year 1975-76 he reopened the assessment of that year in both the cases in August 1981, to include the dividend income of Rs. 3,75,000 and granted credit for tax deducted at source thereon amounting to Rs. 86,250 in each case, for that year also. As the dividend income had been taxed twice, the assessment for assessment year 1976-77 was rectified (February 1987) in pursuance of orders of Commissioner of Income-tax passed in January 1987, to exclude the dividend income. However, credit for tax deducted at source granted in the assessment for assessment year 1976-77, was not withdrawn, while excluding the dividend income, which resulted in grant of incorrect refund of Rs. 1,72,500 in the aggregate in the case of the two assessees.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

5. The regular assessment of a public limited company for the assessment year 1983-84 was completed in October 1985 and refund of Rs. 5,01,457 inclusive of interest of Rs. 1,08,785 for excess payment of advance tax was authorised to the assessee. The assessment was set aside by the Commissioner of Income-tax in exercise of his revisionary powers and the revised assessment was completed in March 1988 resulting in a tax demand. As a consequence, the interest of Rs. 1,08,785 paid earlier was required to be withdrawn which was not done by the assessing officer. This resulted in short levy of tax of Rs. 1,08,785.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3.57 Non-levy/Short-levy of interest for delay in filing the return

Under the Income-tax Act, 1961, where the return for an assessment year is furnished after the specified due date, the assessee shall be liable to pay simple interest at twelve per cent (fifteen per cent from 1 October 1984) from the date immediately following the specified date to the date of furnishing of the return on the amount of tax determined on regular assessment as reduced by the advance tax, if any, paid and any tax deducted at source. The Central Board of Direct Taxes on advice by the Ministry of Law clarified in December 1974 that for this purpose the actual date of filing the return should be included in computing the period for which interest is leviable.

1. In the case of three companies assessed in three different Commissioner's charge the returns of income for the assessment years 1984-85 and 1985-86 were filed between August 1984 and October 1985 while the due dates for filing the returns were June 1984 and January 1985 respectively. For belated filing of the returns the assessees were liable to pay interest aggregating to Rs. 41.07 lakhs which was not levied/short levied.

The details of the cases are as under :

Sl. No.	Commissioner's Charge	Assess-ment year	Date of filing of return	Due Date for filing of return	Interest leviable	Interest levied	Non/short levy of interest
					Rs.	Rs.	Rs.
1	West Bengal III A	1984-85 1985-86	22-8-84 30-10-85	30-6-84 30-6-85	2,12,895 30,55,481	— —	32,68,376
2	Delhi II A	1985-86	30-9-85	30-6-85	15,17,910	9,61,622	5,56,288
3	Delhi I B	1984-85	15-10-84	30-6-84	8,47,512	5,65,009	2,82,503
							41,07,167

The paragraphs were referred to the Ministry of Finance for comments between July 1989 and August 1989; the reply from the Government has not so far been received (October 1989). However, in one case, the Ministry of Finance have accepted the objection.

2. It has been judicially held that an assessment could be completed only on the basis of a correct and complete return and that when a revised return is filed, the original return must be taken to have been withdrawn and to have been substituted by the fresh return for the purpose of assessment.

A widely held company filed a return for assessment year 1984-85 originally in September 1984. In January 1986, it filed a revised return for an enhanced income of Rs. 1,38,56,810. The assessment was completed in February 1987 on a taxable income of Rs. 1,44,93,080 and a demand of Rs. 17,24,250 was raised. Scrutiny of records revealed (October 1986) that interest of Rs. 17,242 for the belated filing of return had been levied for one month only reckoning the period of delay upto September 1984 with reference to the date of filing of original return. It was, however, pointed out that as per judicial pronouncements, the period of delay should have been computed as seventeen months upto the date of filing of revised return, viz., January 1986. The mistake resulted in short levy of interest by Rs. 3,40,537.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989)

3.58 Short payment of Advance tax

Under the Income-tax Act, 1961, where an assessee company has paid advance tax for any financial year on the basis of his own estimate and the advance tax paid falls short of seventy five per cent (eighty three and one third per cent with effect from 1 September 1980) of the tax determined on regular assessment, interest at twelve per cent (fifteen per cent from 1 October 1984) per annum is payable by the assessee on the amount by which the advance tax paid falls short of the assessed tax from the first day of the next financial year to the date of regular assessment.

1. During the financial years relevant to the assessment years 1975-76, 1982-83 and 1984-85 to 1986-87 were assessed between September 1978 and March 1988 in five different Commissioner's charges, the advance tax of Rs. 155.69 lakhs paid by the five assessee companies fell short of seventy five/Eighty three and one third per cent of assessed tax. As such, the assessee companies were liable to pay interest on account of short payment of advance tax under the provisions of Income-tax Act, which was, however, not levied/short levied by the department. This led to non/short levy of interest aggregating to Rs. 37.19 lakhs.

The details of the cases are as under :

Sl. No.	Commissioner's charge/ Name of assessee	Assessment years	Assessment completed	Assessed tax	Advance tax paid	Non levy/short levy of interest
				Rs.	Rs.	Rs.
1	Bombay City II A	1975-76	September 1978 September 1982 (Revised)	76,15,920	4,37,490	29,43,144
2	West Bengal I A	1986-87	March 1987	94,21,363	73,35,041	2,61,251
3	West Bengal I B	1982-83	February 1985 March 1986 (Revised)	64,37,295	53,32,000	94,242
4	Surat A	1985-86	March 1988	24,48,986	19,80,000	2,05,181
5	Madurai A	1984-85	July 1986 September 1987 (Revised)	11,82,441	4,84,632	2,14,785
		Total			1,55,69,163	37,18,603

The paragraphs were referred to the Ministsy of Finance for comments between March 1989 and July 1989; the reply from the Government has not so far been received (October 1989). However, in three cases the Ministry of Finance have accepted the objections.

2. In the regular assessments of four companies assessed in four different Commissioner's charges for the assessment year 1984-85 and 1985-86 completed between December 1987 and March 1988 the interest for short payment of advance tax was not correctly worked out resulting in short levy of interest aggregating to Rs. 9.97 lakhs.

Sl. No.	Commissioner's charge/ Name of assessee	Assessment year	Assessed tax	Pre-assessment tax paid	Interest leviable	Interest charged	Short levy of interest
1	Bihar Ranchi A	1984-85	4,85,45,990	4,75,02,464	22,02,465	17,89,403	4,13,062
2	Bhopal A	1984-85	—	—	(Interest chargeable for 47 months)	(Interest charged for 35 months)	3,04,060
3	West Bengal IV A	1985-86	39,79,239	15,00,000	4,69,371	2,71,459	1,97,912
4	Karnataka I A	1985-86	—	—	(Interest chargeable for 33 months)	(Interest charged for 17 months)	81,798
			Total				9,96,832

The paragraphs were referred to the Ministry of Finance for comments between May 1989 and August 1989; the reply from the Government has not so far been received (October 1989). However, in two cases, the Ministry of Finance have accepted the objections.

3. Under the provisions of the Income-tax Act, 1961, where on making regular assessment the assessing officer finds that any person has not sent a statement of advance tax payable by him computed in the manner laid down in the Act or has not sent an estimate of his current income and has not paid advance tax, interest at the prescribed rates from the first day of April next following the financial year upto the date of regular assessment is payable by the assessee.

In the cases of the two non-resident companies and one closely held company the return for the assessment years 1984-85 and 1985-86 were filed through their agent in India in two different Commissioner's charges. The representative assessees/ assessee did not, however, file any statement or estimate of advance tax payable by them nor paid any advance tax. Consequently, interest at the prescribed rates from the first day of April next following the financial year upto the date of regular assessment on the assessed tax determined in the assessments completed between August 1987 and February 1988 for failure to file statement/estimate of advance tax was leviable which was not levied by the department. This led to non-levy of interest aggregating to Rs. 3.94 lakhs.

The details of cases are as under :

Sl. No.	Commissioner's charge/Name of assessee	Assessment year	Assessment completed	Non-levy of interest
				Rs.
1	Bombay City II A	1984-85	September 1987	1,04,148
2	Bombay City II B	1984-85	August 1987	92,004
3	West Bengal IV	1985-86	February 1988	1,97,902
		Total		3,94,054

The paragraphs were referred to the Ministry of Finance for comments between July 1989 and August 1989; the reply from the Government has not so far been received (October 1989).

3.59 Delay in payment of tax demand

1. Under the Income-tax Act, 1961, any demand for tax should be paid by an assessee within thirty five days of service of the notice of the relevant demand and failure to do so would attract simple interest at 12 per cent (15 per cent from 1 October 1984) per annum from the date of default. In April 1982, the Central Board of Direct Taxes clarified through executive instructions that in case where the original assessment is either varied or set aside by the appellate authority, but on appeal by the department, the original order of the Income-tax Officer is restored wholly or partly, the interest for non-payment of demand should be calculated with reference to the date of service of the original notice of demand on the tax finally determined and the fact that during the intervening period there was no tax leviable by the assessee under any operative order would make no difference to the position.

The assessments of twelve assessee companies for the assessment years 1972-73 to 1984-85 were completed between February 1975 and March 1987 in seven Commissioner's charges and notice of tax demand were served on the assessees between March 1975 and March 1987 subsequently on revision of original tax demand to give effect to the appellate orders, the revised tax demands were paid beyond the permissible period of thirty five days from the date of service of demand notice and as such the assessees were liable to pay interest under the provisions of the Income-tax Act. The omission led to non-levy of interest aggregating to Rs. 69.12 lakhs.

The details of cases are as under :

Sl. No.	Commissioner's charge/ Name of the assessee	Assessment year/	Date of issue of tax demand	Final tax demand	Non levy/short levy of interest
				Rs.	Rs.
1	West Bengal-III A 1983-84		19 March 1987	1,46,73,774	16,50,791
2	West Bengal II B 1981-82		13 August 1986	3,40,11,973	14,77,826
3	West Bengal I C	1984-85	24 March 1987	2,68,98,574	13,78,548
4	West Bengal III D	1984-85	March 1987	1,71,85,595	4,29,638
5	West Bengal I E	1985-86	February 1987	33,22,258	3,90,359
6	West Bengal I F	1972-73 1973-74	March 1975 October 1976	1,41,381 3,55,272	1,09,036 2,08,437
7	West Bengal II G	1980-81	December 1983	28,14,343	1,93,087
8	West Bengal V H	1981-82	18 March 1985	4,23,106	1,65,223
9	West Bengal IV H	1983-84	27 March 1986	1,26,70,839	1,57,735
10	West Bengal III J	1978-79	28 September 1981	14,60,735 6,31,107 (revised net demand)	97,872
11	Coimbatore A	1975-76 1976-77 1978-79	October 1978 September 1979 June 1981	5,47,874 21,23,686 52,58,219	5,05,111
12	Bhopal A	1973-74	June 1976	2,64,992	1,48,396
		Total			69,12,059

The paragraphs were referred to the Ministry of Finance for comments between March 1989 and August 1989; the reply from the Government has not so far been received (October 1989). However, in two cases each the Ministry of Finance/department have/has accepted the objection.

2. Under the Income-tax Act, 1961, in case of default the Income-tax Officer shall calculate the interest payable under the Act at the end of each financial year and issue a notice of demand. The Board issued instructions (November 1974 and June 1975) that this work should be completed within a period of thirty days from the end of the financial year and the interest for the belated payment of tax should be calculated and charged within a week of the date of final payment of tax demand.

The original assessment of five companies for the assessment years between 1975-76 to 1977-78 and 1982-83 to 1985-86 were completed between September 1977 and March 1987 in 3 different Commissioner's charge. The demands specified in the notices were not paid within the prescribed periods by the assessee companies for which interest was leviable but the same was not levied resulting in non levy of interest aggregating to Rs. 16.68 lakhs.

The details of the cases are as under :—

Sl. No.	Commissioner's charge/ Name of the assessee/ assessment year	Assessment completed	Nature of objection	Non levy of interest Rs.
1	Cochin A 1984-85	March 1987	Original demand raised in March 1987 was reduced to Rs. 20,02,203 in the revision made in March 1988 against which only Rs. 62,243 was paid.	5,09,373
2	Coimbatore A 1975-76 1976-77	September 1978 September 1979	The original demands were raised in October 1978 and September 1979 were reduced to Rs. 4,28,360 and Rs. 18,30,730 in revision made in March 1982. But interest leviable upto the date of issue of tax recovery certificate i.e., 31 March 1980 and 30 March 1981 respectively and the balance tax demand of Rs. 2,50,000 remained unpaid upto 31 March 1988.	4,46,445
3	Coimbatore B 1977-78	September 1980	The original demand of Rs. 31,69,750 was raised on 12 September 1980 and further additional demand of Rs. 1,95,010 was raised in the revision made on 12 December 1986. Out of which Rs. 30,37,941 and Rs. 1,19,811 were realised during October 1980 to March 1983 and on 29 June 1986 leaving a balance of Rs. 75,199, unpaid upto 31 March 1988. However, the interest was not levied on the balance outstanding and delayed payment of tax demand.	3,56,654
4	Coimbatore C 1983-84	February 1986 December 1986 (Revised)	Original demands raised in Feburary 1980 was reduced to Rs. 19,11,135 in the revision made in December 1986 against which Rs. 2,50,035 remained unpaid upto 31 March 1987.	1,92,451
5	Central II Madras D 1982-83	March 1985 May 1986 (revised)	The original demand raised in March 1985 was reduced to Rs. 10,87,215 which was adjusted in full against refunds due in May 1986. But the interest for delay was not levied.	1,63,080
	Total			16,68,003

The Ministry of Finance have accepted the objections.

3.60 Incorrect working in interest

In the assessment of two companies for the assessment years 1984-85 assessed in March 1987 and February 1988 in two Commissioner's charges, interest for non-payment of failure to file estimate of advance tax were levied on the assessed tax of Rs. 7,96,742 and Rs. 18,85,803 respectively. It was, however, noticed that while computing the interest, the assessing officer had wrongly calculated the interest of Rs. 3,26,647 for 34 months instead of the correct amount of Rs.4,46,152 for 46 months and Rs. 6,84,607 for the period from 1-4-1984 to 28-2-1987 instead of correct amount of Rs. 7,96,750 for the same period respectively. This led to short levy of interest aggregating to Rs. 2,31,648.

The paragraphs were referred to the Ministry of Finance for comments in April 1989 and July 1989; the reply from the Government has not so far been received. However, in one case, the department has accepted the objection.

3.61 Failure to deposit tax deducted at source

If the person responsible for deducting tax at source under the provisions of Income-tax Act, does not deduct such tax or after deducting fails to pay tax as required by the Act, he is liable to pay interest at 12 per cent (15 per cent from 1 October 1984) per annum on the amount of such tax from the date on which such tax was deductible or deducted to the date on which such tax is actually paid.

In the assessment of two assessee companies for the assessment years 1982-83 to 1984-85 assessed between February 1985 and March 1988 in two different Commissioner's charges either the tax was not deducted at source or if deducted was not deposited with the Central Government within the specified period. The deparment did not levy any penal interest leviable under the provisions of the Act. The failure to do so resulted in non-levy of penal interest of Rs. 11.61 lakhs.

Sl. No.	Commissioner's Charge/ Name of assessee /Assessment year	Nature of objection	Non levy of interest/penalty Rs.
1	Bihar. Patna A 1982-83 1983-84	Failure on the part of the assessee to deposit the tax deducted at source amounting to Rs. 19,49,119 to the credit of Central Government.	10,09,939
2	West Bengal IV A 1982-83 to 1984-85	Failure to deposit tax aggregating to Rs. 6,55,265 which was deducted at source to the credit to Central Government.	1,50,907
	Total		11,60,846

The paragraphs were referred to the Ministry of Finance for comments between January 1989 and July 1989; the reply from the Government has not so far been received (October 1989). However, the Ministry of Finance/department have/has accepted the objection in one case each.

3.62 Avoidable /Incorrect payment of interest by Government

1. Under the provisions of the Income-tax Act, 1961, where as a result of any order passed in appeal, revision or any other proceedings under the Act refund of any amount becomes due to the assessee and Income-tax Officer does not grant the refund within a period of three months from the end of the month in which such order is passed, the assessee shall be entitled to interest at the rate of twelve per cent (fifteen per cent from 1 October 1984) on the amount of refund due from the date immediately following the expiry of the period of three months aforesaid to the date on which the refund is granted. The Central Board of Direct Taxes issued executive instructions in January 1977 directing that such refunds should be granted within a month of receipt of appellate order.

In the assessments of 2 public limited companies for the assessment years 1977-78 and 1984-85 assessed in two different Commissioner's charges, the delay in issuing the refund pursuant to the appellate orders resulted in avoidable payment of interest by the Government aggregating to Rs. 40.60 lakhs.

The particulars of these cases are as follows :—

Sl. No.	Name of Assessee	CIT Charges/ Assessment year	Nature of objection	Tax effect
				Rs.
1	A	Bombay City II 1977-78	The refund of Rs. 5,88,59,235 as a result of appellate orders in March 1987/April 1987 made belatedly in December 1987.	34,66,875
2	B	Jaipur 1984-85	Delay of 7 months in authorisation of refundable amount of Rs. 82,04,217 (including interest of Rs. 14,37,839 under section 244 (1A.)	5,93,189
		Total		40,60,064

The paragraphs were referred to the Ministry of Finance for comments between July 1989 and August 1989; the reply from the Government has not so far been received (October 1989).

2. Where the advance tax paid by an assessee exceeds the amount of tax payable on regular assessment the Government is liable to pay interest on the advance tax paid in excess for the period from 1 April of the assessment year to the date of regular assessment. Prior to amendment of law from the assessment year 1985-86 the interest is not to be enhanced in the event of subsequent reduction of tax liability.

In the assessment of 5 assessees companies for the assessment years 1975-76 to 1985-86 assessed between February 1979 and March 1988 in five different Commissioner charges non completion of provisional assessment/incorrect computation of interest on refunds resulted in avoidable payment of interest by Government aggregating to Rs. 35.65 lakhs.

The particulars of these cases are :—

Sl. No.	Name of assessee Co.	CIT/Aessessment years	Nature of objection	Tax effect
				Rs.
1	A	Delhi III 1984-85	Failure to make a provisional assessment for refund apparently due resulted in payment of avoidable interest on refund of Rs. 1,20,89,957 authorised on regular assessment in August 1986	23,38,115
2	B	Trivandrum 1984-85	Incorerct payment of interest on interest on excess advance tax based on a revised assessment to give effect to an appellate order in April 1987.	4,81,805
3	C	West Bengal I 1975-76	Interest incorrectly allowed on refund due to excess payment of advance and self assessment tax of Rs. 42,66,847 which was not in pursuance of any orders of assessments penalty finally reduced in appeal.	3,99,998
4	D	Central I West Bengal 1985-86	Incorrect payment of interest on refund of Rs. 24,17,500 made upto November 1988 instead of March 1988.	2,41,750
5	E	West Bengal III 1978-79	Incorrect reckoning of period for which the interest was payable as ten months instead of the correct period of 8 months.	1,03,428
			Total	35,65,096

The paragraphs were referred to Ministry of Finance for comments between June 1989 and July 1989; the reply from the Government has not so far been received (October 1989) in three cases. However, the Ministry of Finance have accepted the objection in two cases.

3.63 Non-levy of penalty

1. The Income-tax Act, 1961, as amended from the assessment year 1985-86 and onwards provides that every assessee, whose total sale turnover or gross receipts of the business exceed forty lakhs rupees in any previous year, should get his accounts audited by an authorised accountant before the due date for submission of the return of income and obtain report of such audit in the prescribed form within the due date. The due date for filing the return for business cases has been prescribed as 30 June or 31 July of the assessment year according as the accounts of the assessee are closed before the preceding December or March. Failure to get the accounts audited and to obtain the audit report within the due date renders the assessee liable to a penalty equivalent to one half per cent of the turnover or one lakh rupees whichever is lower. The Central Board of Direct Taxes issued instructions in June 1985 that for assessment year 1985-86, the penalty proceedings should not be initiated provided the audit report prescribed has been obtained by 30 September 1985 and the self assessment tax has been paid within the normal period prescribed under the Act for filing of return of income. The Board have also issued instructions in July 1964 and again in September 1975 that where the Income-tax Officer does not initiate penalty proceedings in any case, he should record the reasons for not doing so.

In the case of 13 assessee companies, the returns of income for the assessment years 1985-86 to 1987-88 were filed alongwith the prescribed audit reports of Chartered Accountants on various dates between November 1985 and February 1988 after the expiry of the due dates specified for each of the assessment years as the due dates for obtaining the audit reports expired on 30 September 1985 for the assessment year 1985-86, 30 June for the assessment year 1986-87 and 31 July for later years, the assessee companies were liable for penalty for the delay. In the assessment completed between April 1987 and March 1988, the assessing officers did not initiate any penalty proceedings or keep a note of the reasons for not initiating the proceedings. At the rate of one half per cent of the turnover of Rs. 1 lakh whichever is lower, the penalty leviable in these cases aggregated to Rs. 13.48 lakhs for the assessment years 1985-86 to 1987-88.

The paragraphs were referred to the Ministry of Finance for comments between March 1989 and August 1989; the reply from the Government has not so far been received (October 1989). However, the Ministry of Finance/department have/has accepted the objection in two/one cases.

2. Under the provisions of the Income-tax Act, 1961, where any tax is payable by an assessee on the basis of a return after taking into account the amount of tax, if any, already paid by the assessee shall be liable to pay such tax before furnishing the return. For failure to pay such tax or any part thereof a penalty is leviable at the rate of two per cent of the tax for every month of default.

In two cases, the assessee companies filed its returns for the assessment years 1980-81 and 1985-86 in September 1980 and 11 September 1985 showing an income of Rs. 5,42,790 and Rs. 69,35,340 respectively. On the basis of returns the assessees were required to pay tax of Rs. 2,50,099 and Rs. 18,19,000 on self assessment before furnishing the return. But in one case, the tax was paid only on 6 August 1985 that is beyond the normal date and in another case no such tax was paid even up to the date of assessment. The assessee companies were liable to pay penalty in these cases aggregating to Rs. 2,20,000 for the assessment years 1980-81 and 1985-86.

The paragraphs were referred to the Ministry of Finance for comments between June 1989 and August 1989; the reply from the Government has not so far been received (October 1989).

3.64 Non-levy of additional income tax

Under the provisions of the Income-tax Act, 1961, where the profits and gains of any previous year distributed as dividends within the twelve months immediately following the expiry of the previous year by a company, not being one in which the public are substantially interested or a hundred per cent subsidiary of any such company are less than statutory percentage of the distributable income of that previous year, the company is liable to pay additional income-tax at specified rates on the distributable income as reduced by the amount of dividends actually distributed, if any. Effective from 1 April 1978 additional income-tax is not leviable in the case of a company whose business consists mainly in the construction of ship or in the manufacture or processing of the goods or in mining or in the generation or distribution of electricity or any other form of power.

In the assessment of 7 closely held companies for the assessment years 1981-82 to 1985-86 assessed in four different Commissioner's charges between October 1986 and March 1988, non/short distribution of statutory percentage of distributable income as dividend resulted in non-levy of additional income tax of Rs. 26.02 lakhs in the aggregate.

Sl. No.	C.I.T.'s charge/Assessee Co.	Assessment year	Distributable Income	Amount of statutory percentage of distributable income to be declared as dividend	Dividend declared	Non levy of additional Tax
1	West Bengal-III A	1985-86 1986-87	3,89,457 8,58,924	3,50,511 7,73,032	Nil	6,24,190
2	West Bengal-II B	1985-86	14,68,448	8,81,068	5,40,000	3,43,526
3	West Bengal-II	1985-86	6,49,606	5,84,646	1,67,568	2,41,019
4	II-Gujarat State Ahmedabad A	1983-84	8,53,491	4,26,745	98,138	3,77,676
5	II-Gujarat State Ahmedabad A	1983-84	6,48,253	5,73,428	Nil	3,24,121
6	II-Gujarat State Ahmedabad A	1981-82	7,10,916	6,39,824	Nil	2,63,038
7	Tamil Nadu III	1982-83	6,33,641	5,70,277	Nil	4,28,333
	A	1985-86	5,27,328	4,74,595	Nil	
	Total					26,01,903

3.65 Change of previous year prejudicial to revenue

1. Under the provisions of the Income-tax Act, 1961, an assessee can change the hitherto followed previous year in respect of his business with the consent of the Income-tax officer upon such conditions as the Income-tax Officer may impose. The Central Board of Direct Taxes have issued instructions in May 1971 and August 1976 requiring the Income-tax Officers to ensure that the assessee is not attempting to make use of the device of changing his previous year in a manner detrimental to revenue, including undue deferment of payment of advance tax. Where the application is made with the object of causing loss to revenue, the orders of Commissioner of Income-tax should be obtained before granting permission to the assessee to change the previous. year. The Board also specifically directed the Commissioner of Income tax to cancel all permissions granted for change of previous year by the Income-tax Officer if they are found to be prejudicial to revenue.

A public limited company with previous year ending 30 June 1982, upto the assessment year 1983-84 sought permission for a change in the accounting year as a result of which the next accounting year covered a period of 18 months. The department consented to the change without imposing any condition. The assessee was accordingly allowed normal depreciation and additional depreciation. Grant of additional depreciation calculated on normal depreciation for a period of 18 months as against the normal period of 12 months was prejudicial to revenue. Omission to safeguard the interest of the revenue in accordance with the provisions of the Act and failure to comply with the instructions of the Board at the time of completing the original as well as the revised assessment for the assessment year 1984-85 in March 1987 and January 1988 respectively by the assessing officer led to allowance of additional depreciation in excess by Rs. 6,92,400 and excess carry forward of unabsorbed depreciation by a like amount involving tax effect of Rs. 3,99,861.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. Under the Income-tax Act, 1961, in computing business income of an assessee a deduction on account of depreciation on plant and machinery is admissible at the rates prescribed in the Income-tax Rules, 1962, provided they are owned by the assessee and used for the purpose of the business during the relevant previous year. Under the Income-tax Rules where the previous year is for a period of 13 months or more, the quantum of depreciation calculated at the prescribed rate shall be proportionately increased without affecting the rate prescribed. The Act further provides that in respect of new plant and machinery installed after 31 March 1980 but before 1 April 1985 an additional sum computed at half the rate prescribed for the plant and machinery shall be allowed by way of additional depreciation. There is no provision in the Act or Rules to increase proportionately the quantum of or rate prescribed for additional depreciation when the previous year is for a period of 13 months or more.

In the assessment of a company for the assessment year 1982-83 (previous year consisted of 15 months) completed by the Inspecting Assistant Commissioner (Assessment) in June 1982 (revised in July 1984 and August 1987) normal depreciation (applicable rate 20 per cent) including additional depreciation of Rs. 93,91,083 at the proportionately increased rate of 25 per cent. was allowed. It was, however, noticed in audit that the additional depreciation of Rs. 16,27,063 included in Rs. 93,91,083 ibid was incorrectly allowed at 12/1/2 per cent (half of proportionately increased rate of 25 per cent) on additions to plant and machinery worth Rs. 1,30,16,501 instead of at the correct rate of 10 per cent (half or applicable rate of 20 per cent) amounting to Rs. 13,01,650. Adoption of incorrect rate of additional depreciation resulted in excess allowance of additional depreciation of Rs. 3,25,413 leading to excess determination of loss by an identical amount involving a potential short levy of tax of Rs. 1,87,927.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3. A limited company with the previous year ending 31 December each year sought permission for a change in the accounting year covering a period of 18 months from 1 January 1981 to 30 June 1982 for the assessment year 1983-84. The department consented to the change without imposing any condition. In the assessment for the assessment year 1983-84 made in February 1986 (revised in November 1986) the assessee was allowed total depreciation (Rs. 17,08,910) including additional depreciation of Rs. 2,25,143 for 18 months and also deduction of Rs. 3,67,238 being tax holiday relief in respect of new industrial undertaking calculated for 18 months. Since the additional depreciation is an incentive the grant of additional depreciation for 18 months as against the normal period of 12 months was prejudicial to revenue. Similarly, the grant of tax relief for 18 months instead of restricting it to the period of 12 months was also not in order. The mistakes accounted for excess computation and carry forward of loss to the extent of Rs. 2,00,816 (Rs. 78,403 + Rs. 1,22,413) involving potential short charge of tax of Rs. 1,15,970.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3.66 Non-completion of set-aside assessment with in the prescribed time limit

Under the Provisions of the Income-tax Act, 1961, if an order of assessment made by the assessing officer is considered by the Commissioner to be prejudical to the interest of revenue and is set aside for making a fresh assessment, the assessment has to be made afresh by the assessing officer within two years from the end of the financial year in which orders for setting aside are passed by the Commissioner.

The assessment of a State Matsya Vikas Nigam for the assessment year 1981-82 made by the assessing officer in January 1984 on income of Rs. 7,12,290 was considered by the Commissioner to be prejudicial to the interest of revenue because the assessing officer had allowed certain claim and expenditure. etc. totalling to Rs. 4,12,612 without proper examination, and the assessment was set aside (January 1986) by the Commissioner with directions to make a fresh assessment after proper examination. It was noticed in audit (January 1989) that the fresh assessment required to be completed by 31 March 1988, was not completed. Thus by not making the fresh assessment within the statutory time limit admissibility of the amount of Rs. 4,12,612 involving tax effect of Rs. 3,07,285 (including interest for short payment of advance tax) remained to be examined and quantified.

The Ministry of Finance have accepted the objection.

3.67 Failure to revise the assessment of a company consequent upon firm s assessment in which it was a partner

The assessments of a company for the assessment years 1984-85 and 1985-86 were completed in December 1984 and October 1986 and rectified in March 1987 and May 1987 by adopting provisional share income of Rs. 1,32,847 and Rs. 10,430 respectively from the firm in which it was a partner. A note of adopting provisional share income had been kept in the register of cases of share income for the assessment year 1984-85 but no follow up action was taken on the basis of entries in the register to ascertain the determined share income till it was pointed out by Audit in November 1987. As regards assessment year 1985-86 neither any such note was kept in the said register nor any action taken to ascertain the correct share income though the determined share income of the company was Rs. 2,50,338 for the assessment year 1984-85 and Rs. 1,42,431 for the assessment year 1985-86 which involved aggregate additional demand of Rs. 1,86,650.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

MISCELLANEOUS

3.68 Incorrect issue of demand notice

Under the provisions of the Income-tax Act, 1961, when any tax interest, penalty, fine or any other sum is payable in consequence of any order passed under the Act, the assessing officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable.

The assessment of a company, for the assessment year 1985-86 originally made in September 1987, was revised in November 1987 determining total income at Rs. 3,13,870 and aggregate tax demand at Rs. 2,40,309 including interest of Rs. 59,049 for late filing of return and short payment of advance-tax. After adjusting advance tax of Rs. 28,875 the net demand of tax of Rs. 2,11,434 was computed as payable by the company. It was, however, noticed that the demand notice was issued for a sum of Rs. 45,715 being interest for short payment of advance-tax only instead of the correct demand of Rs. 2,11,434. The mistake resulted in short demand of tax of Rs. 1,65,719 for the assessment year 1985-86.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; tht reply from the Government has not so far been received (October 1989).

SURTAX

As a disincentive to excessive profits a special tax called super profits tax was imposed on companies making excessive profits during the assessment year 1963-64 under the Super Profits Tax Act, 1963. This tax was replaced from the assessment year 1964-65 by surtax levied under the Companies (Profits) Surtax Act, 1964 which was also abolished from the assessment year 1988-89. However, more important mistakes noticed in the assessment and levy of surtax during the course of audit in 1988-89 in respect of past cases are detailed below:—

During the period under report underassessment of surtax of Rs. 871.03 lakhs was noticed in 152 cases. A few illustrative cases are given in the following paragraphs.

3.69 Incorrect computation of capital

1. Under the provisions of Companies (Profits) Surtax Act, 1964 surtax is leviable on the amount by which the chargeable profits of a company exceed the statutory deduction which is an amount equal to 15 per cent of the capital of the company as on the first day of the previous year or Rs. 2 lakhs, whichever is greater. Capital for the purpose includes the paid up share capital and reserves.

It was judicially held that (111 ITR 6) if during the course of a previous year, a part of amount standing to the credit of the general reserve is capitalised by issue of fully paid up bonus shares it cannot be said that the capital of the company computed in accordance with surtax rules is increased by any amount by such issue of bonus shares.

Bombay

During the previous year relevant to the assessment year 1980-81 a company's share capital was increased by Rs. 56,60,500 with effect from 7 November 1979, on account of issue of bonus shares. In the surtax assessment of the company, assessment completed in January 1987 while computing the capital base the capital was proportionately increased by Rs, 8,52,952 for 55 days. However it was seen that bonus shares were issued by capitalising amount of Rs. 6,18,525 standing to the credit of share premium account and Rs. 50,41,975 out of revenue reserve. Since there was a corresponding decrease in the capital due to reduction of reserve and share premium account the proportionate addition made to the capital base on account of increase in share capital was not in order. This resulted in excess computation of capital base by Rs. 8,23,258 and excess allowance of statutory deduction of Rs. 1,23,487. Consequently chargeable profits were underassessed by Rs. 1,23,487 with short levy of surtax of Rs. 55,569.

The Ministry of Finance have accepted the objection.

Excess deduction allowed in assessment over and above the debit to account

2. Under the Surtax Act, in computing the capital of a company, its other reserve shall be reduced by amounts credited to such reserves as have been allowed as deductions in computing the income of the company for purposes of Income-tax Act, 1961. It has been judicially held that if the amount of depreciation provided in the books of an assessee company for a particular year was less than the amount of depreciation actually allowed by the assessing officer for computation of its income under Income-tax Act, then the difference between these two amounts has to be deducted from the amount standing to the credit of its general reserve, while computing the capital employed for surtax purposes.

Tamil Nadu and Bombay

(i) In the surtax assessment of four companies in the charges of two different commissioners in Tamil Nadu and Bombay for the assessment years 1980-81, 1981-82, 1983-84 and 1984-85 which were completed between May 1986 and December 1988 the difference of Rs. 21,69,342 in aggregate between the depreciation already allowed in income-tax assessments and that debited to the accounts of the assessee companies was not reduced from the general reserve as being not a reserve. The incorrect computation of capital led to a short levy of surtax of Rs. 6,80,166.

The surtax assessments in the above cases were completed by the Inspecting Assistant Commissioners (Assessment).

The paragraphs were referred to the Ministry of Finance for comments during February 1989 and May 1989; the reply from the Government has not so far been received (October 1989).

(ii) The Central Board of Direct Taxes clarified in November 1974 that 'debenture sinking fund' or 'debenture redemption reserve' are only provisions and not reserves and as such they are not to be included in the computation of capital.

In the surtax assessment of a pharmaceutical company for the assessment year 1980-81 completed by the Inspecting Assistant Commissioner (Assessment) in January 1987 the assessing officer while computing the capital base for levy of surtax included under reserves an amount of Rs. 33 lakhs being debenture redemption reserve and the capital base worked out accordingly. As debenture redemption reserve was in the nature of a provision and not a reserve as clarified by the board it was required to be excluded in computing the capital base. Omission to do so resulted in excess allowance of statutory deduction of Rs. 4,77,766 involving short levy of surtax of Rs. 2,14,994.

The Commissioner of Income-tax has set aside the surtax assessment with the directions to revise the assessment by excluding the amount of Rs 33 lakhs from the capital base.

The paragraph was referred to the Ministry of Finance for comments in August 1989 ; the reply from the Government has not been received so far (October 1989).

Deductions from total income

3. Under the Rules, for computing the chargeable profits the income received by an assessee by way of dividends from an Indian company is required to be excluded from the total income for this purpose. The total income assessed as reduced by income-tax payable on the said income is the basis for computation of chargeable profits of a company for the purpose of levy of surtax.

Further, where a part of the income, profits and gains of a company is not includible in its total income as computed under the Income-tax Act, its capital for the purpose of surtax is required to be diminished by an amount proportional to the amount of income, profits and gains excluded from the total income. The Central Board of Direct Taxes also have in their executive instructions issued in September 1973 clarified that the proportional amount in respect of deductions allowed under Chapter VI-A of the Income-tax Act has to be deducted in computing the capital base for surtax purpose.

Bombay

(i) In the Surtax assessment of a company for the assessment year 1984-85 completed by the Inspecting Assistant Commissioner (Assessment) in March 1987 the net chargeable profits was determined as 'nil'. While doing so, the assessing officer deducted gross dividends of Rs. 2,28,23,396 instead of the net dividends of Rs. 80,44,519 from the total income assessed for income-tax purpose, even though the amount of net dividends only was included in the said total income. This resulted in allowance of excess deduction by Rs. 1,47,78,877. Again from the total income the assessing officer deducted a sum of Rs. 11,94,56,522 as tax payable instead of Rs. 9,93,52,741 being the correct amount of tax payable after deducting deposit made to Industrial Development Bank of India. The excess deduction allowed on this account was Rs. 2,01,03,781. These mistakes resulted in short computation of chargeable profits of Rs. 3,48,82,658 in aggregate.

In the income-tax assessment for assessment year 1984-85 completed in January 1987, the assessing officer allowed deductions aggregating to Rs. 1,48,30,619 under Chapter VIA of the Income tax Act. A proportionate amount of Rs. 3,38,78,060 corresponding to these deductions was required to be reduced from the capital base as laid down in Central Board of Direct Taxes instructions of September 1973. Again an amount of Rs. 4,51,305 being depreciation allowed in excess over that debited in the account was also required to be reduced from the capital base in accordance with the judicial decision cited. Both these reductions were not made by the assessing officer which resulted in excess computation of capital base by Rs. 3,43,29,365 and excess allowance of statutory deduction by Rs. 51,49,405.

The above mistakes in computation of chargeable profits and capital base led to the net chargeable profits being computed at nil as against a sum of Rs. 1,34,37,838. The consequent non levy of surtax amounted to Rs. 33,59,460.

The paragraph was referred to the Ministry of Finance for comments in August 1989 ; in reply from the Government has not been received so far (October 1989).

(ii) The Surtax assessment of a corporation for assessment year 1983-84 was completed by the Inspecting Assistant Commissioner (Assessment) in March 1987. In working out the profits chargeable to surtax the assessing officer had deducted the gross amount of dividends instead of the net dividends overlooking the amendment to the Surtax Act 1964 brought out by the Finance Act 1981. Besides, in the income-tax assessment the assessee corporation was allowed Chapter VI-A deduction of Rs. 1,27,06,567 and hence the proportionate amount corresponding to the above deduction was required to be excluded from the capital base and the statutory deduction allowable worked out on the reduced capital base. Omissions to do so resulted in short levy of surtax of Rs. 8,76,519.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not been received so far (October 1989).

Madhya Pradesh

(ii) The surtax assessments of a private limited company for the assessment years 1983-84 to 1985-86 were completed by the Inspecting Assistant Commissioner (Assessment) in May 1987 on net chargeable profits of Rs. 9,05,665, Rs. 11,76,050 and Rs. 18,39,723 respectively on the basis of the income-tax assessments completed in December 1986. Audit scrutiny (October 1988) revealed that the assessee had been allowed deductions of Rs. 27,32,764, Rs. 36,95,540 and Rs. 51,29,935 respectively towards relief for new industrial undertaking in backward areas established after 31 March 1981, in computing its total income for the assessment years 1983-84 to 1985-86 but a proportionate deduction had not been made in the computation of capital base for surtax purposes. The omission resulted in excess computation of capital leading to under-assessment of chargeable profits to the extent of Rs. 6,36,540 involving aggregate short levy of surtax of Rs. 5,04,185 (including interest for non-payment of advance surtax).

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989).

Delhi

(iv) The capital for the purpose will not include amount credited to reserves as have been allowed as a deduction in computing the income of the company for the purpose of the Income-tax Act, 1961.

The surtax assessment of a Central Government Corporation for the assessment year 1981-82 was completed in October 1984 (revised in August 1986) and those for the assessment years 1982-83 and 1983-84 was completed in August 1986. While computing the capital employed by the corporation for the purpose of levy of surtax, Inspecting Assistant Commissioner (Assessment) included 'bonus reserve' of Rs. 83,56,170, Rs. 87,74,600 and Rs. 92,21,600 relating to the respective years although these amounts had been allowed as deduction in computing the income of the Corporation for the respective assessment years for the purpose of the Income-tax Act, 1961. The mistake resulted in the excess computation of statutory deduction with consequential under assessment of chargeable amounts of Rs. 12,53,426, Rs. 13,16,189 and Rs. 13,83,240 involving short levy of surtax of Rs. 5,64,041, Rs. 5,87,538 and Rs. 6,22,455 for the assessment years 1981-82, 1982-83 and 1983-84 respectively.

The paragraph was referred to tht Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989).

West Bengal

(v) The surtax assessments of a public limited company for the assessment years 1982-83 and 1983-84 were completed by the Inspecting Assistant Commissioner (Assessment) in June 1986 wherein capital base was determined at Rs. 4,56,85,057 and Rs. 5,92,09,670 respectively. Audit scrutiny, however, revealed that the capital base was arrived at after including Rs 15,76,322 on account of a provision for outstanding liabilities which was incorrectly treated as a reserve in the assessment years 1982-83 and 1983-84. The mistake resulted in enhancement of capital by Rs. 15,76,322 in each of these assessment years involving short levy of surtax aggregating to Rs. 2,86,689 including excess payment of interest of Rs. 73,886 for excess payment of advance surtax for both the assessment years.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not been received so far (October 1989).

Surplus balances

4. According to the Act, the surplus i.e. the balance in the profit and loss account after providing for proposed allocations viz., dividend, bonus or reserves shown under 'Reserves and Surplus' in the Balance Sheet of a company, shall not be regarded as a reserve for the purposes of computation of capital.

Tamil Nadu

The surtax assessment of a widely held company for the assessment years 1976-77, 1977-78 and 1978-79 were completed in August 1984 (revised in December 1986, February 1987 and February 1987 respectively) determining the capital base by taking into account the value of the assets as on the first day of the computation period relevant to the assessment year concerned. Audit scrutiny revealed

(June 1988) that the value of the assets was computed after including Rs. 13,35,064, Rs. 30,89,178 and Rs. 41,72,258 being the surplus balances of the profit and loss account after providing for taxation and dividend. As the provisions of the Act expressly prohibit inclusion of these amounts in the capital base, the computation of capital was not in order. The mistake resulted in enhancement of the capital by Rs. 13,35,064, Rs. 30,89,178 and Rs. 41,72,258 for the assessment years 1976-77, 1977-78 and 1978-79 respectively with consequential short demand of surtax aggregating to Rs. 5,02,746.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not been received so far (October 1989).

Income from investments

5. Under the Rules governing the computation of chargeable profits where a company owns any asset, the income from which is required to be excluded from the total income in computing the chargeable profits, the amount of capital shall also be diminished by the cost of the said asset, in so far as such cost exceeds any money borrowed and remaining outstanding as on the first day of the said previous year.

Bombay

(i) In the assessments of a company for the assessment years 1980-81, 1981-82 and 1982-83 completed by the Inspecting Assistant Commissioner (Assessment) in June 1985, the excess provision for taxation aggregating to Rs. 51,88,823 was taken into account in the computation of capital. The item being a provision and not a reserve was not includible in the computation of capital. Similarly, investments in Government units and securities for the said three assessment years aggregating to Rs. 91,74,325 exceeding the borrowed moneys was to be deducted from the capital. The omission to do so, resulted in excess computation of capital with consequent undercharge of surtax aggregating to Rs. 9,69,507 for the three assessment years.

The Ministry of Finance have accepted the objection.

(ii) Under the Companies (Profits) Surtax Act, 1964, in computing the capital of the company, where the provisions for taxation in the accounts falls short of the amount which should have been reasonably provided such shortfall shall be reduced from the capital computation.

Tamil Nadu

The surtax assessment of a widely held company for assessment year 1979-80 was completed in June 1985. Audit scrutiny (September 1986) revealed that while the provision made in the accounts towards payment of tax was Rs. 1,08,00,000 the correct tax liability, however, amounted to Rs. 1,16,40,276 (both Income-tax and Surtax). The shortfall in the provision made was not, however, reduced from the capital. The omission resulted in the capital base of the company being determined excessively by Rs. 8,40.276 with consequent short levy of surtax of Rs. 56,719.

The Ministry of Finance have accepted the objection.

Other cases

6. As per provisions of the Companies (Profits) Surtax Act, 1964, the paid up share capital or reserve brought into existence by revaluation or otherwise of any book asset is not capital for computing the capital base for surtax purpose.

West Bengal

(i) The surtax assessments of a company for the assessment years 1982-83 to 1984-85 were completed by Deputy Commissioner (Assessment) in March 1988. Audit Scrutiny revealed that capital reserves of Rs. 1,18,37,841, Rs. 1,17,72,768 and Rs. 1,17,72,768 created in the years relevant to surtax assessment years 1982-83 to 1984-85 respectively on account of revaluation of land and buildings of the company were incorrectly included in the computation of capital base as on the first day of the relevant previous years. The mistake resulted in excess allowance of statutory deduction from chargeable profits to the tune of Rs. 53,07,642 with consequent short levy of surtax of Rs. 23,24,544 for the assessment years 1982-83 to 1984-85.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989).

(ii) In the surtax assessments of a company for the assessment years 1979-80 to 1982-83 completed by the Inspecting Assistant Commissioner (Assessment) between December 1986 and January 1987 capital reserves of Rs. 40,53,873, Rs. 40,53,873, Rs. 25,16,454 and Rs. 25,16,454 respectively brought into existence by revaluation and otherwise of its book assets were incorrectly included in the computation of the capital base as on the first day of the relevant previous year as explained by the company, in contravention of the provision of the Surtax Act. The mistake alongwith certain other errors committed in the assessment years 1980-81 to 1982-83 resulted in excess computation of capital leading to consequent under-assessment of chargeable profits aggregating to Rs. 20,04,780 involving short levy of surtax of Rs. 5,65,135 (including short levy of interest of Rs. 63,941 for short payment of advance surtax for the assessment year 1982-83) for the assessment years 1979-80 to 1982-83.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not been received so far (October 1989).

(iii) The Rules provide that where after the first day of the previous year the paid up capital of a company is either increased or reduced, the capital for the purpose of computation shall be increased or reduced by a sum which bears to that amount the same proportion as the number of days during which the increase or the reduction remained effective during the total number of days in that previous year.

Seven tea companies were merged with the assessee company with effect from 1 January 1977 in pursuance of a scheme of arrangement approved by the Calcutta High Court the excess of assets over liabilities were paid to the seven companies by the assessee by issue of shares of Rs. 1,48,00,000 on 31 December 1977, the last day of the previous year. The taking over of the business as per court order was effective from 1 January 1977. There was, however, no direction in the court order that the issue of share capital also was to have retrospective effect. In the surtax assessment of the assessee company for the assessment year 1978-79 (completed in March 1985) the assessing officer allowed a statutory deduction of Rs. 8,88,004 taking into consideration the effective increase in capital for the whole year. However, the capital employed for purposes of calculating the statutory deduction was required to be considered at Rs. 16,247 (including capital of Rs. 70 as on 1 January 1977 in the books of the assessee company) which is the sum which bears to the capital the same proportion as the number of days (in this case i.e. 1 day 31 December 1977) during which this increase in capital was effective in the 12 month of the previous year ending 31 December 1977. The assessee was, therefore, entitled to a statutory deduction of Rs. 2,00,000 only, the minimum amount prescribed in the Rules. The incorrect computation of capital and statutory deduction thereon led to under-assessment of net chargeable profit by Rs. 6,88,004 involving a short levy of surtax of Rs. 3,19,480 in assessment year 1978-79.

The Ministry of Finance have accepted the objection.

Tamil Nadu

(iv) Under the Companies (Profits) Surtax Act, 1964, where a part of the income, profits and gains of a company is not includible in its total income as computed under the Income-tax Act, its capital for purpose of surtax is required to be diminished by an amount proportional to the amount of income, profits and gains excluded from the total income.

The surtax assessment of a widely held company for the assessment year 1985-86 was completed by the Deputy Commissioner (Assessment) in August 1986 (revised in December 1986 and March 1988). Audit scrutiny (November 1988) of the income-tax assessment completed in July 1987 revealed that during the previous year relevant to the assessment year 1985-86, the company received income of Rs. 1,07,70,557 from Singapore branch and Rs. 89,544 from Malaysia and these receipts were not included in the total income determined. But, while computing the capital base for surtax purposes, proportionate reduction in respect of these two receipts were not given. Taking these two items into account, the deduction to be made from the capital would be Rs. 5,80,85,837 as against Rs. 4,14,82,266 and the capital employed would, correspondingly, be reduced to Rs. 75,24,96,686 as against Rs. 76,91,00,257 determined. The omission to do so resulted in excess computation of capital base by Rs. 1,66,03,571 and short computation of chargeable profits by Rs. 24,90,537 involving short levy of surtax of Rs. 11,20,742.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection.

3.70 Mistake in computation of chargeable profits

1. The chrgeable profits of any year for the purpose of surtax are computed with reference to the total income assessed for levy of income tax for the year after making certain prescribed adjustments. Under the Rules, for computing the chargeable profits, the income of an assessee by way of devidends, capital gains, interest on the income tax free securities, etc., are required to be excluded from the total income for the purpose. The total income is further reduced by the income-tax payable as reduced by any relief, rebate or deduction allowable under the Income-tax Act or the relevant annual Finance Act.

Income-tax payable

In the case of three assessee companies under the charge of 2 different Commissioners on income-tax in West Bengal and Bombay, surtax assessments for the assessment years 1977-78 and 1984-85 were completed between January 1988 and March 1988. While working out the net income-tax payable for the purposes of computation of chargeable profit, the additional income-tax and surcharge on income. tax deposited under Companies Deposits (Surcharge on Income-tax) Scheme was not reduced from the gross income tax and this resulted in under-assessment of chargeable profits by Rs. 4,70,722, involving short levy of surtax of Rs. 2,25,704.

In the case of two assessees covering two assessment years, assessments were completed by the Inspecting Assistant Commissioner (Assessment).

The baragraphs were referred to the Ministry of Finance for comments during March 1989 and July 1989. The Ministry of Finance have accepted the objection in two cases. The reply from the Government has not so far been received in the remaining cases (October 1989).

Bombay

2. Under the Companies Deposit (Surcharge on Income-tax) Scheme 1976, surcharge which is levied on income-tax is not payable by a company if the company deposits with Government, an amount equal to the surcharge.

The surtax assessment of a public limited company for the assessment year 1977-78 was completed by the Inspecting Assistant Commissioner (Assessment) in July 1987. While working out the chargeable profits the assessing officer, interalia, deducted tax aggregating to Rs. 2,16,75,030 comprising income tax of Rs. 2,06,42,886 and surcharge on income tax of Rs. 10,32,144. The company had deposited a sum of Rs. 11,00,000 in lieu of surcharge and hence no surcharge was payable by the company. As such the deduction for surcharge allowed by the assessing officer for working out chargeable profits was not in order. The mistake resulted in under-assessment of chargeable profits by Rs. 10,32,144 involving short levy of surtax of Rs. 2,58,052.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not been received so far (October 1989). However, the department has accepted the objection in principle.

West Bengal

3. One of the adjustments prescribed is the addition of the amount of interest paid by the company on its debentures or long term loans included in its capital.

The surtax assessment of a company for the assessment year 1964-65 made originally in August 1969 was last revised in November 1987. It was, however, noticed in audit that while computing the chargeable profits of the company for this year in November 1987 the amount of interest of Rs. 1,22,448 paid by it on the debentures forming part of the capital base was not added although the said interest was added back to the chargeable profits computed in the assessment revised in August 1971. The mistake resulted in under assessment of chargeable profits by Rs. 1,22,448. Further, the capital of the company originally computed at Rs. 95,68,735 was increased to Rs. 95,80,048 in the assessment revised in May 1971 and subsequently reduced by Rs. 15,74,000 in the revised orders passed in September 1972. Thus, the amount of capital as per revised assessment made in September 1972 worked out to Rs. 80,06,048 (Rs. 95,80,048 minus Rs. 15,74,000) instead of Rs. 80,86,048 as considered in the assessment subsequently revised in December 1973 and last revised in November 1987. The mistake resulted in excess computation of capital by Rs. 80,000 and consequent under-assessment of chargeable profits by Rs. 8,000. These mistakes resulted in under-assessment of chargeable profits by Rs. 1,30,448 leading to short levy of surtax aggregating to Rs. 1,82,559 including short levy of interest for non payment of surtax demand.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not been received so far (October 1989).

4. Under the Rules, for computing the chargeable profits the income received by an assessee by way of dividends from an Indian company alongwith income-tax payable on the total income, is required to be excluded from the total income for this purpose.

While computing the chargeable profits of a company for the assessment year 1981-82 in January 1988, for the purpose of levy of surtax, the Deputy Commissioner (Assessment) excluded the dividend income from the total income as computed under the Income-tax Act. However, the proportionate tax on the dividend income amounting to Rs. 8,19,865 which was also required to be excluded from the gross income-tax allowable as a deduction in the computation, was instead added to the gross tax. The mistake resulted in computation of chargeable profits at Rs. NIL in place of Rs. 6,70,906, resulting in non levy of surtax of Rs. 1,67,727 in assessment year 1981-82.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not been received so far (October 1989).

3.71 Avoidable mistake in calculation of tax (Surtax)

While computing the chargeable profits of a company in June 1987 for the assessment years 1982-83 and 1983-84 for the purpose of levy of surtax, the Inspecting Assistant Commissioner (Assessment) committed the following mistakes :—

(a) He deducted income on account of royalties amounting to Rs. 2,56,969 and Rs. 4,56,831 instead of Rs. 2,41,970 and Rs. 2,74,099 respectively correctly worked out from the total income as computed in the respective income-tax assessments. The mistake resulted in under assessment of chargeable profits of Rs. 14,999 and Rs. 1,82,732 in the assessment years 1982-83 and 1983-84 respectively. (b) Further, the profits on sale of depreciable assets amounting to Rs. 61,920 and Rs. 46,528 instead of the correct figures of Rs.

40,774 and Rs. 13,159 as included in the total income computed in the respective income-tax assessments, were deducted from the total income to arrive at the chargeable profits of the company for the assessment years 1982-83 and 1983-84 respectively. The mistakes resulted in excess deduction and consequent under-assessment of chargeable profits by Rs. 21,146 and Rs. 33,369 in the assessment years 1982-83 and 1983-84 respectively. (c) Also an amount of Rs. 13,237 being the income from long term capital gains was deducted from the total income for the purpose of computing chargeable profits of the company for the assessment year 1983-84. It was, however, noticed in audit that the total income considered for the purpose of computation did not include income from capital gains. As such the allowance of deduction of Rs. 13,237 was not in order. The mistake resulted in under assessment of chargeable profits by Rs. 13,237 in the assessment year 1983-84. (d) He also deducted sum of Rs. 7,462 representing tax on long term capital gains from the total income in computing chargeable profits for the assessment year 1983-84. As the total tax considered in the surtax assessment was calculated on the total income excluding income from capital gains, deduction of Rs. 7,462 on account of tax on capital gains was not in order. The mistake resulted in underassessment of chargeable profits by Rs. 7,462 in the assessment year 1983-84.

The mistakes resulted in under-assessment of chargeable profits by Rs. 37,722 and Rs. 2,36,800 in the assessment years 1982-83 and 1983-84 respectively involving short levy of surtax of Rs. 1,59,076 in aggregate including short levy of interest of Rs. 54,925 for short payment of advance surtax for the assessment year 1983-84.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the department has not been received (October 1989).

3.72 Omission to make surtax assessments

Under the Companies (Profits) Surtax Act, 1964, there is no statutory time limit for completion of surtax assessments. Pursuant to the recommendatios of the Public Accounts Committee in Para 6.7 of their 128th Report (Fifth Lok Sabha), the Central Board of Direct Taxes issued instructions in October 1974 that surtax assessment proceedings should be initiated alongwith the income tax assessments. The Board further laid down that the surtax assessment should not bt kept pending on the ground that the additions made in the income-tax assessment were disputed in appeal and the time-lag between the date of completion of income-tax assessments and surtax assessments should not ordinarily exceed a month unless there are special reasons justifying the delay.

Noticing the persistent delay or omission in completing the surtax assessments despite the above recommendations and issue of instructions by the Board, the Public Accounts Committee recommended in Paragraphs 3.3 to 3.10 of their 85th Report (Seventh Lok Sabha) that a statutory time limit for completion of surtax assessments under the Surtax Act should be prescribed. The need for a statutory time limit for completion of surtax assessment was again stressed by the Public Accounts Committee in para 1.16 of their 193rd Report (Seventh Lok Sabha).

Instances of delay in the computation of surtax assessments continued to occur leading to postponement of realisation of larger revenue.

In the case of 19 companies assessed in 15 different Commissioners' charges for the assessment years 1980-81 to 1986-87, although the income tax assessments had been completed between March 1983 and March 1988, the corresponding surtax assessments had not been made, the delay ranging from 3 months to 68 months, (as on the date of audit). The omission resulted in non-levy of surtax of Rs. 1,31,12,167.

None of the assessee companies had filed the surtax return and the department had also not initiated any action in any case.

The income-tax assessments of eight of the above companies were completed by the Inspecting Assistant Commissioner (Assessment)/Deputy Commissioner of Income-tax.

The paragraphs were referred to the Ministry of Finance for comments during April 1989 and August 1989. The Ministry of Finance have accepted the objection in 7 cases and have not accepted the objection in one case for administrative reasons. This is contrary to the Board instructions of October 1974. The reply from the Governmtnt has not been received so far in the remaining cases. However, the department has accepted the objection in 3 other cases.

3.73 Advance payment of surtax

Under the provisions of Companies (Profits) Surtax Act 1964, effective from 1 April 1981 every company is required to send to the assessing officer an estimate of the advance surtax payable and to pay the advance surtax payable, as accords with the estimate in 3 instalments on the dates prescribed. Where in any financial year, a company has paid advance surtax on the basis of its own estimate and the advance surtax so paid is less than eighty three and one third per cent of the assessed surtax, simple interest at the prescribed rate is payable by the company on the amount by which the advance surtax paid fall short of assessed surtax from the first day of next financial year to the date of regular assessment. Failure to send the estimate or to pay the advance tax also entails levy of penalty. The assessed surtax as defined in the Surtax Act means the surtax determined on the basis of the regular assessment without making any deduction therefrom.

West Bengal

1. The surtax assessment of a company for the assessment year 1983-84 was completed by the Inspecting Assistant Commissioner (Assessment) in June 1987 on a net chargeable profit of Rs. 43,41,990 with a surtax demand of Rs. 15,57,675. During the previous year relevant to the assessment year 1983-84, the company paid advance surtax of Rs. 12,23,400 on the basis of its own estimate. The company also paid a further sum of Rs. 4,36,062 on 27 September 1983. The said payment of Rs. 4,36,062 being made after the expiry of the relevant previous year, was not to be treated as advance surtax. Since the advance surtax paid fell short of eighty three and one third percent of the assessed surtax the assessee was liable to pay interest of Rs. 1,93,836 for short payment of advance surtax. It was however, noticed in audit that the department worked out interest of Rs. 16,687 instead of Rs. 1,93,836 on assessed surtax as reduced by advance surtax paid including therein Rs. 4,36,062 incorrectly paid in September 1983 i.e. after the expiry of the relevant previous year. The mistake resulted in short levy of interest of Rs. 1,77,149.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not been received so far (October 1989).

Madhya Pradesh

2. In the surtax assessment of a private limited company for the assessment years 1983-84 to 1985-86 completed by the Inspecting Assistant Commissioner (Assessment), in May 1987 interest totalling Rs. 4,44,960 was levied for failure to file estimate of advance surtax and to pay the same. However, the correct amount of interest leviable for these years worked out to Rs. 6,15,685. The mistakes resulted in short levy of interest of Rs. 1,70,725.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not been received so far (October 1989).

Kerala

3. The surtax assessment of a company for the assessment year 1985-86 was completed in February 1987 on a net chargeable profit of Rs. 16,49,800, and a sum of Rs. 6,06,455 was determined as the surtax payable, as against the correct amount of Rs. 6,16,455. Interest of Rs. 60,363 was also charged for non-payment of advance surtax. In working out the amount of interest, credit was given for surtax remittances made by the assessee in July 1985 (Rs. 3,87,874) and July 1986 (Rs. 2,30,552). This was not in order, as the interest had to be computed on the amount of surtax determined on the basis of the regular assessment, i.e., Rs. 6,16,455, without making any deduction therefrom. The mistakes resulted in short levy of surtax of Rs. 10,000 and interest of Rs. 1,09,162.

The Ministry of Finance have accepted the objection.

3.74 Belated payment of surtax demand

Under the provision of Companies (Profits) Surtax Act, 1964, read with the relevant provisions of the Income-tax Act 1961, where the amount specified in a notice of demand is not paid within thirty five days the assessee is liable to pay interest at 12 per cent per annum (15 per cent from 1 October 1984) from the day commencing after the end of the period.

Tamil Nadu

The surtax assessment of a closely held company for assessment years 1980-81 and 1981-82 were completed in March 1985 raising a net surtax demand of Rs. 3,68,065 and Rs. 3,36,765 respectively. The assessments were revised in December 1987 and November 1987 reducing the demands to Rs. 34,605 and Rs. 2,03,980 respectively. The revised demands were collected by adjustment from out of refunds due to the assessee in April 1988. It was noticed in audit that interest under the provisions of the Act for the belated payment of surtax demand was omitted to be charged. The total interest leviable for the two assessment years worked out to Rs. 1,01,362.

The Ministry of Finance have accepted the objection.

3.75 Avoidable payment of interest

Under the provisions of the Companies (Profits) Surtax Act, 1964, and the Income-tax Act, 1961, where an assessee became entitled to refund of any amount paid after 31 March 1975 as a result of any order passed in appeal or other proceedings under the Act, the Central Government shall pay interest at 12 per cent per annum (15 per cent per annum with effect from 1 October 1984) on the amount so refundable from the date the disputed demand was originally paid to the date on which the refund is granted. No interest is, however, payable for a period of one month from the date of the order passed in appeal or other proceedings. The Central Board of Direct Taxes issued instructions in January 1977 to the effect that appellate orders involving refunds should be given effect to with extra-ordinary promptness ensuring that in any case they are given effect to within a period of one month of the date of the order.

The appellate orders under Companies (Profits) Surtax Act, 1964 in respect of a nationalised bank for the assessment years 1980-81 to 1982-83 were passed in October and November 1984. Consequently refunds of Rs. 2,46,79,417, Rs. 1,17,84,955 and Rs. 1,66,01,276 became payable to the assessee for these years by the end of November 1984 and December 1984 respectivey. It was, however, noticed in audit that the Inspecting Assistant Commissioner (Assessment) gave effect to the appellate orders ibid only in August 1985. The delay in allowing the refunds resulted in avoidable payment of interest aggregating to Rs. 49,51,751 for the three years.

The Ministry of Finance have accepted the objection.

CHAPTER 4

INCOME TAX

4.01 Income-tax collected from persons other than companies is booked under the Major Head '021 Taxes on income other than corporation tax'. Eighty five per cent of the net proceeds of this tax, except in so far as these are attributable to Union emoluments, Union Territories and Union surcharge is assigned to the States in accordance with the recommendations of the Finance Commission.

4.02 The trend of receipts from income-tax was as follows during the last five years :

Year	Total collection of all Direct Taxes	Amount of Income-tax	Percentage of Income-tax to Total
	(In crores of rupees)		
1984-85	4,797.33	1,927.75	40.18
1985-86	5,621.83	2,511.29	44.70
1986-87	6,236.46	2,878.97	46.15
1987-88	6,757.18	3,192.43	47.25
1988-89@	88,28.68	4241.16	48.03

4.03 The number of assessees (other than companies) borne on the books of the Income-tax department during the last five years was as follows:

As on 31 March	Number
1985	48,79,179
1986	54,33,431
1987	61,84,262
1988	64,37,826
*1989	67,15,066

4.04 The following table indicates the progress in the completion of assessments and collection of demand under income-tax (excluding corporation tax) during the last five years :

Year	No. of assessments		Amount of demand	
	Completed during the year	Pending at the close of the year	Collected during the year	In arrears at the close of the year
			(in crores of rupees)	
1984-85	53,25,158	11,97,877	1,927,75	781.59
1985-86	58,07,170	10,94,051	2,511.29	772.07
1986-87	69,82,419	13,71,247	2,878.97	800.08
1987-88	63,75,745	10,53,602	3,192.43	987.79
*1988-89	60,51,670	9,10,649	4,241.16	1,163.31

4.05 Some instances of mistakes notices in the assessments of persons, other than companies, are given in the following paragraphs.

4.06 Avoidable mistakes in the computation of income-tax

Under-assessments of tax of substantial amounts on account of avoidable mistakes, resulting from carelessness or negligence have been noticed year after year. Despite audit pointing out such mistakes every year in the local audit reports and Audit Reports and the department issuing repeated instructions, such mistakes continue to occur, suggesting the need for close supervision and control.

The various types of mistakes noticed included among other things, incorrect adoption of figures, totalling errors, transcription errors, double allowance, calculation errors etc. Brief particulars of 27 representative cases, involving short levy of tax of Rs. 75,23,570 are given below :

Sl. No.	State/Commissioners's Charge/ Name of the assessee	Assessment year	Nature of mistake	Tax effect/financial implication Rs.
1	Madhya Pradesh/A(Association of persons)	1985-86	Omission to add back investment allowance reserve of Rs. 76,48,868 debited to the profit and loss account.	34,36,991 (potential)
2	West Bengal/B (Individual)	1979-80	Erroneous determination of revised income under Amnesty Scheme at Rs. 1,84,532 as against the correct assessable income of Rs. 9,23,996.	5,27,602
3	Bombay/C (Hindu undivided family)	1985-86	Omission to add back disallowances of items of expenditure amounting to Rs. 4,50,000.	4,48,031 (including interest)
4	Bihar/D (Unregistered firm)	1985-86	Total income incorrectly taken as Rs. 1,50,720 instead of Rs. 5,10,720.	2,87,504 (including interest

*Figures furnished by the Ministry of Finance are provisional.

@Figures furnished by the Controller General of Accounts are provisional.

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5	Bombay/E (Association of persons)	1985-86	Omission to withdraw depreciation and additional depreciation of Rs. 5,36,365 already allowed while allowing these allowances aggregating to Rs. 12.92 lakhs under appellate orders.	2,41,360
6	Bihar/D (Individual)	1985-86	Assessee's total income incorrectly taken as Rs. 6,29,940 instead of the correct amount of Rs. 8,29,940.	2,06,694 (including interest)
7	Bihar/D (Individual)	1986-87	Tax payable for calculation of interest taken at Rs. 1,61,170 instead of Rs. 7,61,170.	1,86,543
8	Andhra Pradesh/F (Association of persons)	1985-86	Tax payable erroneously determined at Rs. 1,33,642 as against the correct amount of Rs. 2,53,106.	1,83,513 (including interest)
9	Bihar/D (Registered firm)	1987-88	The cost of materials taken as Rs. 54,58,000 instead of Rs. 24,58,000 leading to excess deduction of Rs. 30 lakhs.	1,66,373
10	Madhya Pradesh/G (Individual)	1985-86	Omission to add back an amount of Rs. 1,79,580 on account of inflated expenditure towards repairs, renewals, etc.	1,63,890
11	Rajasthan/H (Individual—Registered firm)	1985-86	Omission to add back income from interest of Rs. 36,050 and unexplained income of Rs. 1,33,587	1,50,361 (including interest)
12	Tamil Nadu/I (Individual)	1983-84	Incorrect allowance of additional depreciation of Rs. 2,49,296 on new machinery instead of the correct allowable amount of Rs. 24,929.	1,48,084
13	Delhi/J (Registered firm)	1985-86	Incorrect computation of taxable income at Rs. 63,65,342 instead of the correct total income of Rs. 66,81,219.	1,40,723 (including interest)
14	Tamil Nadu/K (Individual)	1985-86	Tax on income erroneously worked out at Rs. 2,71,255 as against the correct amount of Rs. 3,39,137.	1,27,376 (including interest)
15	Karnataka/L (Registered firm)	1983-84	Omission to add back the claim of investment allowance of Rs. 1,10,066 as against the amount of Rs. 3,09,177 on this account leading to excess carry forward of loss of Rs. 1,99,111.	1,21,299
16	Karnataka/M (Individual)	1985-86	Income from capital gains incorrectly adopted as Rs. 2,80,710 as against Rs. 3,80,710 returned by the assessee and incorrect computation of loss in excess by Rs. 1 lakh.	1,19,970 (potential)
17	Bombay/N (Registered firm)	1984-85	Omission to add back an amount of Rs. 1,28,928 being commission paid to another firm, the independent existence of which was not accepted by the department.	1,13,916 (including interest)
18	Bihar/D (Individual)	1985-86	Tax payable incorrectly worked out on a sum of Rs. 6 lakhs instead of the assessed total income of Rs. 6,94,950.	92,637 (including interest)
19	Delhi/O (Association of persons)	1984-85	Incorrect computation of tax at Rs. 6,34,290 as against the correct amount of Rs. 6,72,436 as also incorrect allowance of capital expenditure of Rs. 42,161 on installation of water cooler.	91,373 (including interest)
20	Assam/P (Individual)	1981-82	Incorrect computation of tax payable on the total income of Rs. 1,19,130 at Rs. 16,050 instead of the leviable amount of Rs. 55,746.	88,730 (including interest)
21	Madhya Pradesh/A (Individual)	1982-83	Tax on total income levied at Rs. 7,24,361 as against the correct amount of tax leviable at Rs. 7,86,412.	76,311 (including interets)
22	West Bengal/Q (Registered firm)	1985-86	Short computation of income of the registered firm by Rs. 80,000.	73,319 (including interest)
23	Bombay/R (Individual)	1983-84	Omission to take note of the refund already allowed in the original order while working out the revised refund.	71,364 (excess refund)
24	Madhya Pradesh/A (Individual)	1984-85	Omission to include income from salary, house property and interest in the computation of total income though credit of Rs. 25,700 towards tax deducted at source was allowed.	70,137
25	Karnataka/S (Individual)	1981-82	Taxable income erroneously worked out as Rs. 5,04,900 instead of correct figure of Rs. 6,04,900.	66,220
26	West Bengal/T (Individual)	1983-84	Incorrect determination of tax due on the assessed income of Rs. 1,20,200 at Rs. 16,333 instead of the correct leviable tax of Rs. 57,140 according to the status of assessee.	61,767 (including interest)
27	Uttar Pradesh/U (Registered firm)	1983-84	Profit from trading activity incorrectly computed at Rs. 5,99,906 instead of the correct amount of Rs. 6,81,906.	61,485

The department has accepted the objections in 8 cases.

The Ministry of Finance have accepted the objections in 16 cases. The remaining paragraphs were referred to the Ministry of Finance, for comments between April 1989 and August 1989. Their replies have not been received so far (October 1989).

4.07 Incorrect application of rates of tax

For the assessment year 1985-86, the rate of tax applicable to an unregistered firm having total income between Rs. 70,000 and Rs. 1,00,000 was Rs. 20,250 plus 50 per cent of the amount by which the total income exceeded Rs. 70,000. The rate of tax for income exceeding Rs. 1,00,000 was, however, 55 per cent of the amount by which it exceeded Rs. 1,00,000.

While computing the tax leviable in respect of an unregistered firm for the assessment year 1985-86 (assessed in June 1987) having total income of Rs. 6,63,640, the rate of tax leviable for income between Rs. 70,000 and Rs. 1,00,000 was only applied to the income in excess of Rs. 1 lakh resulting in short levy of income-tax of Rs. 51,450 including surcharge and interest.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4.08 Failure to observe the provisions of the Finance Act

From the assessment year 1974-75, agricultural income is includible in total income for determining the rate of tax applicable to the taxable non-agricultural income of a non-corporate assessee. It has been judicially held (106 ITR 804) that income from sale of jaggery cannot be held to be agricultural income and so is taxable in full as non-agricultural income.

The assessments of a Hindu undivided family of specified category for the assessment years 1982-83, 1984-85 to 1986-87 were completed in February 1988, July 1986 and January 1988 respectively. The income computed included agricultural income of Rs. 1,12,875, Rs. 2,95,680, Rs. 1,75,435 and Rs. 2,02,048 for the above assessment years reckoned for rate purposes only. Audit scrutiny, however, revealed that the agricultural income included was by way of sale of jaggery of Rs. 1,52,012, Rs. 2,03,569, Rs. 2,01,354 and Rs. 1,72,471 which should have been treated as non-agricultural income and brought to tax. Omission to do so resulted in an aggregate short levy of tax of Rs. 2,31,331.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

4.09 Mistakes in computation of trust income

1. Under the provisions of the Income-tax Act, 1961, prior to its amendment by Finance Act, 1984, effective from assessment year 1985-86, the income of a private definite trust, viz., a trust where the shares of beneficiaries are definite and ascertainable, is divided among the beneficiaries according to their shares and each of such divided share is taxed in the hands of the trustee as a representative assessee, or each beneficiary is taxed separately on his income including his share income, whichever course is more beneficial to revenue. In respect of trusts doing any business under the terms of a trust deed, the Board, relying on a decision of the Supreme Court (81 ITR 310), issued instructions in July 1985 that, except in the case of beneficiaries being all minors, all the beneficiaries having a common interest, have acquiesced in the continuance of the business and, therefore, the taxable entity that conducts the business is the "association of persons" consisting of the beneficiaries as members. The trust should, accordingly, be assessed on its entire business income in the status of association of persons representing the group of beneficiaries, and the splitting up of the income of the trust and taxing each beneficiary separately on his share was not permissible.

In five Commissioner's charges, five private trusts created under trust deeds for the benefit of their beneficiaries authorised the trustees to carry on business with the funds of the trust. For the assessment years 1982-83 to 1984-85, these trusts derived incomes of Rs. 26,92,473 from their businesses and in the respective assessments completed between May 1984 and March 1987, the income of the trust was allocated to the beneficiaries of the trust according to their respective shares and each one of them was assessed on his share separately and the trust by itself was declared as non-assessable. As the business was carried on by the trustees on behalf of and for the benefit of the beneficiaries as clarified by the Board in July 1985, the entire incomes of these trusts should have been assessed in its hands in the status of an association of persons. The mistakes resulted in the short levy of tax aggregating Rs. 20.11 lakhs.

The department has accepted the objection in three cases.

The paragraphs were referred to the Ministry of Finance for comments between March 1989 and July 1989; the reply from the Government has not so far been received (October 1989).

2. Income of a charitable trust/institution created for the benefit of any particular religion, community or caste will not qualify for exemption from the levy of tax.

During the audit scrutiny of the assessment records of a charitable trust created on July 15 1976 for the benefit of a particular community, it was noticed that the income of the previous year relevant to the assessment years 1985-86 and 1986-87 was allowed exemption by the assessing officer. As the trust was created for the benefit of a particular community, the exemption was not admissible at all. This resulted in short levy of tax amounting to Rs. 4,40,500 and Rs. 6,10,790 for the assessment years 1985-86 and 1986-87 respectively aggregating to short levy of tax of Rs. 10,51,290.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3. Where the individual shares of the beneficiaries of a trust are indeterminate or unknown, tax is chargeable on such income in the hands of the trust at the maximum marginal rate as applicable to the highest slab of income in the case of an 'association of persons' as specified in the Finance Act of the relevant years.

In the assessment of a trust for the assessment year 1984-85 completed in December 1986, income determined at Rs. 2,22,630 was allocated amongst the beneficiaries according to their shares and each one of them was assessed on his share separately, declaring the trust as not assessable. It was noticed in audit that as per the deed constituting the trust, it only specified the ratio in respect of the corpus of the trust and not the income derived. Further, the trustees had absolute discretion either to pay the income from the trust for the beneficiaries or to apply it for their maintenance, education etc., or use in any other way in any emergency or in urgent necessity. The income or even capital could also be paid to the parents of the beneficiaries or the surplus income invested for increasing the trust corpus. For the assessment year 1984-85, no income was handed over to the parents of the beneficiaries or spent directly on the beneficiaries but was allowed to accumulate. Income of earlier years was also similarly accumulated. No amount had, therefore, been received by the beneficiaries. The distribution of the corpus of Rs. 25,000 plus the accumulation of all the years would be distributed amongst the surviving beneficiaries when the last beneficiary attained the age of 18 years. Thus, the income distributable was not ascertainable from the deed, though it had been provisionally allocated amongst the present nine beneficiaries. Thus the trust had all the attributes of a discretionary trust and accordingly, the income was taxable in the hands of the trust at the maximum marginal rate.

It was also seen that the assessee trust had taken loans from various parties and paid interest at more than 12 per cent. However, the assessee had not charged any interest on loan of Rs. 5,56,900 given by it. As the amount of Rs. 5,56,900 had not been utilised for the purpose of business, interest at least at the rate of 12 per cent paid on this amount amounting to Rs. 66,828 should have been disallowed. The assessing officer disallowed an amount of Rs. 33,414 only. Hence, interest of Rs. 33,414 remained to be disallowed.

The above mistakes resulted in short levy of tax of Rs. 2,41,103 including interest for delay in filing the return and for non-filing of estimate of advance-tax.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4. Income derived from property held under trust wholly for charitable or religious purposes is exempt from tax to the extent it is applied for such purposes in India. When the said income is not actually so applied but is accumulated for the future application, relief from tax is available only in respect of such accumulation as does not exceed 25 per cent of the income of the assessee. However, a charitable trust can still avail of full exemption from tax even where 75 per cent of the income is not applied or not deemed to have been applied for charitable purposes, provided the assessee (i) specifies by notice in writing given to the Income-tax Officer in the prescribed manner the purpose and the period, which in no case should exceed 10 years, for which the income is to be accumulated, and (ii) invests the money set apart in the manner specified in the Act.

A charitable trust conducted a Yagna, during the previous year relevant to the assessment year 1984-85, as part of its centenary celebrations in January-February 1983. Collections to the extent of Rs. 9,29,111 were made during the Yagna. The entire collections which were initially accounted for under a separate fund account were subsequently transferred to another fund account. In addition to these collections the trust had (i) receipts of Rs. 1,99,271 during the year, directly accounted for in the latter fund accounts, and (ii) receipt of Rs. 64,531 on account of life membership. All these receipts were not accounted for by the assessee as revenue receipts, and thus remained excluded in computation of income. Collections to the fund, by virtue of provisions contained in the Income-tax Act, and the membership fee by its very nature, were includible in the total income. Credits to the fund by transfer to another fund cannot be treated as expenditure as it amounts only to setting apart. The assessee was, therefore, required to give notice to the Income-tax Officer in the prescribed manner and to make investments of the moneys set apart in the manner specified in the Income-tax Act to avail of the relief admissible. The assessment records revealed that the assessee had not complied with these requirements. Consequent on this default, the assessee could avail of relief only in respect of the income which is actually applied for charitable and religious purposes and a sum which did not exceed 25 per cent of the gross receipts.

The gross receipts worked out to Rs. 15,41,132 and the net income liable to tax worked out to Rs. 3, 56,400 against the deficit of Rs. 4,51,322 computed in the assessment for the assessment year 1984-85 completed in March 1987. The incorrect grant of relief resulted in non-levy of tax of Rs. 2,40,496 including interest for delay in filing of the return.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

5. One of the conditions for claiming exemption of income derived from property held under a charitable trust is that the trust has to make an application for registration in the prescribed form and in the prescribed manner to the Commissioner of Income-tax before 1 July 1973 or before the expiry of period of one year from the date of creation of the trust, whichever is later. The income of the trust shall not be exempted if the trust or institution is created or established for the benefit of any particular religious community or caste.

An association of persons (Trust) was created on 15 March 1974. The trust did not apply for registration before 1 July 1973 or before the expiry of a period of one year from the date of creation of the trust, that is, 15 March 1975. The application for registration was, however, filed on 28 March 1985, after a lapse of eleven years from the date of creation of the trust and it was not recommended for registration. It was observed in audit that in the absence of registration accorded to the trust, the entire income of the trust was liable to tax and that the exemption of the total income of Rs. 1,94,516 claimed by the assessee trust for the assessment year 1982-83, the assessment of which was completed in March 1985 and allowed by assessing authority was not in order notwithstanding the fact that some of the objects of the trust were meant for the benefit of a particular religious community, and income was liable to tax on this account as well. The resultant non-computation of income was Rs. 1,94,516 with a short demand of tax of Rs. 1,32,142 including interest for delayed filing of return and for failure to file the estimate of income for advance-tax.

The Ministry of Finance have accepted the objection.

6. Any part of the income which does not enure for the benefit of the public or which enures or is used or applied directly or indirectly for the benefit of an interested person, such as a trustee of a concern in which the trustee has a substantial interest, is not so exempted. The Act as amended by Finance Act, 1984, effective from the assessment year 1985-86, provides that tax shall be charged at maximum marginal rate in case where the whole or any part of the aforesaid income of the trust does not qualify for exemption, for the reasons that such income is invested for the benefit of interested persons.

In the assessments of two charitable religious trusts concluded in March 1988 for the assessment year 1985-86, the assessing officer determined an income of Rs. 1,71,505 and Rs. 93,750 as against the income of Rs. 105 and nil income returned by the assessee. The Income-tax Officer held that the entire income assessed should be charged to tax at maximum marginal rate in the status of association of persons, in view of the fact that the fund of the trusts were either lent or remained invested in concerns in which the trustees of institutions had substantial interest. However, the tax was levied at the rates applicable to 'association of persons' as against the maximum marginal rates applicable. This resulted in short demand of tax of Rs. 64,583 including interest for belated filling of return and non-filing of estimate of advance tax.

The Ministry of Finance have accepted the objection.

4.10 Incorrect status adopted in assessment

Under the Income-tax Act, 1961, the residential status is dependent on the actual number of days of stay in India and maintenance of a dwelling place in India for and upto the assessment year 1982-83. If a person is resident in India in respect of one source of income, he shall be deemed to be resident in India in respect of each of the sources of income. It has been judicially held that the expression 'maintains a dwelling place' would cover a case where the assessee has a right to occupy or live in a dwelling place, though the expenses of maintaining the dwelling place are not met by him (22 ITR 359).

The residential status of an assessee individual who had left India on 14 December 1976 and who thereafter had been making periodical visits to India subsequently was considered as non-resident in the assessments for the assessment years 1978-79 to 1982-83, assessment completed in March 1987, on the ground that the assessee had not been to India for 182 days or more in any of these previous years or had not been maintaining a dwelling place in India. However, it was noticed in audit that the assessee was a member of a resident Hindu undivided family and has thus a right to occupy and stay with the family in India, without any body's leave or permission, as such, the condition of maintenance of dwelling house was satisfied. On this basis the correct status of the assessee was 'resident' in respect of the assessment years 1980-81 to 1982-83. So far as the assessment year 1978-79 was concerned the assessee had one source of income in relation to which the status was treated as 'resident' and the individual was to be considered as 'resident' for all sources of income. The assessee was, therefore, liable to pay tax in the status of 'resident' in respect of assessment years 1978-79, 1980-81, 1981-82 and 1982-83 and the entire income outside India was includible in the computation of total income. Failure to include the income of the assessee abroad resulted in short levy of tax to the extent of Rs. 13,01,000 (approximately) for the four assessment years.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

4.11 Incorrect computation of salary income

Under the provisions of the Income-tax Act, 1961, the value of any benefit or amenity granted free of cost or at concessional rate by a company to an employee is to be treated as perquisite and is chargeable to tax under the head salary.

An assessee individual (non resident) was assessed for the assessment years 1984-85 and 1985-86 in March 1988 on income of Rs. 3,02,220 and Rs. 1,88,510 respectively under the head 'salaries'. The assessee was also provided with rent free accommodation and a motor car, by the employer, but the value of these perquisites was not included in the total income of the assessee while framing the assessments. The value of these perquisites worked out to Rs. 35,722 and Rs. 24,351. The omission to include the value of perquisites in the taxable income resulted in short levy of tax aggregating to Rs. 40,177.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4.12 Incorrect computation of income of foreign technicians

1. The Income-tax Act, 1961 allows, subject to certain conditions, exemption from tax on certain portion of the remuneration received by or due to foreign technicians in the employment of Government or of a local authority or of a statutory corporation or in any business carried on in India. One of the conditions to be fulfilled for claiming the exemption from tax on remuneration of foreign technicians is that the contract of service should be approved by Central Government. Where such an employment is without the approval of the Central Government and tax on his remuneration is paid by the employer, the same is to be treated as a perquisite in the hands of the technician and taxed.

In the case of a foreign technician employed in India, the income-tax assessments for assessment years 1982-83 and 1983-84 were completed treating the tax payable by the employer as a perquisite in the hands of the technician as the assessee's claim for exemption was rejected. However, while finalising the assessment for the assessment year 1984-85 in January 1987, the tax payable by the employer to the extent of Rs. 1,36,627 was not treated as perquisite in the hands of the technician. This mistake resulted in short levy of tax of Rs. 93,263.

The Ministry of Finance have accepted the objection.

2. Remuneration by way of salary and perquisites paid to foreign technicians in the employment of an Indian concern is taxable in the hands of the technician as salary. Where the contract of service is approved by the Central Government, exemption at the rate of Rs. 4,000 per month is admissible subject to fulfilment of certain conditions. The Central Board of Direct Taxes clarified in May 1978 that the amount of remuneration charged from the Indian concern employing the technician and paid whether in India or abroad did not constitute any profit to the foreign collaborater and, therefore, payments to technicians in such cases are taxable as salary income.

In the case of three foreign technicians whose services were made available to an Indian concern by a non resident company, while salary portion of remuneration was remitted to the non-resident company, other perquisites such as, allowance for meals and travels and a suitable amount of pocket money were payable to the technicians in India. As the foreign technicians were in employment with the Indian concern for which the contract of service and the daily rate of salary and pocket money were approved by the Central Government the salary was taxable in the hands of the technicians. While assessing the case for the assessment year 1985-86 in February 1986, the assessing officer treated the payment of allowance for meals, travel and the pocket money to the foreign technicians through non resident company as fees for technical services and taxed the same in the hands of the non resident company instead of taxing the remuneration as salary in the hands of the foreign technicians. Adoption of incorrect procedure in assessment resulted in under charge of tax of Rs. 76,304.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4.13 Incorrect computation of income from house property

1. It has been held by the Supreme Court in 1972 that the income derived from letting out of building owned by the assessee to tenants is to be computed under the head "income from house property' and not under the head income from 'profits and gains of business or profession' regardless of the object of the assessee viz., letting out of buildings at rents, with or without amenities. It has also been judicially held that under the Indian Partnership Act, a firm is an entity known to law and is capable of acquiring and owning property and under the Income-tax Act it would be liable to tax as owner of the property. It was also held in that case that income from such property was not to be taxed in the hands of partners of the firm as co-owners (1973) (90 ITR 267). Further, in a case where a firm let out a building and realised rents therefrom, it was judicially held that there was no existence of any business carried on by the partners and, therefore, there was no valid partnership in law entitled to registration (1984) (158 ITR 777).

(i) For the assessment years from 1985-86 to 1987-88, a firm was granted continuance of registration and the assessments were completed in February 1987/March 1988 on a total income of Rs. 59,870, Rs. 51,500 and Rs. 1,01,090 respectively. The scrutiny of assessment records revealed that the firm had acquired lands on lease and constructed buildings thereon and derived rental income from those buildings. Thus, the firm was engaged in letting out the buildings and realising rents therefrom. However, the assessee treated the rental receipts as 'business income' and after claiming expenses on various items like interest on deposits, lease rent, depreciation on buildings etc., returned the net income as income from profits and gains of business. The assessee firm being the legal owner of the buildings which were let out, the income from rents should have been assessed to tax under the head 'income from house property' and not under 'income from business'. Further, as the firm was only collecting rents from its tenants and not doing any other business, there was no business carried on by the partners and consequently the firm was also not entitled to registration. The omission to assess the income under the proper head and the incorrect grant of registration resulted in an aggregate under-assessment of income of Rs. 1,71,540 and consequent short levy of tax of Rs. 1,45,441 including short levy of interest for delay in filing returns of income, and short payment of advance tax.

The Ministry of Finance have not accepted the objection stating that the assessment was completed under summary assessment scheme.

(ii) In the assessment of an assessee individual for the assessment year 1985-86 completed in March 1988, a deduction of Rs. 1,12,896 on account of arrears in house tax was allowed out of the rental income. It was, however, revealed in audit that deduction on this account had already been claimed by the assessee in earlier assessment years on accrual basis. The incorrect deduction allowed resulted in under-assessment of income from house property by Rs. 92,497 and short levy of tax of Rs. 66,727.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government, has not so far been received (October 1989).

2. The income under the head 'house property' is computed after allowing permitted deductions from the annual value. From the assessment year 1985-86, the deduction for municipal taxes will be allowed in the previous year in which the taxes are actually paid. Such taxes already allowed upto the assessment year 1984-85 on accrual basis will not be again allowed in the year in which payment of such tax is made.

(i) An assessee registered firm claimed deduction towards municipal taxes amounting to Rs. 1,08,000 and Rs. 1,20,000 for the previous years relevant to assessment years 1985-86 and 1986-87 respectively in the computation of income from house property which were allowed in the assessments completed in March 1988. It was, however, noticed that these deductions claimed by the assessee firm were the amounts debited to its profit and loss accounts for the relevant previous years as provisions and not actual payment of taxes pertaining to the relevant previous years. A comparison of profit and loss accounts and balance sheets for the previous years showed that while during the previous year relevant to assessment year 1985-86 the firm had not paid any municipal taxes, during the previous year relevant to assessment year 1986-87, only Rs. 40,000 had been paid as municipal taxes actually pertaining to the previous year relevant to the assessment year 1985-86. Accordingly, no deduction towards municipal taxes admissible for the assessment year 1985-86 and such deduction was to be restricted to Rs. 40,000 for the assessment year 1986-87. The incorrect deductions thus allowed resulted in short computation of income by Rs. 90,000 and Rs. 70,840 in the assessment year 1985-86 and 1986-87 respectively involving short levy of tax aggregating to Rs. 87,979 in the hands of firms and its partners.

The Ministry of Finance have accepted the objection.

(ii) Expenditure incurred in collecting rent is deductible subject to the maximum limit of 6 per cent of annual value for the purpose of computation of income from house property.

While completing the assessment of an assessee for the assessment year 1985-86 in March 1987, the Income-tax Officer determined the house property income after allowing collection charges at the rate of 60 per cent of annual value of Rs. 1,48.927 in place of 6 per cent as prescribed in the Income-tax Act, 1961. This resulted in underassessment of income of Rs. 80,422 leading to short levy of tax of Rs. 70,545 including interest for short payment of advance tax and belated submission of return.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

INCORRECT COMPUTATION OF BUSINESS INCOME

4.14 Incorrect allowance of liability

1. Under the provisions of the Income-tax Act, 1961, as applicable with effect from the assessment year 1984-85 and onwards, a deduction otherwise allowable under the Act in respect of any sum payable by the assessee by way of the tax or duty under law for the time being in force shall be allowed in computing the business income of that previous year in which such sum is actually paid by him and not merely on the basis of accrual of the liability. It has been judicially held by the Supreme Court (October 1972 and November 1974) that the amount of sales-tax collected by the trader in the course of business constitutes his trading or business receipts and as such liable to be included in his business income. It has also been judicially held (March 1983) that if a receipt is a trading receipt, the fact that it is not so shown in the accounts books of the assessee would not prevent the assessing authority from treating it as trading receipt.

In the assessments of 16 assessees, 14 registered firms, and 2 association of persons, for the assessment years 1984-85 to 1987-88 completed between March 1985 and March 1988, the sales tax, purchase tax, sugar cane purchase tax, provident fund contributions, professional tax, excise duty, royalty, cess and entertainment tax amounting to Rs. 76,97,535 charged to profit and loss account but not actually paid to the Government in the relevant accounting year and shown as liability respectively in the balance sheet were not disallowed and added back to the income liable to tax. Omission to disallow the unpaid amounts of statutory liability led to under charge of tax aggregating to Rs. 38,08,555 including elements of interest for belated filing of return and short payment of advance tax.

The department has accepted the objection in three cases.

The Ministry of Finance have accepted the objection in one case. In another case the objection has not been accepted stating that the assessment was completed under the summary assessment scheme. Other cases were referred to the Ministry of Finance between January 1989 and August 1989, the reply from the Government has not so far been received (October 1989).

2. A provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions made do not qualify for deduction.

(i) During the previous year relevant to assessment year 1981-82 an individual doing sole proprietary business created a private trust for the welfare of his employees and contributed Rs. 1,01,000 and Rs. 1,00,000 to the trust fund during the previous years relevant to assessment years 1981-82 and 1982-83. While completing the assessments for these assessment years in March 1982 and November 1982 respectively the assessing officer allowed these contributions as deduction as claimed by the assessee. Audit scrutiny revealed (June 1983) that the amounts did not represent any actual expenditure relating to staff welfare activities but only provisions set apart to meet any welfare expenditure that may be incurred on a future date. The deduction was, therefore, not allowable. The mistake resulted in short computation of income by Rs. 1,01,000 and Rs. 1,00,000 for the assessment years 1981-82 and 1982-83 with consequential aggregate short levy of tax of Rs. 1,32.600.

The Ministry of Finance have accepted the objection.

(ii) In the case of a registered firm, provision of Rs. 2,14,000 was made for 'Stock Reserve Account' in the accounts of the previous year relevant to assessment year 1984-85. While completing the assessment in March 1987, the assessing officer allowed this sum as deduction. Since the amount was in the nature of provision and not an ascertained liability it was required to be added back to the business income. Omission to do so resulted in under assessment of income of Rs. 2,14,000 involving short levy of tax of Rs. 1,41,303.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4.15 Mistakes in valuation of closing stock

1. In order to determine the profits from business, an assessee who maintains accounts on mercantile basis, may choose to value the closing stock of his business every year at cost or market price,

whichever is lower. It has been judicially held in September 1980 that the privilege of valuing closing stock in a consistent manner would be available only to a continuing business and that it cannot be adopted where a business comes to an end, when stock on hand should be valued at the market price in order to determine the true profits of business on the date of closure of business.

(i) A registered firm consisting of eleven partners was dissolved during the previous year relevant to assessment year 1983-84 and its assets and liabilities were taken over by a private company. The assessment of the firm for the assessment year 1983-84 was completed in September 1984 accepting the value of the closing stock at Rs. 90,80,749 being its cost price as returned by the assessee firm. As the erstwhile business had come to a close, the market rate of the closing stock should have been taken into account to ascertain the true profits of the firm on the date of its dissolution. In the absence of the relevant details regarding the market value of the stock, if the gross profit rate of about 20 per cent is adopted, the market value of the closing stock would come to Rs. 110 lakhs (approximately) and the amount of addition to be made to the taxable income of the assessee firm on this account would be about Rs. 19.00 lakhs involving short levy of tax of Rs. 13,15,600 in the hands of the firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(ii) A registered firm consisting of two partners and dealing in gold and silver jewellery was dissolved in July 1986 and the business was taken over by one of the partners as a proprietory concern from August 1986. In the assessment for the assessment year 1987-88 completed in March 1988, while computing the business income of the dissolved firm for the period ended 24 July 1986, an addition of Rs. 2,00,000 was made to the closing stock which was returned by the assessee at cost price. Audit scrutiny in August 1988 revealed that the closing stock included 88.520 grams of gold. The market value of gold on the date of dissolution was Rs. 193 per gram. On this basis, the correct amount of addition that should have been made to the closing stock to arrive at the true profits of the dissolved firm was Rs. 7,08,610 as against Rs. 2,00,000 made by the assessing officer. The mistake resulted in underassessment of income by Rs. 5,08,610 involving short levy of tax of Rs. 3,15,059 in the hands of the firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(iii) During the previous year 1978-79, a registered firm consisting of five partners was dissolved and its assets and liabilities were taken over by a closely held company which was one of the partners in the registered firm. While completing the assessment of the firm for the assessment year 1978-79 in February 1981 (revised in September 1986), the assessing officer adopted the value of the closing stock at cost price viz., Rs. 14,70,758 as returned by the assessee. As the firm had been dissolved and its business had come to a close, the closing stock would require to be valued at market price to ascertain the true profits of the firm on the date of dissolution. In the absence of the details regarding the market value of the stock on the basis of the gross profit rate of 34.92 per cent, the value of the stock would work out to Rs. 19,84,346. The omission to adopt this value resulted in underassessment of income by Rs. 5,13,588 with a consequential short levy of tax of Rs. 3,11,944 in the hands of the firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(iv) During the previous year relevant to the assessment year 1982-83, a registered firm was dissolved in December 1981 and the business of the firm was taken over by a company. On the date of dissolution (31 December 1981), the firm valued its closing stock of biris at cost price of Rs. 37,61,840. While completing the assessment for the assessment year 1982-83 in August 1983, the assessing officer also adopted the value of the closing stock of 'biris' at cost price instead of at market price to ascertain the true profits of the firm on the date of dissolution. By adopting the gross profit rate of 9.75 per cent as per the trading account of 'biris', the market value of the closing stock would work out to Rs. 41,28,620. Consequently, the income was underassessed by Rs. 3,66,780 involving short levy of tax of Rs. 2,92,905 including interest for late filing of return and short payment of advance tax in the hands of the firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(v) In the case of an assessee firm the closing stock of scants (wood) at the end of assessment year 1981-82 was valued at Rs. 95 per scant and was accordingly taken as opening stock of the following year. In the subsequent previous yeat relevant to assessment year 1982-83 the production cost of scants worked out to Rs. 72.62 per scant. The scants were sold at Rs. 93 each but the closing stock of Rs. 10,036 scants were valued at Rs. 5,50,334 at Rs. 54.83 each. Thus, the rate at which the closing stock was valued during the assessment year 1982-83 (assessed in March 1985) was neither the cost price nor the market price of the scant. The valuation of the closing stock at cost price of Rs. 72.62 worked out to Rs. 7,28,814. The under valuation of closing stock resulted in underassessment of income by Rs. 1,78,480 and short levy of tax of Rs. 1,44,199 in the hands of the firm and its partners.

The Ministry of Finance have accepted the objection.

4.16 Mistake in the allowance of ex-gratia or adhoc payments

1. Under the Income-tax Act, 1961, bonus paid to employees covered by the Payment of Bonus Act, 1965 in excess of the limits prescribed therein or any other payment in addition to the bonus paid under the Act was not an admissible expenditure.

The Central Board of Direct Taxes clarified in December 1980 that such additional payment cannot be treated as an expenditure incurred wholly and exclusively for the purpose of business and resort can not, therefore, be had to any provisions of the Income-tax Act to claim deduction in excess of what is admissible under the Bonus Act.

The law has been amended with effect from 1 April 1989 to provide that any sum paid to an employee as bonus or commission for services rendered would be allowable as deduction.

(i) During the previous year relevant to the assessment years 1984-85 and 1985-86 a co-operative society made payment on account of 'Kamgar Bakshis' of Rs. 2,51,168 and Rs. 3,94,392 respectively in addition to the bonus admissible under the Bonus Act. While completing the assessment in February 1986 and March 1988, this payment towards Kamgar Bakshis was allowed as deduction by the assessing officer. As the payment towards Kamgar Bakshis over and above the usual payment of bouns, was not allowable in computing the income, the incorrect deduction resulted in excess computation of loss by Rs. 2,51,168 and Rs. 3,94,392 with potential tax effect of Rs. 1,08,523 and Rs. 1,72,973 for the assessment years 1984-85 and 1985-86 respectively.

The Ministry of Finance have accepted the objection.

(ii) An assessee firm of two partners paid bonus of Rs. 1,24,930, Rs. 1,22,991 and Rs. 1,14,264 to certain petty contractors as per trade practice during the previous years relevant to assessment years 1984-85, 1985-86 and 1986-87 respectively over and above the normal bonus of Rs. 10,525, Rs. 12,010 and Rs. 15,196 paid to its employees in the respective years. As the payment of bonus was made to contractors (who were not employees of the concern) and there was no contractual obligation to pay bonus, the exgratia payment of bonus paid, was not an admissible deduction in the computation of business income. The incorrect deduction resulted in underassessment of taxable income by Rs. 1,24,930, Rs. 1,22,991 and Rs. 1,14,264 for the assessment years 1984-85, 1985-86 and 1986-87 respectively. This together with the mistake in allowing relief in respect of export turnover for the assessment year 1986-87 led to total undercharge of tax of Rs. 2,61,847 including interest for short payment of advance tax in the hands of the firm and its partners.

The department has accepted the objection in principle.

The paragraph was referred to the Ministry of Finance for comments in July 1989 ; the reply from the Government has not so far been received (October 1989).

4.17 Incorrect allowance of non-business or capital expenditure

1. Under the provisions of the Income-tax Act, 1961, any expenditure not being in the nature of capital expenditure or personal expenses of the assessee laid out and expended wholly and exclusively for the purpose of business or of profession, shall be allowed in computing the income chargeable under the head 'profits and gains of business or profession'.

(i) While completing the assessment of an assessee firm for the assessment years 1981-82 in March 1984 and 1982-83 in March 1985, the assessing officer disallowed Rs. 1,74,000 and Rs. 41,095 in the assessment for the assessment year 1981-82 and Rs. 1,82,033, Rs. 1,13,326 and Rs. 28,200 in the assessment for the assessment year 1982-83, being expenses not laid out and expended wholly and exclusively for the purposes of business. These accessments were set aside in appeal in March 1987 on a petition filed by applicant under the Amnesty Scheme before the Commissioner of Income-tax. The Commissioner accepted the surrender of Rs 41,000 (out of disallowance of Rs. 41,095) for assessment year 1981-82 and Rs. 1,16,424 (out of disallowance of Rs. 1,82,033 for assessment year 1982-83). While framing re-assessment in August 1987, the assessing officer neither added back the remaining three disallowances of Rs. 1,74,000 in the assessment for the assessment year 1981-82 and Rs. 1,13,326 and Rs. 28,200 in the assessment for the assessment year 1982-83 nor discussed the reasons for their non-inclusion. This resulted in under assessment of Rs. 1,74,000 in assessment year 1981-82 and Rs. 1,41,526 in assessment year 1982-83 with tax effect of Rs. 2,00,408 both in the hands of firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) An assessee registered firm entered into an agreement with an Indian company for technical know-how under which royalty at the rate of 5 per cent of the selling price of the goods sold was payable to the company. The assessee had effected sales of Rs. 1,86,14,570 during the previous year relevant to the assessment year 1986-87 and had debited the profit and loss account with Rs. 10,22,135 on account of royalty which was allowed as a deduction in the assessment made in March 1987. Based on the sales effected, the assessees liability for payment of royalty at 5 per cent of sale would work out only to Rs. 9,00,728 as against Rs. 10,22,135 claimed by the assessee. Incorrect allowance of expenditure on royalty resulted in under assessment of income of Rs. 1,21,407 involving short levy of tax of Rs. 1,17,830 in the hands of the firm and its partners.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989 ; the reply from the Government has not so far been received (October 1989).

(iii) During the previous years relevant to assessment years 1982-83 to 1987-88, an assessee firm was allowed (between January 1984 and March 1988) deductions of interest amounting to Rs. 91,987, Rs. 34,744, Rs. 29,871, Rs. 1,44,918, Rs. 1,71,074 and Rs. 2,06,287 respectively, on account of loans raised by it. The assessee firm further advanced loans of Rs. 2,27,689, Rs. 2,41,005, Rs. 2,35,546 Rs. 5,79,397, Rs. 5,54,392 and Rs. 4,65,849 respectively, during these years to one of its partners from whom no interest was charged. Thus, loans to this extent were not for the purposes of business and non-inclusion of interest receipts thereon amounting to Rs. 36,430, Rs. 34,744, Rs. 29,871, Rs. 92,703, Rs. 88,702 and Rs. 74,535 while computing taxable profits in respect of previous years relevant to assessment years 1982-83 to 1987-88 assessed between October 1984 and March 1988 respectively, resulted in short assessment of income to this extent in these years with revenue effect of Rs. 1,00,249 in the hands of firm alone. The tax effect in the hands of the partners is yet to be ascertained.

The paragraph was referred to the Ministry of Finance for comments in August 1989 ; the reply from the Government has not so far been received (October 1989).

(iv) While computing the income of an individual for assessment year 1982-83, (assessment completed in November 1982) the expenditure on the installation of a computer representing technical service charges, handling, freight and forwarding charges amounting to Rs. 2,65,500 included under 'computer maintenance' was allowed. Audit scrutiny revealed (June 1988) that this expenditure was incurred in lump before installation of the computer and in connection with its acquisition. The expenditure being of a capital nature should have been disallowed. The omission to do so resulted in short computation of income by Rs. 2,65,500 involving a tax effect of Rs. 96,377.

The Ministry of Finance have accepted the objection.

(v) Agricultural income is not to be included in computing the total income of an assessee. As such expenditure incurred by the assessee for the purpose of earning such income is not an admissible deduction.

In the assessment of a co-operative society for the assessment year 1985-86 completed by the Inspecting Assistant Commissioner (Assessment) in March 1982, agriculture receipts of Rs. 5,28,761 credited to profit and loss account were excluded. Audit scrutiny (December 1988) revealed that agricultural expenditure of Rs. 4,03,154 debited to the profit and loss account (included in the details of expenditure under extension and development expenses) was, however, not disallowed in the assessment. The mistake resulted in excess computation and carry forward of business loss by Rs. 4,03,154 with potential tax effect of Rs. 81,418.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4.18 Omission to disallow excessive expenditure on advertisement, publicity and sales promotion

Under the provisions of the Income-tax Act, 1961, as applicable during the period 1 April 1984 to 31 March 1986 where the aggregate expenditure incurred by an assessee on advertisement, publicity and sales promotion, running and maintenance of air-craft and motor cars, and payments made to hotels, exceeded Rs. one lakh, twenty per cent of such excess is not to be allowed as deduction in computing the income chargeable under the head 'profits and gains of business or profession.

A co-operative society incurred an expenditure aggregating Rs .18,28,346 on advertisement, publicity, running and maintenance of conveyance during the previous year relevant to the assessment year 1984-85. While completing the regular assessment for the assessment year 1984-85 in February 1988, the assessing officer allowed deduction of the full amount of the expenditure. As the expenditure exceeded Rs. 1 lakh, 20 per cent of such expenditure in excess of Rs. one lakh, amounting to Rs. 3,45,669 was required to be disallowed in computation of the assessee co-operative society, which was not done. This resulted in under assessment of income by Rs. 3,45,669 with short levy of tax of Rs. 1,51,050.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4.19 Mistake in the grant of export markets development allowance

Under the provisions of the Income-tax Act, 1961, domestic companies and resident non-corporate assessees engaged in the business of export of goods outside India or of providing services or facilities outside India were entitled, upto March 1983, to export markets development allowance, equal to the actual amount of qualifying expenditure, plus an additional amount of one third thereof as weighted deduction. It has been held judicially (June 1981) that payment of commission for procuring orders from the foreign buyers would not qualify for weighted deduction.

In the assessment of a resident individual engaged in the export of fabrics and garments for the assessment years 1981-82 and 1982-83, completed in January 1984 and January 1985 respectively, the assessing officer allowed weighted deduction of Rs. 30,052 and Rs. 1,30,564 respectively towards export markets development allowance. The expenditure considered for the purpose of allowing the deduction, however, included Rs. 64,219 and Rs. 3,42,468 respectively being commission paid to foreign agents for procuring orders, which did not qualify for the weighted deduction. The mistake resulted in under assessment of income of Rs. 21,406 and Rs. 1,14,156 respectively in the assessment years 1981-82 and 1982-83, and consequent undercharge of tax aggregating to Rs. 90,399.

The department has accepted tthe objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

4.20 Other mistakes in the computation of business income

1. Where an assessee incurs any expenditure in respect of any payment made after 31 March 1969, of a sum exceeding rupees two thousand five hundred (the limit has been raised to 10,000 with effect from 1 April 1989), otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, such expenditure shall not be allowed as deduction in computing the income of the assessee. The Act provides that no disallowance shall be made where any payment exceeding the limit specified is made in cash subject to the extent of banking facilities available, consideration of business expediency and other relevant factors. The Income-tax Rules, 1962, exempt the payments made in cash for purchases of the produce of animal husbandry including hides and skins to the grower or producer of such articles, produce or products, from the provisions of the Act.

The assessment of a registered firm engaged in the business of purchase and sale of raw skin, hides and skin, etc., for assessment year 1983-84 was completed in March 1986 on a taxable income of Rs. 1,97,590. Audit scrutiny of the accounts of the assessee revealed (October 1986) that the assessee had made several cash payments to several reputed trading concerns dealing in these goods ranging from Rs. 5,000 to Rs. 50,000 totalling Rs. 6,46,491 but no disallowance was made accepting the assessee's explanation that the cash payments were made in lieu of dishonoured cheque originally issued and towards purchase of raw skin which is permitted under the Rules. As purchases were made from reputed concerns trading in raw skin, the provisions of the Act are clearly applicable, and the Rules provide for exemption in respect of cash payments only if they are made to producers or growers and not to others. Failure to apply the provisions of the Act, resulted in short computation of income by Rs. 6,46,491 involving an aggregate short levy of tax of Rs. 4,84,713 in the hands of the firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. 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 assessee has obtained any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof, the amount so received shall be income of the assessee liable to tax in the assessment year relevant to the previous year of receipt.

(i) During the previous year relevant to the assessment year 1983-84, an assessee registered firm received refund of sales-tax of Rs. 1,31,316 which was accounted for in the 'sales tax refund account' and was taken to balance sheet. As the sales tax paid had been allowed in the earlier year's assessments, the refund therefrom was chargeable to tax in the relevant year of its receipt. In the assessment for the assessment year 1983-84 completed in February 1986, the assessing officer did not include the refund as income of that year. The omission resulted in under-assessment of income of Rs. 1,31,316.

Further, the tax-audit reports filed with the returns of income for the assessment years 1985-86 and 1986-87 indicated that a sum of Rs. 2,07,932 shown in the balance sheet under the head 'sales tax old account' also represented refund of sales tax. The amount of Rs. 2,07,932 shown in the above account right from the assessment year 1980-81 to 1986-87, was, therefore, similarly chargeable to tax in the assessment year 1980-81, but was not taxed as such. These mistakes resulted in under assessment of income of Rs. 3,39,248 involving aggregate short levy of tax of Rs. 2,65,395 including interest for short payment of advance tax and late filing of return in the hands of the firm and its partners.

The Ministry of Finance have accepted the objection.

(ii) As assessee firm, following financial year as its accounting year, was assessed in March 1988 on a total income of Rs. 1,87,040 in the assessment year 1985-86. The firm was dissolved and assets and liabilities were distributed amongst the partners at the end of the relevant accounting year. The assessee firm had received an amount of Rs. 5,14,565 by way of refund of central excise duty in the previous year relevant to the assessment year 1985-86 which was directly credited to the partners' accounts instead of crediting the same to the profit and loss account of the firm for being brought to tax. This resulted in under-assessment of income of Rs. 5,14,565 with consequent short levy of tax of Rs. 2,58,290 in the hands of the firm and its partners.

The Ministry of Finance have accepted the objection.

3. Interest paid on capital borrowed for the purpose of business or profession is allowed as deduction in computing the profits and gains of business or profession. Where on a subsequent date, the assessee obtains any benefit in respect of such expenditure or liability allowed earlier, the benefit accruing thereby shall be deemed to be profits and gains of business or profession chargeable to tax as income of the previous year in which the benefit had accrued.

An assessee Hindu undivided family received Rs. 2,10,900 during the previous year relevant to assessment year 1987-88 as subsidy on interest towards loan from bank for acquisition of a barge during the previous year relevant to assessment year 1984-85 which according to the cited provisions was chargeable to tax in the assessment year 1987-88. Similar interest subsidy received in the previous years relevant to assessment years 1984-85 and 1985-86 had in fact been brought to tax and these assessments had also been upheld in appeal. In the assessment for the assessment year 1987-88 completed in March 1988, the benefit of Rs. 2,10,900 accruing to the assessee led to an under-charge of tax of Rs. 1,15,995.

The Ministry of Finance have not accepted the objection stating that the assessment was completed under the summary assessment scheme.

4. The Income-tax Rules, 1962, provide that the rate of exchange for the calculation of the value in rupee of any income accruing or arising or deemed to accrue or arise to the assessee in foreign currency or received or deemed to be received by him in foreign currency which is chargeable under the head 'profits and gains of business or profession' shall be the 'telegraphic transfer buying rate' of such currency as on the last day of the previous year of the assessee. Accordingly, even in cases where the income in foreign currency is actually received by the assessee, during the course of the previous year, the rate of exchange for conversion of the income into Indian rupees applicable is the 'telegraphic transfer buying rate' as on the last day of the previous year.

An assessee registered firm during the previous year ending on 13 April 1984 and 13 April 1985 relevant to assessment year 1984-85 and 1985-86 received income in foreign currency amounting to U.S. Dollars 21,47,08.24 and 23,81,26.97 and returned the value of the income in Indian currency at Rs. 21,68,250 and Rs. 27,71,316 respectively. In the assessments for the assessment years 1984-85 and 1985-86 completed in February 1987 and March 1987, the assessing officer accepted the conversion made by the assessee. It was noticed in audit (November 1987) that as on 13 April 1984 and 13 April 1985 (the last date of the relevant previous years) the buying rates by the State Bank of India were 9.280 U.S. Dollar and 8.035. U.S. Dollars for every hundred rupees and at this rate the rupee equivalent of the above earnings of the assessee in U.S. Dollars worked out to Rs. 23,13,666 and Rs. 29,63,621 respectively The incorrect application of conversion rate thus resulted in short computation of income by Rs. 3,32,000 in aggregate leading to short levy of tax of Rs. 2,22,853 for the two assessment years in the hands of the firm and its partners (assuming that the partners had no other income).

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

5. With effect from the assessment year 1972-73, any compensation or other payments due to be received by any person for or in connection with the vesting in the Government or in any corporation owned or controlled by the Government under

any law for the time being in force, of the management of any property or business shall be chargeable to income-tax under the head 'profit and gain of business or profession. It has been judicially held (150 ITR 164) that moneys on acquisition of motor vehicles became due only on determination by the arbitrator. It has also been judicially held (106 ITR 748) that where amount of compensation was quantified and paid with interest years later, the whole amount of interest received was assessable in the year of receipt. It was further held that as long as the compensation was not quantified, it was difficult to hold that interest was accruing on yearly basis though for the purpose of working out the quantum of interest the rate indicated on annual basis would be taken into account.

An assessee firm prior to its dissolution in April 1976 was having the business of running contract carriages. The contract carriages were acquired by the Government in January 1976. The compensation payable to the firm was determined by the arbitrator as Rs. 8,13,000 in July 1980 along with interest thereon at 6 per cent per annum from January 1976 to the date of payment. The compensation alongwith interest thereon was received by the assessee firm during the previous year relevant to the assessment year 1981-82. The compensation and interest payable in terms of the award amounted to Rs. 8,13,000 and Rs. 2,52,300 respectively. Of this, only compensation of Rs. 8,13,000 and an interest of Rs. 48,780 relatable to the previous year relevant to the assessment year 1981-82 was brought to tax in the assessment of that year (February 1986). The balance of interest of Rs. 2,03,520 had been apportioned amongst the assessment years 1977-78 to 1980-81, the assessments of which were later rectified (August 1986) in pursuance of an appellate order (May 1986) which held that interest on the compensation was taxable only in the year of the award. Nevertheless action was not taken to re-open the assessment for the assessment year 1981-82 for charging the interest of Rs. 2,03,520. This was also not done when the assessment for assessment year 1981-82 was redone in August 1987. The omission resulted in under assessment of income by Rs. 2,03,520 leading to short levy of tax of Rs. 2,16,674 in the hands of the firm and its partners including interest for belated filing of return and non-filing of estimates of advance tax.

The Ministry of Finance have accepted the objection.

6. Income chargeable to tax is computed in accordance with the method of accounting regularly employed by the assessee. It has been judicially held that goods should not be written down below cost price unless there is a loss actual or a prospective. So long as the fall in prevailing prices is only such as to reduce the prospective profit the initial valuation at cost should be retained (83 ITR 269).

The assessment of an assessee Hindu undivided family deriving income from partnership firms and from sale of shares for the assessment year 1985-86 was completed in February 1988 on a loss of Rs. 10,29,175 as returned by the assessee. The loss computed included an amount of Rs. 3,82,500 claimed as loss due to revaluation of equity shares held by the assessee. Audit scrutiny revealed that the loss was not attributable to any result of actual sale transactions. There was no decline in the value of the shares at the end of relevant previous year either (31 March 1985). The loss of Rs. 3,82,500 was thus only notional and was not allowable as deduction in computing the income. Omission to do so led to excess carry forward of loss of Rs. 3,82,500 involving potential tax effect of Rs. 2,14,453 in the assessment year 1985-86.

The Ministry of Finance have accepted the objection in principle.

7. Under the provisions of the Act, as applicable upto 1987-88, where any building, machinery, plant or furniture which is owned by the assessee and which was or has been used for the purposes of business or profession is sold, discarded, demolished or destroyed and the moneys payable in respect of such building, machinery, plant or furniture, as the case may be, together with the amount of scrap value, if any, exceed the written down value, so much of the excess as does not exceed the difference between the actual cost and the written down value shall be chargeable to income-tax, as income of the business or profession of the previous year in which the moneys payable for the building machinery, plant or furniture became due.

In the assessment of an unregistered firm for the assessment year 1985-86 completed in February 1988 by the Inspecting Assistant Commissioner (Assessment) the profit on sale of machinery was computed at Rs. 1,065 adopting the figures of sale price and written down value as Rs. 2,10,360 and Rs. 2,09,295 respectively. In the schedule of fixed assets forming part of the balance sheet which was also treated as depreciation schedule for income-tax purposes, the amount of Rs. 2,09,295 taken as the written down value actually represented the cost of the machinery sold. The correct amount of the written down value of the machinery sold after deduction of depreciation of Rs. 1,72,158 allowed thereon upto the assessment year 1984-85 as shown in the above schedule, worked out to Rs. 37,137. The mistake in adopting the incorrect figures of the written down value resulted in under assessment of income of Rs. 1,72,158 with consequent short levy of tax of Rs. 1,51,780 including interest for short payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

8. A firm of carriage contractors, disclosed a loss of Rs. 43,000 in its return of income for the year 1984-85. While completing the assessment in March 1985, revised in September 1985 on the basis of the books/records produced, the assessing officer disallowed Rs. 55,000 out of the expenses claimed for want of proof and computed the income at Rs. 12,000. A scrutiny of the assessment records, however, revealed that the firm had received Rs. 14,95,345 from the carriage business against which deduction of Rs. 14,51,561 was claimed on account of expenses. The assessee had thus actually earned a profit of Rs. 43,784 instead of incurring a loss of Rs. 43,000 as reflected in the return. By taking into account the disallowance of Rs. 55,000 as made by the assessing officer, the taxable income worked out to Rs. 98,784 instead of Rs. 12,000 as assessed. Besides, the carriage receipts of Rs. 1,53,909 for the months of February and March 1983 as per the certificates of tax deducted at source filed with the return, were not included in the income of the assessee firm for the assessment year 1984-85 leading to escapement of income of Rs. 1,53,909 and eventually resulted in short levy of tax of Rs. 80,468 inclusive of interest.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

MISTAKES IN ALLOWANCE OF DEPRECIATION AND INVESTMENT ALLOWANCE

4.21 Mistakes in the allowance of depreciation

1. Under the Income-tax Act, 1961, in computing the business income of an assessee, a deduction on account of depreciation on plant, machinery or other assets is admissible at the prescribed rates provided these are owned by the assessee and used for the purposes of his business during the relevant previous year.

Depreciation on buildings, plant and machinery is calculated on their cost or written down value, as the case may be, according to the rates prescribed in the Income-tax Rules, 1962. Special rates of depreciation ranging from 15 per cent to 100 per cent are prescribed for certain specified items of machinery and plant. A general rate of 10 per cent (15 per cent from the assessment 1984-85) is prescribed in respect of machinery and plant for which no special rate has been prescribed.

In the assessment of 5 registered firms, 2 co-operative societies and 2 unregistered firms for the assessment years 1983-84 to 1985-86 assessed in nine different Commissioners' charges between October 1985 and March 1988 due to incorrect application of rates of depreciation allowance and other irregularities in the calculation of depreciation allowance, there was an aggregate excess allowance of depreciation of Rs. 26,38,527 resulting in short levy of tax of Rs. 10,10,526.

The particulars of these cases are as under :

Sr. No.	State/Commissioner's charge/ Name of the assessee	Assessment year	Natue of mistake	Tax effect (Rs.)
1	Bombay/A/Co-operative society	1984-85	Excess allowance of depreciation including extra shift allowance of Rs. 5,15,005 (*ie* allowed as Rs. Rs. 25,74,790 as against admissible amount of Rs. 20,59,785) on plant and machinery	2,27,250 (potential)
2	Delhi/B/Registered firm	1985-86	Incorrect allowance of depreciation including additional depreciation at higher rate of 20 per cent instead of admissible rate of 15 per cent on equipments used in processing, developing and printing of colour films.	2,06,298 (including interest)
3	Assam/C/Unregistered firm	1985-86	Excess allowance of depreciation of Rs. 1,34,370 on account of omission to take into account the last years' depreciation while determining the written downvalue of the machinery for the subsequent assessment year.	1,38,583 (including interest)
4	Karnataka/D/Co-operative society	1983-84	Incorrect allowance of depreciation including extra shift allowance on machinery at the rate of 15 per cent instead of the general rate of 10 per cent applicable to the assessment year 1983-84.	1,25,448 (potential)
5	West Bengal/E/Registered firm	1984-85	Incorrect allowance of depreciation on plant and machinery as claimed by the assessee at the rate of 30 per cent instead of general rate of 15 per cent correctly admissible on plants not running on solar energy.	83,714 (including interest)

6	Andhra Pradesh/F/Unregistered firm	1984-85	Incorrect allowance of depreciation of Rs. 1,54,017 on transformer and electrical fittings as against the admissible depreciation of Rs. 15,401.	70,647 (potential)
7	Rajasthan/G/Registered firm	1982-83 to 1984-85	Incorrect allowance of depreciation at the higher rate of 30 per cent instead of admissible general rate of 10/15 per cent on diesel generating set running otherwise than on wind energy.	56,429
8	Gujarat/H/Registered firm	1983-84	Incorrect adoption of written down value and incorrect application of rate of depreciation of 15 per cent instead of 10 per cent (general rate) applicable for assessment year 1983-84 on plant and machinery.	50,729
9	Bombay/I/Registered firm	1984-85 and 1985-86	Incorrect allowance of depreciation on factory building at the rate of 15 per cent as against the correct rate of 10 per cent.	51,428

The Ministry of Finance have accepted the objections in five cases. The other paragraphs were referred to the Ministry of Finance for comments between May 1989 and July 1989; the reply has not so far been received October 1989. However, the department has accepted the objection in two cases.

2. No depreciation allowance is, allowable, if in any previous year the machinery, plant or furniture is sold, discarded, demolished or destroyed. The word 'sold' had been defined in the Act to include transfer by way of exchange, etc. It had also been judicially held that the taking over the assets of any firm by a company against the payment of the capital of the partners in a firm, constitutes, 'sale' (59 ITR 221).

An assessee registered firm was engaged in the business of manufacturing of carpets, etc. In the previous year relevant to the assessment year 1985-86, through a revised partnership deed, the assessee firm took a private limited company as one of the partners in the firm but after a few days, the said firm was dissolved and the business of the firm was taken over by the private limited company. All assets and liabilities of the said firm were also taken over. It was also agreed upon through the dissolution deed that the capital of the partners in the firm as on the date of dissolution will carry interest at the rate of 12 percent till the same is paid to them.

In the statement of income of the previous year relevant to the assessment year 1985-86 assessment completed in March 1987, the assessee firm claimed and was allowed depreciation allowance of Rs. 1,77,674 on its assets which had been sold to the company in the relevant previous year. This irregular allowance resulted in short assessment of income by Rs. 1,77,674.

Besides, the details of the sundry debtors as filed by the assessee firm indicated the amounts of Rs. 1,20,818 and Rs. 9,973 on account of interest receivable and rebate receivable but these amounts pertaining to the relevant previous year were not found credited to the profit and loss account of the previous year resulting in escapement of income of Rs. 1,30,791. These mistakes resulted in under-assessment of the income of the firm for the assessment year 1985-86 by Rs. 3,08,465 with short levy of tax of Rs. 1,83,045 in the hands of the firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3. Under the Income-tax Rules, 1962, an extra shift allowance is admissible (prior to rationalisation and simplification with effect from 1 April 1988) in respect of certain plant and machinery upto a maximum of an amount equal to one half of the normal depreciation allowance where the concern works double shift, and upto a maximum of an amount equal to the normal depreciation allowance where a concern works triple shift.

For the assessment year 1984-85 an assessee a co-operative society, claimed a depreciation allowance of Rs. 53,05,567 which included extra shift allowance of Rs. 31,83,340. While completing the assessment in March 1987 the claim was allowed by the assessing officer. The number of days the concern worked double shift or triple shift was not available on records. Even assuming that the concern worked in triple shifts on all the working days, the maximum extra shift allowance admissible would be an amount equal to the normal depreciation of Rs. 21,22,227 as against Rs. 31,83,340 allowed. This resulted in incorrect allowance of extra shift allowance of Rs. 10,61,113 involving a potential tax effect of Rs. 4,77,500.

The Ministry of Finance have accepted the objection.

4.22 Incorrect grant of investment allowance

1. Under the Income-tax Act, 1961, in respect of machinery owned by the assessee and used for the purpose of business carried on by him, a deduction shall be allowed in the previous year ot installation or in the previous year of first usage of a sum by way of investment allowance equal to 25 per cent of the actual cost of the machinery to the assessee. No investment allowance is admissible on machinery or plant which are not used in the industrial undertaking for the purpose of business of manufacture or production of any article or thing. Deduction on account of investment allowance is calculated on the basis of the actual cost of the plant or machinery installed and used for the purpose of business.

In the assessment of seven registered firms and an individual for the assessment years 1981-82 to 1987-88 assessed in eight different Commissioners' charges between may 1982 and October 1988, due to incorrect grant of investment allowance there was an aggregate excess investment allowance of Rs. 42,79,365 resulting in short levy of tax of Rs. 23,84,927.

The particulars of these cases are as under:--

Sr. No.	State/Commissioner's charge/Assessee	Assessment years	Nature of mistake	Tax effect (Rs.)
1	Tamil Nadu/A/Individual	1984-85 to 1986-87	Incorrect grant of investment allowance to an assessee not engaged in the manufacture or production of any article or thing but engaged in processing of films.	7,04,733
2	Haryana (U.T. Chandigarh)/B/ Registered firm	1983-84	Incorrect grant of investment allowance to an assessee which was neither an industrial undertaking nor engaged in the activity of producing any article but only engaged in the business of construction of building.	5,95,500
3	West Bengal/C/Registered firm	1985-86	Incorrect grant of investment allowance in the business of purchasing condemned ship and their conversion into scraps.	2,56,263
4	Tamil Nadu/D/Registered firm	1981-82	Incorrect grant of investment allowance to an assessee firm engaged in the business of mining granites not involving any activity of manufacture or production of any article or thing.	2,25,191
5	Gujarat/E/Registered firm	1985-86	Incorrect grant of investment allowance for installation of a crane to an assessee engaged in the business of ship breaking.	1,99,888
6	Bihar/F/Registered firm	1985-86 to 1987-88	Erroneous grant of investment allowance to an assessee firm deriving income from transport business.	1,82,521
7	Bombay/G/Registered firm	1986-87	Irregular grant of investment allowance on loader which is only a vehicle put to use for loading.	1,39,400
8	Rajasthan/H/Registered firm	1983-84	Incorrect grant of investment allowance to an assessee firm not engaged in production of any article or thing but engaged in construction of roads and buildings.	81,431

The Ministry of Finance have accepted the objection in one case. The remaining paragraphs were referred to the Ministry of Finance for comments between April 1989 and July 1989; the reply from the Government has not so far been received (October 1989). However, the department has accepted the objection in five cases.

2. When the total income is nil or less than the full amount of investment allowance admissible only so much of the investment allowance is to be allowed as is sufficient to reduce the total income to nil and the balance of investment allowance is to be carried forward to the following assessment year and so on upto eight assessment years. It has been judicially held that a partnership would not be validly constituted if a partner by agreement is exempted from all losses and such a partnership would not be entitled to registration under the Income-tax Act (155 ITR 377-Calcutta and 143 ITR 464-Andhra Pradesh). The Supreme Court's dictum in 82 ITR 680 that there should be an agreement to share the profits as well as the losses of the business was relied upon by the High Court in deciding the case. It has also been judicially held that in the milling process of grain what is recovered as wheat flour is not different or a new thing, and as such the conversion, of wheat into flour amounted only to 'processing' and activity involved was not one of manufacture (1976 U.P.T.C. 322).

(i) In the case of a registered firm running flour mills for converting wheat into flour and other products, the assessment for the assessment year 1986-87 was completed in March 1988 allowing a deduction of Rs. 5,47,095 (Rs. 30,178 for the assessment year 1986-87, Rs. 5,01,717 and Rs.15,200 relating to assessment years 1984-85 and 1985-86 respectively being investment allowance carried forward for set off in the assessment year 1986-87) on account of investment allowance. As the assessee was not an industrial undertaking engaged in the business of manufacture of any article or thing, the grant of investment allowance was not in order. This resulted in under assessment of income of Rs. 5,47,095. Treating the firm as 'association of persons' for the reasons that some of the partners were not required to share losses, the short levy of tax worked out to Rs. 3,55,598 including interest for late filing of return and non filing of estimate of advance-tax.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) In the assessment of an assessee firm for the assessment year 1985-86 completed in March 1988, the income was computed at Rs. 3,90,840, after setting off unabsorbed investment allowance of Rs. 3,01,578 and Rs. 1,10,349 relating to assessment years 1983-84 and 1984-85 respectively (total Rs. 4,11,927) as claimed by the assessee. However, the assessment records for the previous assessment years 1983-84 and 1984-85 revealed that no unabsorbed investment allowance in respect of those years had remained to be carried forward for set off in the following years. Omission to disallow the incorrect claim of the assessee resulted in short computation of income for assessment year 1985-86 by Rs. 4,11,927 with consequent short levy of tax of Rs. 2,16,662 in the hands of the firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(iii) It has been judicially held that conversion of proprietory business into partnership involved transfer of capital assets. It has also been judicially held that development rebate originally allowed to the individual was to be withdrawn if the conversion of proprietorship into partnership takes place within the period specified in the Act. The ratio of these decisions was applicable to withdrawal of investment allowance also. However, no rectification in such cases could be carried out after the expiry of four years from the end of the previous year in which the transfer took place.

Two proprietorship firms converted themselves into partnership firms (one during previous year relevant to assessment year 1986-87 and the other during previous year relevant to assessment year 1984-85). Both the proprietorship firms had been allowed investment allowance amounting to Rs. 1,01,338 and Rs. 71,813 during assessment years 1981-82 to 1985-86 (assessments completed between March 1984 and April 1986) and asessment year 1979-80 to 1983-84 (assessment completed between December 1980 and October 1986) respectively. As the conversion of proprietorship business into partnership business amounted to transfer and the transfer had taken place within eight years of the acquiring of the machinery, the department should have taken action to revise the assessments of the assessee within four years from the end of previous years in which the conversion took place to withdraw investment allowance already allowed to them but this was not done. The omission to withdraw the investment allowance resulted in loss of revenue of Rs. 99,629.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

3. The grant of investment allowance is subject to furnishing of particulars in this behalf and creation of a reserve equal to seventy five per cent of the amount actually to be allowed. The Central Board of Direct Taxes have clarified in June 1981 that the condition for the creation of reserve shall stand satisfied if the sum total of reserves created either in the year of installation of use or in the subsequent year, is equal to the requisite percentage of actual allowance. This implied that though the obligation to create statutory reserve may be postponed from a year of loss to the subsequent year of earning profits, the eligibility of investment allowance should be determined only in the year of installation or use of the machinery and plant. The Act also gives the assessee an option to create reserve for the full amount irrespective of the fact that the amount debited to the profit and loss accounts and credited to reserve exceeded the amount of profit of such previous year.

A registered firm, in the accounting year ended March 1985 relevant to assessment year 1985-86 created an investment allowance reserve of Rs. 1,85,940 and claimed investment allowance of Rs. 2,47,920 on the value of plant and machinery (Rs. 9,91,680) installed and put to use during the previous years relevant to assessment years 1978-79 (Rs. 9,06,271), 1980-81 (Rs. 17,257), 1981-82 (Rs. 8,492), 1983-84 (Rs. 4,040), 1984-85 (Rs. 1,000) and 1985-86 (Rs. 54,620). Audit scrutiny revealed that there was no claim for investment allowance in respect of bulk machinery and plant worth Rs. 9,06,271 installed and put to use in the earlier year relevant to assessment year 1978-79 as also in subsequent years upto 1984-85. The assessee's claim was, however, admitted in the assessment completed in May 1987 without examining the admissibility or otherwise of investment allowance on plant and machinery put to use in earlier years. Since there was not claim for investment allowance in the five earlier years of installation and use of plant and machinery and allowance was not determined and permitted to be carried forward by the department in those years, assessee's claim was liable to be rejected.

The incorrect grant of investment allowance for the earlier years resulted in under-assessment of total income by Rs. 2,34,265 with consequent short levy of tax of Rs. 1,63,687 inclusive of interests for belated filing of return and short payment of advance-tax in the hands of assessee firm and its partners.

The department has accepted the objection. The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4. The Act stipulates that where a firm is succeeded to by a limited company and as a result thereof the firm transfers machinery or plant to the company, the benefit of investment allowance is continued in the hands of the company provided all the property of the firm immediately before succession becomes the property of the company, and all the liabilities of the firm immediately before succession become the liability of the company and all the shareholders of the company were partners of the firm immediately before succession. In other words the newly formed company cannot exceed in strength the numbers of partners in the firm immediately before the succession and no new person can become a member of the company.

In the assessment of a registered firm for the assessment year 1986-87 completed in September 1987, the assessee firm was allowed investment allowance of Rs. 1,45,187 on new machinery installed. During the previous year relevant to the assessment year 1986-87, the assessee firm did business only for three months from 1 April 1985 to 30 June 1985 and was succeeded by a company with effect from 1 July 1985 and the company took over all the assets and liabilities of the firm immediately before succession. However, it was noticed during the audit that there were eleven shareholders in the company whereas there were only eight partners in the firm immediately before succession of the firm by the company. As all the shareholders of the company were not partners of the firm, three of them not being partners in the firm, there was a transfer in taking over of assets of the firm by the company, and since the transfer took place within eight years of installation, the assessee firm was not entitled to investment allowance. Incorrect allowance of investment allowance resulted in under-assessment of income of Rs. 1,15,187 involving short levy of tax of Rs. 78,982 in the hands of the firm and its partners.

The assessee firm was also allowed investment allowance aggregating to Rs. 1,38,720 on new machinery installed during the periods relevant to assessment years 1980-81 to 1983-84 and 1985-86. As the machinery was transferred to the company in the previous year relevant to the assessment year 1986-87, before expiry of eight years from the year of installation, investment allowance of Rs. 1,38,720 already allowed to the assessee firm was also required to be withdrawn. The short levy of tax for assessment year 1983-84 alone amounted to Rs. 69,146 in the hands of the firm and its partners.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989, the reply from the Government has not so far been received (October 1989).

4.23 Incorrect allowance of depreciation and investment allowance

The Income-tax Act, 1961 provides for grant of depreciation allowance on buildings, plant and machinery owned by an assessee and used for the purpose of business, in computing the income from business. According to the depreciation schedule in the Income-tax Rules, 1962, as applicable upto the assessment year 1983-84, depreciation on first class factory buildings was admissible at 5 per cent of the actual cost or written down value, as the case may be. Besides, the Act provides for a deduction by way of investment allowance at twenty five per cent of the actual cost of plant and machinery installed and used for the purpose of business in any industrial under-taking for the purpose of business of construction, manufacture or production of any one or more of the articles or things, etc.

In the assessment of a registered firm for the assessment years 1980-81 to 1983-84, depreciation on cold storage buildings was incorrectly allowed at 15 per cent treating it as plant and machinery instead of at the correct rate of 5 per cent admissible to factory building. This resulted in excess allowance of depreciation of Rs. 3,00,379. Similarly, in the assessment for the assessment year 1979-80, investment allowance of Rs. 6,37,287 was allowed at the rate of 25 per cent of the cost of total assets worth Rs. 25,49,137 which also included the cost of buildings, racks stackings aggregating to Rs. 15,09,914 on which no investment allowance was admissible as being not plant and machinery. This led to grant of excess investment allowance of Rs. 3,77,479. These mistakes resulted in excess computation of loss by an amount aggregating to Rs. 8,67,778 for assessment years 1979-80 to 1983-84, involving potential tax effect of Rs. 1,51,259.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

4.24 Omission to levy tax on capital gains

1. Under the provisions of the Income-tax Act, 1961, any profits or gains arising from the transfer of a capital asset are chargeable to income-tax under the head 'capital gains'. For the purpose of computation of capital gains, the term transfer has been defined to include sale, exchange or relinquishment of an asset or extinguishment of any right therein. It has been judicially held (September 1985) that where a partner of a firm makes over capital assets held by him to a firm as his capital contribution, it amounts to a transfer of a capital asset and if such transfer of a personal asset is merely a device or ruse for converting the asset into money which would remain available for the benefit of the assessee without liability to income-tax on capital gains, it is open to the Income-tax authorities to go behind the transaction and decide the issue of capital gain with reference to certain tests laid down therein for determining whether a transaction is sham or illusory like the real need for the capital contribution, whether the personal asset was sold by the partnership soon after transfer, etc., (156 ITR 509 SC). In yet another case, the Supreme Court has ruled (April 1985) that tax planning may be legitimate provided it is within the frame work of law and that colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious means (154 ITR 148 SC). The Act also provides for exemption from capital gains tax if the full value of the consideration received or accruing as a result of transfer is invested or deposited by the assessee in specified assets within a period of six months after the date of transfer.

(i) A firm was constituted by a person, his son (Hindu undivided family) and a trust (in which the daughter was the sole beneficiary) on June 5, 1983, to carry on business as dealers in real estates and as property developers. The second and third partners were the co-owners of a house property with equal share and both transferred the house property to the firm as their capital contribution during the previous year relevant to the assessment year 1984-85 and in the books of the firm, the two partners (co-owners) were credited, with Rs. 39,07,800 and Rs. 39,15,000 respectively as their capital contribution.

The partnership firm did not do any substantial or real business till the end of December 1984 except planning for construction of flats. The business of the firm was sold as a going concern on 25 February 1985 to a company. The above transactions clearly revealed that the partnership firm was not a genuine one and the formation of partnership was a sham or illusory transaction. The transfer of the personal asset by the assessee as capital contribution to the partnership firm was merely a device or ruse for converting the asset into money which would remain available for the benefit of assessees without the liability to income-tax on capital gains No capital gain, was, however, returned as according to the letter of the law there was no transfer by the assessee. As the Supreme Court has refused judicial benediction to such colourable devices as tax planning, the transaction should have been regarded as transfer and the difference between the value of property credited in the books of firm and the cost of acquisition of the property to the assessee should have been treated as capital gains. However, in the assessments of two partners for the assessment year 1984-85 (after scrutiny of books of account in the case of one partner, the sole beneficiary of the trust, and under summary assessment scheme in the case of the other concluded in February 1987) levy of tax on capital gains was not considered. Omission to bring to charge the taxable capital gain of Rs. 45,49,146 resulted in non levy of tax of Rs. 29,88,677 in respect of the two assessees.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

(ii) An assessee individual on 31 October 1984 joined as a partner in a registered firm and contributed the building, land etc., owned by him (cost of acquisition of property Rs. 4,02,507) towards his share of capital. The assessee's accounts in the books of the firm were credited with Rs. 15 lakhs for the building and land at the time of transfer during the previous year relevant to the assessment year 1985-86. The assessee retired from the partnership on 15 December 1984 when the partnership was dissolved and the assessee received a sum of Rs. 15,06,288 standing to his credit in capital account in full settlement. The assessee invested Rs. 15 lakhs so realised, in fixed deposit in a nationalised bank from 19 December 1984 to 18 March 1985 and later on invested in Rural Development Bonds (second issue) on 17 June 1985 well after $7\frac{1}{2}$ months from the date of transfer of asset which took place on 31 October 1984, when he became the partner by introducing his property as capital.

In November 1986, the assessing officer sought instructions of the Inspecting Assistant Commissioner of Income-tax for assessing capital gains to tax, but no instructions were received. When the assessment was about to become barred by time (31 March 1988), the assessment was concluded in a summary manner on 25 March 1988 accepting the returned income.

Though the assets brought in by the assessee in lieu of capital amounted to transfer of capital assets the liability to capital gains tax on the transfer of property was not considered while completing the assessment for assessment year 1985-86. The net capital gains that escaped assessment worked out to Rs. 6,55,496 with a consequential under charge of tax of Rs. 4,20,780 including interest for belated filing of returns. As the assessee had invested the consideration received in specified assets only after the prescribed time limit of 6 months, the exemption from capital gains was not available.

The Ministry of Finance have not accepted the objection justifying that the assessment in this case was completed under the summary assessment scheme.

4.25 Irregular exemption from capital gains

1. Transfer for the purpose of computing capital gain includes compulsory acquisition of the capital asset under law by Government. In the case of a charitable trust, if any part of the income or any property of the trust is used or applied directly or indirectly for the benefit of the author of the trust or any person who had made a substantial contribution to the trust or other specified persons, or if any funds of the trust are invested or deposited in any form or mode other than those specified, that part of the income is chargeable to tax.

An accountable person of an estate assessed under the Estate Duty Act, before settling the estate duty demand, created a charitable trust and made an oral gift of several properties out of the estate, to the trust under Mohammedan Law on 29 December 1972. One of the properties, a palace, so gifted was acquired by the State Government in September 1981, awarding a total compensation of Rs. 30,19,257. The entire compensation was directly paid by the State Government at the instance of the estate duty officer, towards part discharge of the estate duty dues of the settler of the property who was himself the author of the trust. The proportionate estate duty attributable to all the gifted properties amounted to Rs. 10,14,483 out of which about Rs. 3 lakhs was attributable to the acquired asset. While completing the assessment of the trust for the assessment year 1982-83 in October 1984, the assessing officer exempted the entire capital gains of the trust on the directions of the Inspecting Assistant Commissioner that the trust had not violated the provisions of the Act.

The acquisition of the property being transfer of capital asset, the profits arising therefrom are chargeable to capital gains tax and as the income by way of the capital gains had been applied indirectly for the benefit of the author of the trust by partial discharge of his estate duty liabilities, the trust was not eligible for exemption of its income. The capital gains was chargeable to tax in the assessment year 1982-83 as the property vested with the State Government in September 1981 on acquisition. The capital gains arising from the acquisition of the asset amounted to Rs. 16,66,270 duly taking into account among others, the cost of the asset as Rs. 4,00,000, the value at which it was assessed to estate duty and also allowing the estate duty of Rs. 3,00,000 attributable to the acquired property as a part of cost. Omission to tax the capital gains resulted in a short demand of tax of Rs. 10,76,858.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. Where the whole of the net consideration received from the transfer of a capital asset, not being a short term capital asset, is invested in any of the 'specified assets' within a period of six months after the date of transfer, the whole of the capital gains arising out of the transfer shall not be charged to income-tax. The Act as applicable upto the assessment year 1987-88 defines short term capital asset as one held by an assessee for not more than thirty six months immediately preceding the date of its transfer. With effect from the assessment year 1988-89, the period of 36 months has been reduced to 12 months in respect of capital asset being a share held in a company.

An assessee individual acquired 20,000 shares in a foreign company in the year 1970 at a cost of £ 26,958. The assessee received bonus shares in the rotio 1 : 1 in April 1979 (20,000 shares) and April 1981 (40,000 shares). The entire share holdings of 80,000 shares were sold in July 1983 for a consideration of Rs. 11,41,750 and the whole of the consideration was invested in time in specified assets. While completing the assessment for assessment year 1984-85 in March 1987, the assessee claimed and the assessing officer allowed the entire capital gains as exempt from tax. As, 40,000 shares out of the lot of 80,000 shares received as bonus shares, were held by the assessee for a period of less than 36 months, the capital gain arising out of their transfer amounting to Rs. 3,63,330 (assuming the exchange rate at the time of acquisition as the same as prevailing at the time of transfer) would be short term capital gain and would not qualify for the exemption. The mistake resulted in under assessment of income of Rs. 3,63,330 involving short levy of tax of Rs. 2,45,248.

The Ministry of Finance, have accepted the objection.

3. Where the captial gain arises to an individual from the transfer of a long term capital asset being a residential house and the assessee has within a period of one year before or after the date of transfer purchased or has within a period of three years after that date, constructed a residential house, the capital gains tax shall be charged only on the excess, if any, of the capital gain over the purchase price or cost of construction of the residential house.

An individual purchased a flat on 28 June 1982 for a consideration of Rs. 2,70,600, and sold her old flat for Rs. 9,50,000 on 6 July 1983. In the assessment made in March 1987, for assessment year 1984-85, the department treated the entire cost of new house (Rs. 2,70,600) as exempt in the computation of capital gain. Since the new flat was purchased more than one year before the sale of the old flat the exemption allowed was not correct. This mistake resulted in under-assessment of income of Rs. 1,85,203 with consequent short levy of tax of Rs. 1,25,039.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989, the reply from the Government has not so far been received (October 1989).

4. Where a residential house belonging to an individual, the income from which is chargeable under the head 'income from house property' and held for more than three years, is transferred, the long term capital gains arising therefrom will be exempt, provided the full value of consideration does not exceed Rs. 2 lakhs and he does not own on the date of transfer any other residential house other than residential house sold. In case where the consideration received or accruing exceeds Rs. 2 lakhs, the exemption will be allowed proportionately.

The Act as applicable upto the assessment year 1987-88 also provides that the long term capital gain arising from the transfer of any capital asset, not being a residential house, would be exempt from income-tax if the assessee, being an individual, had purchased a residential house one year before or after the date of transfer or sale of original asset or has constructed a residential house within three years after the date of transfer or sale of original asset. This position applied in a case where the individual completed the purchase or construction of the house in the previous year in which the capital gain arose and accordingly, the exemption from tax would be available. Where however, the purchase or construction was delayed and fell in the next or second or third previous year, the income-tax officer was empowered under Act to rectify the relevant assessment of the year in which the capital gains tax had been initially assessed. The Board clarified in September 1973 that in cases of delay as mentioned above the assessee should disclose the capital gains in the returns of income of the relevant year.

In the assessment of an individual for the assessment year 1987-88 completed in January 1988 under the summary assessment scheme, net long term capital gain of Rs. 4,752 on sale of a building for Rs. 11,00,000 was assessed as detailed in the assessee's return of income. The assessee had worked out the net capital gains of Rs. 4,752 after claiming proportionate exemption of Rs. 1,65,668 on account of owing the building for more than three years and Rs. 4,75,000 for his intention to utilise the sale proceeds for construction of a residential property. The total exemption of Rs. 6,40,668 thus claimed as aforesaid, was allowed by the assessing officer. Audit scrutiny, however, revealed that the exemption of Rs. 1,65,668 was not admissible as the building was not a residential house but was a commercial building used for running hotel and shops. Besides, in the absence of a specific provision in the Act upto the assessment year 1987-88 to exempt capital gains on the basis of mere intention to comply with the requirements of the law, the exemption of Rs. 4,75,000 was not in order.

The incorrect allowance of the exemptions resulted in under assessment of income of Rs. 3,20,334 with consequent short-levy of tax of Rs. 1,56,220 including interest for delay in filing of return.

The Ministry of Finance have not accepted the objection stating that the assessment was completed under the summary assessment scheme.

4.26 Incorrect computation of capital gains

Under the provisions of the Income-tax Act, 1961, as applicable from assessment year 1978-79, the capital gains arising on enhanced compensation awarded by a Court/Tribunal in respect of the assets acquired under any law, the department is empowered to issue a revised order within the specified time limit to bring to charge in the year of transfer the quantum of compensation which does not enjoy exemption. It has, however, been judicially held that when an award is passed for payment of enhanced compensation alongwith payment of interest thereon, the interest is liable to be charged to income-tax in the assessment year relevant to the accounting year in which it was received (144 ITR 270).

Two assessees were having 1/6 share each of 19.24 acres of land, which was acquired by a Town Planning Trust under the Land Acquisition Act, in March 1970. The assessing authority, while completing the assessments of these assessees, for the assessment year 1971-72 in March 1987, taxed the interest amount of Rs. 1,46,304 on the enhanced compensation, received by each of them for the period from January 1971 to January 1985 along with the income from capital gains, which was not correct. The interest income was, however, correctly assessable during the assessment year 1985-86, as it was determined in the previous year relevant to the said assessment year. Thus, interest income of Rs. 1,46,304 escaped assessment in respect of each one of the asessees for the assessment year 1985-86 leading to short levy of tax aggregating to Rs. 1,36,608.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

4.27 Mistakes in the assessment of firms and partners

1. Under the provisions of the Income-tax Act, 1961, if the assessment of the firm had not been completed, the share income from the firm is included in the assessments of the partners on provisional basis and revised later to include the final share income on completion of the assessment of the firm. For this purpose, the Income-tax Officer, is required under the instructions issued by the Central Board of Direct Taxes in March 1973 to maintain a register of cases of provisional share income so that these cases are not omitted to be rectified. No revision of assessment of partner can, however, be made under the Act, after the expiry of four years from the end of the financial year in which the final order was passed in the case of the firm.

The Central Board of Direct Taxes issued instructions in November 1981, that where the firm and its partners are assessed in different wards, the Income-tax Officer assessing the firm should communicate the share income of each partner to the Income-tax Officer having jurisidiction to assess such partners immediately after completion of the assessment of the firm and should insist for its acknowledgement by the other Income-tax Officer. The latter was also required to revise the assessments of the partners within three months of receipt of intimation of share income. These instructions were issued to ensure that the correct share incomes are assessed in the hands of the partners promptly and correct tax due to the Government is assessed and demand raised without loss of time.

Pursuant to the recommendations of Public Accounts Committee made in 85th Report (7th Lok Sabha 1981-82), the department issued fresh instructions in April 1983 for proper maintenance of provisional share income registers and adequate checking of the registers by Range Inspecting Assistant Commissioners and departmental audit parties. Reiterating the earlier instructions, the Board in their instructions issued in October 1984 also stated that there should be co-ordination between the assessing officers assessing the firm and the partners in the matter of ascertaining correct share income of partners and taking rectificatory action based on it. The Board issued clarificatory orders in February 1988 specifying that even in the assessment of partners completed in summary manner the remedial measures to rectify the mistakes could be taken.

Inspite of these instructions cases of failure to revise the share income of the partners consequent upon the completion of the assessments of the firm continues.

During test check in nine Commissioners charges for the assessment years 1980-81 to 1985-86, in the case of 14 registered firms, due to omission to revise the assessment of the partners of the firms consequent upon the assessment of the firms there was a short levy of the tax of Rs. 53,28,874.

The particulars of the cases are given below :

Sr. No.	State/Commissioner's charge	Assessment years	Partner's share income adopted	Share income as assessed	Under assessment	Tax effect
1	Madhya Pradesh/A	1980-81 1981-82 1983-84	94,96,822	1,32,83,747	37,86,925	27,01,992
2	Karnataka/B	1980-81 to 1983-84	18,92,289 (loss)	4,80,890	23,73,179	7,27,237
3	Madhya Pradesh/C	1983-84 to 1985-86	18,76,805	29,56,752	10,80,047	5,87,615
4	Tamil Nadu/D	1984-85 to 1985-86	1,87,703	5,26,918	3,39,215	2,09,713
5	Karnataka/B	1985-86	1,89,193	4,48,057	2,58,864	1,64,170
6	Madhya Pradesh/C	1982-83 to 1987-88	23,30,690	18,86,466	4,42,224	1,32,982
7	Karnataka/E	1985-86	2,04,872	4,22,358	2,17,486	1,28,852

8	Madhya Pradesh/C	1975-76 1980-81 1982-83	(—)6,03,518	(—)4,21,808	1,81,710	1,28,252
9	Tamil Nadu/D	1984-85	1,02,451	2,83,275	1,80,824	1,22,053
10	Karnataka/F	1984-85	36,526	1,81,689	1,45,163	1,15,782
11	Tamil Nadu/G	1981-82 1984-85	4,38,398	6,01,339	1,62,941	1,08,305
12	Karnataka/B	1986-87	68,456	2,45,060	1,76,604	1,04,770
13	Punjab/I	1985-86	50,234	2,40,080	1,89,846	97,151

The department has accepted the objection in two cases.

The Ministry of Finance have accepted the objection in principle in seven cases. The remaining paragraphs were referred to the Ministry of Finance for comments during April 1989 and August 1989; the reply from the Government has not so far been received (October 1989).

2. In the assessment of firms, the Income-tax Officer may treat an unregistered firm as a registered firm if the aggregate amount of tax payable by the firm and its partners, if it were assessed as a registered firm, would be greater than the aggregate amount of the tax payable by the firm and its partners as an unregistered firm.

(i) For the assessment years 1980-81 and 1984-85, an unregistered firm was treated as a registered firm and the assessments completed in March 1987. The aggregate tax payable by the firms and partners was determined as Rs. 10,11,167. Had the firm been assessed as an unregistered one, the aggregate amount of tax payable by the firm and the partners individually would be Rs. 13,03,710 which would be greater than the aggregate amount of tax acually levied. The mistake in treating the unregistered firm as a registered firm, resulted in a total short levy of tax of Rs. 2,92,543 for the two assessment years.

The Ministry of Finance have accepted the objection.

(ii) An assessee firm consisting of two partners was assessed for the assessment year 1985-86 in March 1988 on an income of Rs. 4,35,800 as an unregistered firm. The total tax (including interest) payable by the firm and its partners by treating the firm as unregistered firm amounted to Rs. 4,14,741. If the firm had been treated as a registered firm, the aggregate amount of tax payable by the firm and its partners including interest would work out to higher amount of Rs. 5,12,541. The mistake in not treating the firm as registered firm for fixing the tax demand resulted in total short levy of tax of Rs. 97,800 including interest for belated filing of returns and non payment of advance-tax.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4.28 Incorrect grant of renewal of registration

The application for renewal of registration of a firm is required to be signed personally by all the partners of the firm. If a partner is absent from India or is a lunatic or an idiot, the application may be signed by any person duly authorised by him in this behalf or as the case may be, by a person entitled under law to represent him. If this condition is not satisfied, the firm has to be treated as an unregistered firm.

In the assessment of a firm consisting of twelve partners, doing the business of contract for the assessment year 1982-83 assessed in March 1985 at a loss of Rs. 9,50,000, the prescribed declaration for renewal of registration was signed by only one partner, who had general power of attorney on behalf of all the other eleven partners and the continuation of registration was also granted by the assessing authority. There was no proof on record to show that all the other eleven partners were neither away from India, or lunatic or idiots. As such, the assessee should have been assessed as unregistered firm. The assessee was awarded, in an arbitration proceeding, by way of compensation, Rs. 14 lakhs towards loss of profitability etc., for his not being allowed to complete a contract work and earn the profits which was taken as loss while computing the income (loss) of Rs. 9,50,000 for the reason that the award of the arbitrator, for compensation of Rs. 14 lakhs, was stayed by the Civil Court, as the same was under appeal. The amount of Rs. 14,00,000 as per the award represented the profit that the assessee would have earned had the assessee been allowed to complete the contract. Accordingly, the amount of Rs. 14 lakhs, being not a real loss but a profit not earned should have been taken as a profit while computing the business income. This would result in a positive income of Rs. 4,50,000 as against loss of Rs. 9,50,000 for the assessment year 1982-83. The assessee firm had also not furnished the profit and loss account and balance sheet in respect of the return and the loss computed.

The failure to furnish the details of accounts in support of the loss returned by the assessee to assess the firm as an unregistered firm and the mistake in allowing the compensation for loss of profitability as a loss instead of as income by the assessing authority were pointed out in audit in November 1985. The department accepting the objection, reassessed the income of the assessee by estimating it at 11 per cent of the total gross receipts (Rs. 22.85 lakhs) and adding compensation for loss of profitability etc., (Rs. 14.56 lakhs) loss on account of idle labour (Rs. 9.88 lakhs) and the final bill of counter claims (0.42 lakhs). The fresh assessment resulted in a demand of tax of Rs. 23,28,889 being raised, including interest for short payment of advance-tax.

The Ministry of Finance have accepted the objection.

4.29 Incorrect grant of registration to a firm

1. The Income-tax Act provides that before the grant of registration to a firm, the assessing officer should, inter alia, enquire into its genuineness. It has been judicially held that a partnership firm formed in violation of State Excise Rules are not legal and such partnership firms are not entitled to registration. Departmental instructions to this effect, were also issued by the Central Board of Direct Taxes in June 1981.

A firm of 15 partners was constituted on 15 March 1983 for doing business in liquor. The firm was granted registration for the assessment year 1984-85 in March 1987 and tax on its total income was levied accordingly. It was pointed out in audit (January 1988) that :

(a) against the licence fee of Rs. 27,25,000 for which the liquor contract was awarded by the Excise Department, a sum of Rs. 3,05,120 was shown to have been paid as earnest money on 9 March 1983 (Rs. 2,75,000) and 31 March 1983 (Rs. 30,120). As the firm itself came into existence on 15 March 1983, the payment of Rs. 2,75,000 made on 9 March 1983 could not be said to have been made by the firm. Accordingly, the licence for running liquor business could not also be in the name of the firm but the assessing officer did not examine whether the firm held a valid licence in its name. Further, the assessing officer in his assessment order (March 1987) held that four partners of the firm had failed to prove the investment of Rs. 3,11,000 made in the firm and treated the amount as income of the firm from undisclosed sources. The assessing officer also stated that three lady partners had not appeared before him for verifying the genuineness of the firm. The assessing officer could not, therefore, be said to have satisfied himself that genuine firm had come into existence.

(b) the source of investment of Rs. 3,05,120 for earnest money deposited on 9 March 1983 and 31 March 1983 was stated to be out of capital accounts of the partners. However as per capital accounts of the partners, the contributions towards capital were made on 1 April 1983. Thus, the source of investment of Rs. 3,05,120 was not explained correctly and it was liable to be treated as assessee's income from undisclosed sources. The aforesaid mistakes in the assessment resulted in short levy of tax of Rs. 6,57,446 including interest for non payment of advance tax and belated filing of return.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989 ; the reply from the Government has not so far been received (October 1989).

2. Mutual agency and unlimited liability are the two essential elements in a partnership. It has been judicially held that the property given for maintenance of religious worship and charities connected therewith is not alienable. The property of a Hindu diety cannot ordinarily be alienated by the Shebaits (147 ITR 581).

An assessee was granted registration and assessed as a registered firm for the assessment year 1984-85. Out of the eleven partners in the firm three were 'Shebaits' representing three idols. According to the partnership deed, the idols had been made responsible for the losses in the partnership. Since the 'Shebaits' had made the idols responsible for all the losses in the partnership, as per verdict of the Supreme Court, the assessee firm was not entitled to the registration. This resulted in short levy of tax of Rs. 91,148 including interest for belated filing of returns and filing of untrue estimate.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4.30 Income escaping assessment

1. Under the Income-tax Act, 1961, where in any financial year, the assessee has made investments and the assessing officer finds that the amount expended on making such investments exceeds the amount recorded in this behalf in the books of account maintained by the assessee for any source of income and the assessee offers no explanation about such excess amount on the explanation, offered by him is not, in the opinion of the assessing officer satisfactory, the excess amount may be deemed to be the income of the assessee for such financial year. The Act also provides for levy of penalty on the concealed income.

(i) In the assessment of an individual for the assessment year 1980-81 completed in December 1981, the investment in construction of house property from January 1979 to March 1980 was accepted at Rs. 2,50,000 as shown by the assessee. Subsequently, the department made a search in the residential premises of the assessee in July 1985 and seized loose papers which indicated that the investment made in the construction of house property was more than that declared in the return of income for the assessment year 1980-81. The assessing officer therefore, made a reference to the valuation officer of the department for finding out the correct cost of construction of the house property. The departmental valuer in his report (January 1986) valued the cost of construction at Rs. 5,50,200. On the basis of the departmental valuer's report, the investment made in the house property exceeded the amount shown by the assessee by Rs. 3,00,200 (Rs. 5,50,200—Rs. 2,50,000). The excess amount was liable to be treated as income of the assessee for the assessment year 1980-81. The department did not, however, reopen the assessment already completed for this year to tax the difference of Rs.3,00,200. The mistake resulted in escapement of income of Rs. 3,00,200 with consequent short levy of tax of Rs. 2,09,274. Penalty for concealment of income was also required to be quantified.

The Ministry of Finance have accepted the objection.

(ii) In the case of an assessee firm, the Sales-tax Department raided its premises and seized books according to which the assessee had closing stock of Rs. 7,32,297 on 31 March 1982. As per copies of accounts filed with return of income the closing stock was Rs. 3,15,690. The difference in two sets of accounts called for addition of Rs. 4,16,607 in the taxable income of the assessee which was not done and eventually resulted in short levy of tax of Rs. 1,09,981 in the case of the firm and its partners.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. All income accuring or arising to an assessee in India in a previous year relevant to the assessment year is includible in the total income of that assessee.

(i) It has been judicially held (127 ITR 650) that interest awarded by the court on the amount of additional compensation of land, decreed to the owner of the land under the land acquisition proceedings, becomes the income of the person on the date of decree. As such the amount of interest received by an assessee consequent upon the passing of a decree, awarding the additional compensation, is assessable as income of the previous year in which the decree is passed.

Land measuring 17 acres, 2 kanals and 12 marlas owned jointly by five assessee individuals with equal status, was acquired by the State Government in March 1978. The compensation was enhanced in May 1982 from Rs. 20,000 to Rs. 1,40,000 per acre apart from allowing simple interest at the rate of 6 per cent per annum thereon under Courts orders. Share of each assessee in the interest income, amounted to Rs. 1,25,280 but in the assessment for the assessment year 1983-84 completed in August 1987, a sum of Rs. 34,923 only was subject to tax. This resulted in under-assessment of income of Rs. 90,357 in each case and consequent short levy to tax aggregating to Rs. 2,75,835.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) The wealth-tax return filed by an assessee individual showed that he had a balance of Rs. 30,02,696 representing compulsory deposit as on 31 March 1984 on which interest at 11 per cent worked out to Rs. 3,30,296. This amount was not returned by the assessee in the income-tax return filed for the previous year relevant to the assessment year 1985-86 nor was this amount brought to tax in the assessment completed in February 1988. Thus, an income of Rs. 3,30,296 escaped assessment for the assessment year 1985-86 resulting in short levy of tax of Rs. 2,04,370.

The Ministry of Finance have accepted the objection.

3. If the assessing officer has reason to believe that by reason of omission or failure on the part of the assessee, to make a return for any assessment year, or in consequence of information in his possession, has reason to believe that income chargeable to tax has escaped assessment for any assessment year, he shall call upon such an assessee to file return of income and assess such income.

An assessee individual was a partner in a registered firm. The share income from the firm allocated to the assessee for the assessment year 1983-84 was Rs. 7,643 as could be seen from the assessment of the firm concluded in October 1985. The assessee sold a dumper to the firm in April 1982 whose written down value on date of sale was Rs. 1,36,472 for a consideration of Rs. 2,00,577 and derived a profit of Rs. 64,105. The assessee had also received consultancy charges of Rs. 15,000 and Rs. 12,000 in the assessment years 1982-83 and 1984-85 on the basis of which the consultancy charges for the assessment year 1983-84 could be assessed at Rs. 12,000. However, the asessee did not file the return of income for the assessment year 1983-84.

Though the information regarding taxable income of the assessee was available with the department and the assessee had failed to file the return of income for the assessment year 1983-84, no action was taken to assess the escaped income. Omission to do so resulted in escapment of income of Rs. 83,748 and non-levy of tax of Rs. 1,26,103 including interest and penalty for non filing of the return and non-payment of advance-tax.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4. The total income of a person should include all income that accrues to him in India, during the previous year. Where an assessee maintains accounts according to mercantile system, the income computed for assessment should be the income actually earned though not realised, bringing into credit, what is due immediately it becomes legally due, even though it is not actually received during the year.

According to the terms of contract entered into by an assessee firm, engaged in construction activities, with a Public Sector Company, certain amounts were deducted from the bills payable for work done towards security deposit and retention money. These amounts being deductions from income retained to source fulfilment of obligations under the contract and being eventually receivable, were includible in the total income liable to tax, though not received immediately. It was, however, noticed that such deductions amounting to Rs. 2.50 lakhs out of the bills for work done for Rs. 100.15 lakhs during the previous year relevant to assessment year 1986-87 remained to be brought to tax in the assessment completed in December 1987. The omission resulted in escapment of income of Rs. 2.50 lakhs involving short levy of tax of Rs. 1.14 lakhs.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4.31 Incorrect/irregular set off of losses

1. It has been judicially held that if the income from certain property is not chargeable to income-tax under the provisions of the Income-tax Act, and could not, therefore, be included in the total income of the assessee, the question of determination of income or loss did not arise and such loss cannot be set off against income under any head chargeable to income-tax. It has also been judicially held that the income of an educational institution will be exempt only on that part of the income which has a direct relation or is incidental to the running of the educational institution (118 ITR 235, 111 ITR 42). Thus income of an educational institution from unexplained investment in house property can not be adjusted against the losses arising out of running of the educational institution.

In the assessments of an educational institution for the assessment years 1984-85 and 1985-86 completed in March 1987 and March 1988, unexplained investments in house property amounting to Rs. 2,26,500 and Rs. 2,99,950 respectively were held to be the income of the assessee from undisclosed sources. Such income was adjusted against the losses of Rs. 2,26,500 and Rs. 7,07,823 from running of the educational institution and the resultant income was determined at Rs. Nil and (–) Rs. 4,07,873 respectively. As the income from undisclosed sources was not exempt and the losses from running of the institution were not includible in the computation of total income, the entire income of Rs. 2,26,500 and Rs. 2,99,950 from undisclosed sources was to be taxed in the assessments for the assessment years 1984-85 and 1985-86 respectively. The mistake in not doing so resulted in total short levy of tax of Rs. 5,19,856 including interest for late filing of the returns and non payment of advance tax.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. The Central Board of Direct Taxes have, in their instructions issued in December 1988, clarified that if making summary assessments, adjustments to rectify arithmetical errors in the returns, accounts and documents, as also to give effect to the deduction of carry forward loss etc., with reference to past records have not been made, remedial action should be taken to rectify such mistakes.

(i) In the assessment of an individual for the assessment year 1985-86 completed in November 1987 the carried forward business loss of Rs. 1,73,049 was set off against income from other heads. As business loss of earlier years can be adjusted against business income only and not against income from other heads and for the assessment year 1985-86 the assessee had shown a business loss of Rs. 24,195, the above set off was not in order. The incorrect set off of business loss resulted in under-assessment of income of Rs. 1,73,059 involving short levy of tax of Rs. 1,05,669 including interest for delay in filing of return.

The Ministry of Finance have accepted the objection.

(ii) The assessment of an individual for the assessment year 1979-80 was completed in April 1987 after allowing set off of business loss of Rs. 1,49,422 which was brought forward from the assessment year 1975-76. It was, however, noticed in audit that the income from business during the assessment year 1979-80 was Rs. 35,076 only and the balance of income related to the income like capital gains and income from other sources. The quantum of loss actually available for set off was, therefore, Rs. 35,076 only. The excess set off of business loss to the extent of Rs. 1,14,346 resulted in short levy of tax of Rs. 85,501 including interest for late filing of return.

The Ministry of Finance have accepted the objection.

(iii) An unregistered firm was assessed on a net income of Rs. 33,760 in the assessment year 1983-84 after adjustment of losses of earlier years implying thereby that there was no further loss to be carried forward. However, losses of Rs. 1,02,607, Rs. 62,295, Rs. 27,196 and Rs. 31,693 were adjusted as unabsorbed carried forward losses in the assessment years 1984-85, 1985-86, 1986-87 and 1987-88 respectively assessed between May 1985 and November 1985. This resulted in short assessment of income to this extent in the assessment years 1984-85 to 1986-87 resulting in short levy of tax of Rs. 74,116.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3. Where the assessee is a registered firm, any loss which cannot be set off against any other income of the firm, shall be apportioned between the partners of the firm and they alone shall be entitled to have the amount of the loss set off and carried forward for set off.

While completing the assessment of a registered firm for the assessment year 1985-86 in January 1988, the assessing officer adjusted the brought forward loss of previous year amounting to Rs. 1,16,320 as claimed by the assessee. On scrutiny of the assessment records of the previous year, i.e., assessment year 1984-85, it appeared that the assessee had filed a loss return of Rs. 1,16,320 but in assessment it turned into a positive income of Rs. 66,280. Thus, the carry forward of loss of Rs. 1,16,320 from assessment year 1984-85 and its set off in assessment year 1985-86 was not in order. The mistake resulted in short computation of taxable income of Rs. 1,16,320 with consequent under charge of tax of Rs. 76,186 including interest in the hands of the firm and its three out of four partners.

The Ministry of Finance have accepted the objection.

4. No loss is allowed to be carried forward and set off against the profits of future years unless such loss has been determined in pursuance of a return filed by the assessee.

In the case of an unregistered firm for the assessment year 1984-85, assessed under the summary assessment scheme in September 1987, the loss of Rs. 63,831 relating to the assessment year 1983-84 was deducted from the business profits chargeable to tax. The assessee, however, had not filed any return of loss for the assessment year 1983-84 and as such no loss for this year had been determined. Incorrect alowance of this undetermined loss from the profits of the assessment year 1984-85 resulted in short computation of total income by Rs. 63,831 with consequent under charge of tax of Rs. 74,220 including interest for delay in filing of return and non-payment of advance-tax.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

IRREGULAR EXEMPTIONS AND EXCESS RELIEFS

4.32 Incorrect allowance of relief in respect of export turnover

1. Under the provisions of the Income-tax Act, 1961, as applicable upto the assessment year 1985-86, an assessee being an Indian company or other assessee resident in India engaged in export business of any goods or merchandise other than agricultural primary commodities, mineral oils, minerals and ores and such other goods notified and specified in this behalf was entitled to a deduction in the computation of taxable income of an amount equal to one per cent of the export turnover plus a further amount equal to five percent of incremental export turnover of such goods or merchandise, if the sale proceeds thereof were receivable in convertible foreign exchange. For this purpose, the export turnover has been defined to mean the sale proceeds of any goods or merchandise exported out of India, but does not include freight or insurance attributable to the transport of the goods, or merchandise, beyond the customs station as defined in the Customs Act, 1962 (52 of 1962).

(i) The Central Board of Direct Taxes clarified in January 1987 that rice is an agricultural primary commodity.

An assessee firm engaged in the export of rice, was allowed (November 1985 and October 1986) deductions of Rs. 1,47,310 and Rs. 2,78,972 on the export turnover during assessment years 1983-84 and 1985-86 respectively although rice is an agricultural primary commodity. The incorrect allowance of deduction resulted in under-assessment of income involving short levy of tax aggregating to Rs. 2,04,304.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(ii) In the assessment of an assessee registered firm engaged in the export of quartz and feldspat, for the assessment year 1985-86 completed in August 1987, a sum of Rs. 2,92,819 out of a sum of Rs. 3,78,996 claimed by the assessee was not allowed by the department as deduction in respect of profits on export turnover on the ground that quartz and feldspar exported were nothing but minerals. Audit scrutiny of records (August 1988) revealed that the assessee had claimed a total deduction of Rs. 3,78,996 which was made up of one per cent of total export turnover and five per cent of the incremental turnover. As the assessee firm was only engaged in the export of mineral for which the deduction is not admissible, the entire sum of Rs. 3,78,996 should have been disallowed. The omission to disallow the balance of Rs. 86,177 also resulted in short computation of income of like amount involving short levy of tax of Rs. 73,502 in the hands of firm and its partners including interest for delayed filing of return and short payment of advance-tax.

The Ministry of Finance have accepted the objection.

2. Under the provisions of the Act as applicable for the assessment years 1987-88 and 1988-89, an assessee being an Indian company or a person other than a company resident in India, engaged in business of export out of India of any goods or merchandise, during the previous year, shall be allowed, in computing the total income a deduction equal to the aggregate of 4 per cent of the net foreign exchange realisation and 50 per cent of so much of the profits derived from the exports of such goods or merchandise as exceeded the 4 per cent of foreign exchange realisation. However, the aggregate deduction allowable would not exceed the export profits. Further, to avail the aforesaid deduction, the assessee is required to create a reserve account (to be utilised for the purposes of the business) by debiting to the profit and loss account of the previous year in which deduction is claimed of an amount equal to the amount of deduction.

(i) A registered firm claimed and was allowed a deduction of Rs. 2,70,035 out of income from business of exports out of India, for the assessment year 1987-88 (assessment completed in March 1988). The firm had, however, created a reserve of Rs. 1,12,282 only and not an amount equal to the deduction claimed and as such the deduction was to be restricted to this amount. Omission to do so resulted in excess deduction of Rs .1,57,753 with consequent short levy of tax of Rs. 78,296.

The Ministry of Finance have not accepted the objection stating that the assessment was completed under the summary assessment scheme.

(ii) In the accounts of the previous year relevant to the assessment year 1986-87, a registered firm created a reserve for Rs. 35,000 only and became eligible for the deduction in respect of export turnover to the extent of Rs. 35,000. However, in the assessment completed in March 1988, a deduction of Rs. 1,54,879 for the export turnover was allowed without limiting the same to the amount of the reserve. The mistake resulted in under-assessment of income of Rs. 1,19,879 and short levy of tax of Rs. 74,320 in the hands of the firm and its partners.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(iii) In the assessment of a registered firm for the assessment year 1986-87 completed in February 1988, the assessing officer allowed a deduction of Rs. 1,16,904 from profits derived from export business though the assessee firm did not create the corresponding reserve account and as such was not eligible for the relief in respect of the export turnover. The incorrect allowance of relief resulted in under-assessment of income of Rs. 1,16,904 involving short levy of tax of Rs. 72,506 in the hands of the firm and its partners.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

4.33 Incorrect exemption in the case of co-operative society

1. Under the provisions of the Income-tax Act, 1961, in the case of an assessee co-operative society engaged in the collective disposal of the labour of its members, the whole of the amount of profits and gains of business attributable thereto shall be deducted in computing the total income of the assessee, provided the rules and bye laws of the society restrict the voting rights, inter-alia, to the individuals who contribute their labour.

In the case of an assessee co-operative society engaged mainly in the collective disposal of labour of its members by commercial exploitation of forest coupes, the bye laws of the society provided that any adivasi or social worker is eligible to acquire shares in the co-operative society and secure voting rights in the society without the necessity of having to contribute labour. Since under the bye laws of the society voting rights were not restricted to members who contribute labour, the society was not eligible for any exemption. However, in the computation of income for the assessment years 1981-82, 1982-83 and 1983-84 completed in

January 1984, March 1985 and March 1986 respectively, the assessee was allowed exemption of the income from the collective disposal of its labour in the same proportion as the number of members contributing labour bore to the total number of members. The mistake resulted in under assessment of income of Rs. 12,75,517 and short levy of tax of Rs. 5,61,226 for the three assessment years.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

2. The profits or gains of a co-operative society attributable inter alia, to banking business or providing credit facilities to its members, etc., are allowed as deduction in computing its taxable income. Certain deductions are allowed from the gross total income with reference to the nature of income. In respect of income by way of interest or dividend derived by a co-operative society from investments with any other co-operative society, the whole of such income is exempt from tax.

(i) In the assessment of a co-operative sugar mills assessed as 'association of persons' for assessment years 1983-84 and 1984-85 completed in March 1986 (revised in January 1987 and March 1987 respectively) the sums of Rs. 83,801 and Rs. 95,579 received as interest from its members on the advances made to them for purchase of manures, etc., were allowed as deduction in the computation of its taxable income. As the society was not engaged in the business of banking or providing credit facilities to its members and as the interest income was not derived from another co-operative society, the interest so received was not eligible for exemption. The incorrect exemption allowed resulted in short computation of income by Rs. 83,801 and Rs. 95,579 for the two assessment years involving short levy of tax aggregating to Rs. 79,883.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

(ii) In the case of an assessee, a co-operative society, in the computation of income for the assessment year 1983-84, assessment for which was completed in February 1986, the gross amount of Rs. 1,52,493 being interest from other co-operative societies was considered as fully exempt and excluded from the gross total income but the same amount was again included in the computation of the net income eligible for exemption. Further, gross income of Rs. 96,044 from dividend from co-operative societies was allowed full exemption without restricting it to the net income from the source. Besides, while working out the proportionate expenditure relatable to the exempt income a sum of Rs. 1,13,000 was considered as expenditure even though it formed part of a contra entry in the profit and loss account whole of which had been excluded in the computation. The above mistakes resulted in under-assessment of income of Rs. 1,49,366 and short levy of tax of Rs. 74,699 including excess grant of interest for excess payment of advance-tax.

The Ministry of Finance have accepted the objection.

4.34 Incorrect allowance of relief in respect of profits from newly established industrial undertaking prior to 31 March 1981

1. Under the provisions of Income-tax Act, 1961, prior to its amendment by the Finance Act, 1980, where the gross total income of an assessee included any profits and gains derived from newly established undertaking which went into production before 1 April 1981, the assessee became entitled to tax relief in respect of such profits and gains upto 6 per cent per anum ($7\frac{1}{2}$ per cent from 1 April 1976) of the capital employed in the industrial undertaking in the assessment year in which the undertaking began to manufacture or produce articles and also in each of the four succeeding assessment years in the normal course and in each of the six succeeding assessment years in the case of co-operative society. Where, however, such profits and gains fell short of the relevant amount of capital employed during the previous year the amount of such shortfall or deficiency was to be carried forward and set off against future profits upto the seventh assessment year reckoned from the end of initial assessment year.

(i) An assessee firm was allowed (between March 1986 and March 1988) deductions amounting to Rs. 89,751, Rs. 1,44,608, Rs. 88,387 and Rs. 2,02,347 in the four assessment years 1982-83 to 1985-86 in respect of an industrial undertaking which showed losses of Rs. 10,00,400, Rs. 9,64,694 Rs. 11,64,571 and Rs. 9,37,895 in these assessment years. As there were no profits from this industrial undertaking, deductions were allowed from other profits and gains of the assessee which was not in order as losses could only be carried forward to be adjusted against profits and gains, if any, from the industrial undertaking in the following assessment years. The allowance of irregular deduction led to underassessment of income of Rs. 89,751, Rs. 1,44,608, Rs. 88,387 and Rs. 2,02,347 in the four assessment years 1982-83 to 1985-86. Besides, income of Rs. 2,600 on account of profit on sale of import entitlement and Rs. 39,899 on account of incentive subsidy in octroi account, escaped assessment in assessment year 1985-86 resulting in further under assessment of income by Rs. 42,499 with aggregate short levy of tax of Rs. 3,92,067 in the hands of the firm and its partners.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) An assessee co-operative society, running a dairy started functioning in the previous year relevant to the assessment year 1974-75, and was entitled to the deduction upto assessment year 1980-81. However, in the assessment for the assessment years 1981-82, 1982-83, 1983-84 assessments whereof were completed in August 1985 such deduction was allowed resulting in excess relief of Rs. 6,65,490 and short levy of tax aggregating to Rs. 2,79,616.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(iii) In the assessment of a registered firm for the assessment year 1986-87, tax holiday relief to the extent of Rs. 1,46,154 for that year and also a sum of Rs. 1,22,016 as carried forward relief in respect of the previous assessment year 1985-86 was allowed. The relief allowed was in respect of profits and gains derived by the assessee in respect of its new industrial unit, the income whereof was being returned by the assessee firm from the assessment year 1980-81 and accordingly the said relief could be available to the assessee only upto and inclusive of assessment year 1984-85. The allowance of tax holiday relief for the assessment years 1985-86 and 1985-87 was, therefore, not in order. The mistake resulted in under assessment of income by Rs. 2,68,170 involving a total short levy of tax of Rs. 1,32,695 in the hands of firm and its partners.

The Ministry of Finance have accepted the objection.

(iv) In the case of a registered firm, the assessing officer had incorrectly allowed carry forward and set off of a relief of Rs. 71,683 against the income of assessment year 1984-85 (assessment completed in February 1987) although according to assessment record for the assessment year 1983-84, no such relief was to be carried forward and adjusted. The incorrect carry forward and set off of relief of Rs. 71,683 resulted in short levy of tax of Rs. 62,580 in the hands of firm and its partners.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

4.35 Non-Levy/incorrect levy of interest

1. Under the provisions of the Income-tax Act, 1961, where on making the regular assessment, the Income-tax Officer finds that an assessee has not sent a statement of advance-tax payable by him computed in the manner laid down in the Act, or has not sent an estimate of his current income and the advance-tax payable by him on the current income and has also not paid any advance-tax, simple interest at the rate of 12 per cent (15 per cent from 1 October 1984) per annum from the first day of April next following the financial year upto the date of regular assessment shall be payable by the assessee on the amount of assessed tax.

(i) The regular assessment of an individual for the assessment year 1979-80 was completed on 7 March 1988 with a tax demand of Rs. 43,13,869. The interest payable by the assessee on the assessed tax for failure to file a statement/estimate of advance-tax and for non payment of advance-tax was, however, levied only upto 16 March 1982, the date on which a draft assessment order had been proposed by the assessing officer. The assessee having obtained an order of stay from the High Court (17 March 1982) against the proceedings in his case, the regular assessment was concluded only in March 1988 after the stay was got vacated in February 1988. Interest leviable upto the date of regular assessment (7 March 1988) was not, however, redetermined to cover the entire period from 1 April 1979 to 7 March 1988. This resulted in short levy of interest of Rs. 34,18,742.

The Ministry of Finance have accepted the objection.

(ii) The assessment of an individual for assessment year 1985-86 was completed in February 1988 and revised in August 1988 on a revised taxable income of Rs. 7,85,690. The assessee had neither filed any statement of advance-tax nor paid any advance tax and was, therefore, liable to pay an interest amounting to Rs. 1,64,475 which was, however, not levied.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(iii) While completing the assessment of an individual for the assessment year 1985-86 in March 1988, the period from April 1985 to February 1988 for which interest was chargeable for non submission of estimate of advance-tax was incorrectly taken as 12 months instead of 35 months. The mistake resulted in short levy of interest of Rs. 89,746.

The paragraph was refered to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. Any demand for tax should be paid by an assessee within thirty five days of service of notice of demand and failure to do so would attract simple interest at 12 per cent (15 per cent from 1 October 1984) per annum from the date of default. Under the Income-tax Rules, 1962, where the demand is not paid before the end of the financial year, interest is to be calculated upto the end of the financial year and a demand notice issued within a period of thirty days from the end of the financial year. In April 1982, the Board issued instructions clarifying that the interest is to be calculated on the basis of the date of service of original demand notice on tax finally determined in cases of assessments set aside or varied by appellate authority and the fact that during the intervening period there was no tax payable by the assessee under any operative order would make no difference to the position. In November 1974, the Central Board of Direct Taxes issued instructions that interest for belated payment of tax should be calculated and charged within a week of the date of final payment of tax demand.

(i) The assessment for assessment year 1980-81 of a registered firm was completed in September 1983 and the notice of demand for Rs. 17,30,787 served in September 1983 became due for payment in October 1983. In the revision made in December 1983, the demand was reduced to Rs. 13,92,545. This was partially collected to the extent of Rs. 9,81,167 between March 1985 and April 1985 by adjustment against the refund due to the assessee for the assessment years 1981-82 to 1984-85. For the belated payment of tax, the assessing officer should have charged interest. Further, under the Income-tax Rules, interest was also chargeable for the balance of tax demand of Rs. 4,11,378 outstanding on 31 March 1987. However, no such interest was charged for the delay in payment of tax. This led to aggregate non levy of interest of Rs. 4,01,930.

The Ministry of Finance have accepted the objection.

(ii) The original assessment of a registered firm for the assessment year 1980-81 was completed in July 1984 and subsequently revised in February 1986 raising a net tax demand of Rs. 12,27,442. Out of this, a sum of Rs. 3,99,509 was collected in January 1987 and March 1987. The assessment was further revised in October 1987 to give effect to appellate orders and the demand reduced to Rs. 3,16,750 resulting in a refund of Rs. 82,759. However, interest amounting to Rs. 1,15,487 for the belated payment of tax was not charged.

The Ministry of Finance have accepted the objection.

(iii) In the case of an assessee individual a tax demand of Rs. 28,10,328 was raised on 27 July 1987 which was required to be paid before 9 September 1987. The amount was paid in instalments and the last instalment of Rs. 15,06,959 was paid five months after the expiry of specified date. Thus, the assessee was liable to pay interest amounting to Rs. 94,180 for the delay in payment of the taxes due but no action was taken to levy the interest.

The Ministry of Finance have accepted the objection.

(iv) An individual assessee was served with a demand notice on 27 September 1984 to pay tax of Rs. 2,13,425 for the assessment year 1979-80 (assessment completed in September 1984). This demand was subsequently reduced to Rs. 1,97,830 on 24 March 1988 as a result of appellate orders. While serving demand notice in March 1988, interest for non payment of tax for the period from November 1984 to February 1988 was calculated as Rs. 9,890 only instead of the correct sum of Rs. 98,900 resulting in short levy of interest of Rs. 89,010.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

3. Where the return of income for an assessment year is furnished after the specified date, the assessee is liable to pay simple interest at 15 per cent (from 1 October 1984) per annum from the date immediately following the specified date to the date of furnishing the return, on the amount of tax payable on the total income as determined on regular assessment as reduced by the advance-tax, if any, paid and any tax deducted at source.

(i) An assessee, a registered firm, filed the return of income for the assessment year 1986-87 (previous year ending on 30 June 1985) on 28 December 1987 i.e., after a delay of 17 months. While completing the assessment in March 1988, the assessing authority levied interest of Rs. 72,694 as against the correct amount of Rs. 2,47,170 leviable for belated filing of return. The mistake was due to the calculation of interest for a period of five months only instead of for 17 months. This resulted in a short levy of interest of Rs. 1,74,476.

The Ministry of Finance have accepted the objection.

(ii) Prior to the assessment year 1985-86, for calculation of interest in the case of a registered firm, the tax payable on the total income shall be the amount of tax which would have been payable on the total income if the firm had been assessed as an unregistered firm.

While finalising the assessments of a registered firm for the assessment years 1983-84 and 1984-85 in September 1986 and March 1987 respectively, the department levied interest for belated submission of return and for short payment of advance tax. For the assessment year 1984-85, the department levied interest for belated submission of return on the basis of tax payable by the registered firm instead of calculating the interest on the basis of tax payable as unregistered firm. Further, the department incorrectly applied the rate of 12 per cent for the entire period without charging interest at the higher rate of 15 per cent from October 1984. The mistakes together with minor arithmetical errors led to total short levy of interest of Rs. 79,107.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

4. If a person responsible for deducting tax at source does not deduct or after deducting fails to pay the tax as required by or under the Income-tax Act, he/it shall be liable to pay interest at 12 per cent (15 per cent from 1 October 1984) per annum on the amount of such tax from the date on which such tax was deductible or deducted, to the date on which the tax is actually paid.

During the previous years relevant to the assessment years 1980-81 to 1984-85 an unregistered firm deducted tax at source aggregating to Rs. 4,72,737 on interest paid by it. The firm was required under the Act to credit this tax deducted at source to the Government account but the firm did not deposit the same and apportioned the same keeping them under unpaid liabilities apparently for long periods ranging from 2 to 7 years. As a result huge amounts of taxes deducted at source remained unpaid long after its deduction. Besides, there was no details of payment or indication of payment of any tax except for the assessment year 1980-81, in the absence of which exact position of taxes due to Government but not actually paid was not ascertainable. Failure to deposit the tax deducted at source to the cerdit of the Central Government rendered the assessee also lible to pay interest. No such interest was, however, levied by the department. The omission led to non levy of interest aggregating to Rs. 2,83,375 calculated upto 28 February 1986 in respect of the aforesaid five assessment years.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in May 1989; the reply from the Government has not so far been received (October 1989).

5. Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of interest other than income chargeable under the head "Interest on scrurities", shall, at the time of credit of such income to the account of the payee or at the time of payment thereof, whichever is earlier, deduct income-tax thereon at the rates in force, and pay the sum so deducted to the credit of the Central Government. In the event of failure to do so, he shall be liable to pay penal interest at the rate of twelve per cent (fifteen per cent from 1 October 1984) per annum on the amount of such tax, from the date on which such tax was deductible to the date on which such tax is actually paid.

During the previous years relevant to the assessment years 1983-84, 1984-85 and 1985-86, a registered firm paid by way of interest on outstanding loans of Rs. 4,00,062, Rs. 2,12,083 and Rs. 2,05,957 respectively to a closely held company but no tax was deducted at source from these payments. For failure to deduct tax at source, the assessee firm was liable to pay penal interest of Rs. 85,761 till November 1986 which, however, was not levied.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

4.36 Omission to levy penalty

1. The Income-tax Act, 1961 as amended from the assessment year 1985-86 and onwards has made it obligatory for every assessee whose total sales, turnover or gross receipts in business exceed forty lakh rupees in any previous year to get his accounts audited by an authorised accountant before the due date for submission of the return of income and obtain report of such audit in the prescribed form within the due date. Failure to get the accounts audited and to obtain the audit report within the due date renders the assessee liable to a penalty equivalent to one half per cent of the turnover or one lakh rupees, whichever is lower. The Central Board of Direct Taxes issued instructions in June 1985 that for assessment year 1985-86, the penalty proceedings should not be initiated provided the audit report prescribed has been obtained by 30 September 1985 and the self assessment tax has been paid within the normal period prescribed under the Act for filing of return of income. The Board had also issued instructions in July 1964 and again in September 1975 that where the Income-tax Officer does not initiate penalty proceedings in any case, he should record the reasons for not doing so.

(i) In the case of 48 assessees, 43 registered firms, 2 unregistered firms, one co-operative society and two individuals, the returns of income for the assessment years 1985-86, 1986-87 and 1987-88 were filed alongwith the prescribed audit reports of Chartered Accountants after the expiry of due dates specified for each of the assessment years, as the due date for obtaining the audit reports expired on 30 September 1985 for the assessment year 1985-86 and 30 June 1986/30 June 1987 for the assessment years 1986-87 and 1987-88 respectively. Though the assessees were liable for penalty for the delay, in the assessments completed between March 1986 and

December 1988, the assessing officer did not initiate any penalty proceedings or keep a note of the reasons for not initiating the proceedings. The assessments of 15 cases were completed under the summary assessment scheme. At the rate of one half per cent of the turnover or Rs. 1 lakh whichever is lower, the penalty leviable in these cases aggregated to Rs. 31,71,266 for the three assessment years.

The department has accepted the objection in 3 cases.

(ii) Twenty nine registered firms, one Hindu undivided family and an individual filed the audit reports of Chartered Accountants for the assessment years 1985-86 to 1987-88 before the specified date as extended by the Board but the self assessment tax payable within the normal period prescribed for filing the return was paid only after the due dates. In the assessment of all these 31 cases completed beween September 1985 and April 1988 (11 out of these being assessed under the summary assessment scheme) the assessing officer did not initiate proceedings for levy of penalty for non-compliance with law nor recorded any reasons for not doing so. Penalty leviable on this account would work out to Rs. 21,05,699.

The department has accepted the objection in 2 cases.

(iii) The total sales of five assessees, four registered firms and a co-operative society for the assessment years 1985-86, 1986-87 and 1987-88 assessed during December 1985 to March 1988 (four cases assessed in a summary manner) had exceeded Rs. 40 lakhs. The assessees were as such required to get their accounts audited by authorised accountants and furnish the report of such audit in the prescribed form alongwith the return of income. The statutory audit reports were neither attached with the return nor insisted upon by the assessing officer. For failure to observe the statutory provisions the assessees were liable to pay penalty totalling Rs. 3,01,329 for these three years which was not imposed.

The Ministry of Finance have accepted the objection in two cases.

The remaining paragraphs were referred to the Ministry of Finance for comments between May 1989 and August 1989 ; the reply from the Government has not so far been received (October 1989).

2. Under the provisions of the Income-tax Act, 1961, no person shall after 30 June 1984, take or accept from any other person any loan or deposit of Rs. 10,000 (Rs. 20,000 from 1 April 1989) or more otherwise than by an account payee cheque or an account payee bank draft subject to certain exceptions. Any person contravening these provisions without reasonable cause can be proceeded against at the instance of the Commissioner and then he is, inter alia, liable to pay fine equal to the amount of such loan or deposit. The Central Board of Direct Taxes has directed that in cases where the Income-tax Officer did not initiate penalty proceedings, he should record reasons for not doing so.

The assessments of two firms for the previous years relevant to the assessment years 1985-86 and 1987-88 were completed in September 1987 and March 1988 respectively. It was noticed from the prescribed audit reports filed with returns of income that the assessees accepted loans/deposits in cash amounting to Rs. 2,82,000 i.e. in excess of prescribed limit of Rs. 10,000. The assessing officer neither initiated prosecution proceedings nor recorded any reasons for not initiating action. The total fine leviable in the two cases on successful completion of the proceedings worked out at Rs. 2,22,000.

The Ministry of Finance have not accepted the objection on the plea that the assessment was complated under the summary assessment scheme. The fact, however, remains that there is no bar under the scheme. for initiation of penalty proceedings.

OTHER TOPICS OF INTEREST

4.37 Non-disallowance of expenditure in excess of Rs. 2,500 paid otherwise than by crossed cheque/draft.

The Income-tax Act, 1961, provides for disallowance of expenditure incurred in business or profession for which payment is made for any amount exceeding Rs. 2,500 (since raised to Rs. 10,000 from 1 April 1989) otherwise than by crossed cheque or a crossed bank draft. This provision was designed to counter evasion of tax through claim for expenditure shown to have been incurred in cash with a view to frustrating proper investigation by the department as to the identity of the payee and the reasonableness of the amount. Some cases and circumstances in which exemption from this requirement can be claimed have been provided in the Rules. A residuary provision made in this regard states that exemption can be allowed where the assessee satisfies the Income-tax Officer not only about the genuineness of the payment and identity of the payee but also on the fact that the payment could not be made by a crossed cheque/draft due to exceptional or unavoidable circumstances, or to the impracticability of payment or to avoid causing genuine difficulty to the payee, having regard to the nature of the transaction and the necessity for expeditious settlement thereof.

It has been judicially held (167 ITR 139) that to claim the benefit to the provision of this Rule, it is not sufficient to establish the genuineness of purchases and identity of the payee, the assessee should also be further required to prove that the circumstances mentioned in the Rule existed, and the required conditions were satisfied and in the absence of such evidence such payments are not deductible in the computation of income.

Under the Act as made applicable from the assessment year 1985-86, assessees carrying on business or profession if their total sales, turnover or gross receipts exceeded the specified limit should file in respect of their accounts for a previous year, an audit report furnished by a Chartered Accountant in the prescribed form, to facilitate the assessing officer in allowing the claim for deduction. The form of Audit Report provides for the auditor to list out payments in excess of Rs. 2,500 made otherwise than by crossed cheque or crossed bank draft.

In the case of 10 assessee registered firms, in the audit reports enclosed to their returns of income for the assessment years 1985-86 to 1987-88, Chartered Accountants had listed out payments in each case exceeding Rs. 2,500 made otherwise than by crossed cheque/bank draft to the extent of Rs. 1,20,80,094. There was no indication whether these payments were made in exceptional circumstances as provided under the Rules. No claim for exemption from disallowance was made nor were the circumstances of departure of the provision of law explained by the assessee or their auditors in the accounts enclosed to the return. In the assessments completed in all the cases under summary assessment scheme, no amounts were disallowed by the assessing officer while making the assessments between March 1985 to March 1988. The omission to add back these un-explained payments resulted in a short levy of tax aggregating to Rs. 74,36,135.

The Ministry of Finance have not accepted the objection in three cases justifying that the assessment was completed under the summary assessment scheme.

The paragraph in the remaining one case was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

4.38 Non observance of the provisions of law relating to contractors

Under the Income-tax Act, 1961, and the rules framed thereunder where any contractor enters into a contract with any other person for carrying out any work or the supply of goods or services in connection therewith, the value of which exceeds rupees fifty thousand, he shall within one month of entering into a contract, furnish to the assessing authority particulars of the contract in the prescribed form. In the event of failure to furnish such particulars, the Commissioner of Income-tax may impose a fine not exceeding Rs. 50 for every day of default subject to a maximum of 25 per cent of the value of the contract.

It was noticed that in 36 cases assessed in different wards under the charges of two Commissioner of Income-tax, the assessees failed to furnish the particulars of contracts exceeding Rs. 50,000 in the prescribed form during the assessment years 1981-82 to 1987-88 assessed between November 1985 and March 1988. In all these cases no action had been initiated by the department either to call for the statutory statement or to invoke the penal provisions of the law. The maximum fine imposable in these cases as per scales laid down in the Act amounted to Rs. 32,50,800.

The paragraph was referred to the Ministry of Finance for commens in August 1989; the reply from the Government has not so far been received (October 1989).

4.39 Incorrect set off of short term capital loss

While computing the income of an assessee individual for the assessment year 1983-84 in December 1983, the assessing officer allowed a set off of short term capital loss of Rs. 17,60,199 on sale of 1,77,998 shares worth Rs. 17,79,980 of a private limited company in which the assessee was a Director. The assessee had subscribed to these shares valued at Rs. 10 each in November 1981 by transferring his right to receive a sum of Rs. 17,77, 200 from another company in which he was the Managing Director upto June 1975 and paying cash of Rs. 2,780. The assessment records revealed that the assessee had a right to receive a sum of Rs. 17,77,200 from the company in which he was the Managing Director as he had made payment of Provident Fund arrears of an identical amount to the Provident Fund Authorities during the period January 1976 to January 1978 i.e after he had relinquished the post of the Managing Director to avoid his prosecution by the Provident Fund Authorities as the arrears pertained to the period when he was the Managing Director of that company. The shares valued at Rs. 10 each were sold at a value of 10 paise per share within a year of its subscription, which resulted in short term capital loss of Rs 17,60,199. The copy of the sale deed was not available on record. Information regarding the person to whom the shares were sold and the reasons for selling them at a very low price of 10 paise per share were also not available on records.

It was noticed in audit that the latter company was declared a Relief Undertaking with effect from 9 May 1977 under the Bombay Relief Undertaking Act and hence the amount due to the assessee was not recoverable. Hence the entire transaction of transfer of the right to receive the sum of Rs. 17,77,200 and the purchase of the shares at Rs. 10 per share and the subsequent sale of the shares during the very next year was apparently intended to work out a loss with a view to reduce the incidence of tax. The assessing officer should, therefore, have enquired into the whole transaction in detail before allowing the set off of a loss. The set off of short term capital loss of Rs. 17,60,199 without any detailed enquiry resulted in under assessment of income of Rs. 17,60,199 involving short levy of tax of Rs. 11,39,539.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received. (October 1989).

4.40 Delay in completion of set aside assessment

Under the provisions of the Internal Audit Manual of the Income-tax Department remedial action should be taken on objection raised by Internal Audit within a period of three months. The Central Board of Direct Taxes and the Directorate of Inspection (Audit) of the Department have repeatedly emphasised the need for taking action on internal audit objections within the prescribed time limit. The Manual also lays down that the Assessing Officer (Administration) and Internal Audit Party should ensure prompt remedial action in the field officers of objections raised by audit.

The regular assessment of a specified Hindu undivided family for the assessment year 1981-82 was completed in March 1984 by the assessing officer estimating the total income at Rs. 50,000. The internal audit party of the department while scrutinising the assessment observed (September 1984) that the assessee himself had estimated the income at Rs. 1,38,960 for advance tax purposes and that the income from house property and agricultural income were not considered. Based on this, the assessment was set aside by the Commissioner of Income-tax in March 1986 as prejudicial to revenue. Though the Inspecting Assistant Commissioner directed the assessing officer to note the case in the register prescribed for keeping watch over pending assessments, no entry was made in the register and no action for completing the assessment was taken till the date of audit (July 1987).

The internal audit also did not ensure follow up action.

The Ministry of Finance have not accepted the objection stating that delay in taking remedial action was due to the non co-operation of the assessee. The fact, however, remains that no watch was kept on completion of fresh assessment after the original assessment was set aside in March 1986 and there was a delay of over 16 months at the time of audit and that the assessment was actually revised in March 1988 only on the eve of time bar.

4.41 Delay in completion of reassessment

The assessments of a registered firm engaged in the business of shipping, forwarding and clearing of goods for assessment years 1972-73 and 1973-74 were originally completed in December 1972 (revised in September 1973) and March 1974 on taxable incomes of Rs. 1,73,340 and Rs. 2,11,300 respectively. Based on an application filed by the assessee firm, the Settlement Commissioner passed orders in February 1983 directing certain items of receipts to be brought to tax by reopening the assessments after taking the concurrence of the assessee. Scrutiny of the records revealed (September 1988) that the assessee firm in its letter of March 1984 conveyed its consent for reopening the assessments and also filed revised return of income offering additional income of Rs. 63,178 and Rs. 95,169 for the two assessment years. However, even after a lapse of four years no action was initiated by the department to revise the assessments as directed by the Settlement Commission. This resulted in the non levy of an aggregate additional tax of Rs. 1,31,986 in the hands of the firm and its partners for the two assessment years.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4.42 Loss of revenue due to non completion of assessment in time

Under the provisions of Income-tax Act, 1961, the assessment proceedings are to be completed within two years from the end of the relevant assessment year or within one year of the date of filing of a voluntary return or revised return, whichever is later.

An assessee individual filed a voluntary return for the assessment year 1982-83 on 12 December 1984 showing an income of Rs. 15,000 the assessment whereof was completed on 10 March 1986 at Rs. 1,19,170. The assessment was, further, revised on 29 June 1987 to enhance the amount of interest chargeable for failure to file estimate of advance tax. On an appeal by the assessee against the assessment order dated 10 March 1986 holding that time available for completion of assessment being one year from the date of filing the return i.e. before 12 December 1985, the Commissioner (Appeals) nullified the assessment as having been made beyond the prescribed period of limitation. Thus non completion of assessment in time resulted in loss of revenue of Rs. 1,00,471 including interest for belated filing of return and short payment of advance tax.

The Ministry of Finance have accepted the objection.

CHAPTER 5

OTHER DIRECT TAXES

A—WEALTH TAX

5.01 In the financial years 1984-85 to 1988-89, wealth-tax receipts as against budget estimates were as given below :

Year	Budget estimates	Actuals	Percentage of variation
		(In crores of rudees)	
1984-85	97.00	107.58	10.91
1985-86	104.00	153.44	47.54
1986-87	100.00	174.15	74.15
1987-88	120.00	100.58	(—)16.18
1988-89	120.00	122.48*	2.06

5.02 Particulars of cases finalised, assessments pending and demand in arrears for the five years ending 31 March 1989 are given below :

Year	Number of assessments completed during the year	Number of cases pending assessment at the end of the year	Arrears of demand pending collection at the end of the year
			(In crores of rupees)
1984-85	4,75,833	4,53,575	211.25
1985-86	5,78,386	4,15,662	237.42
1986-87	10,65,944	4,68,762	204.42
1987-88	9,23,182	3,78,499	283.22
1988-89*	6,95,326	3,19,267	405.99

*Provisional.

5.03 During the test audit of assessments made under the Wealth-tax Act, 1957, conducted during the period 1 April 1988 to 31 March 1989 the following types of mistakes were noticed :

(i) Wealth escaping assessment

(ii) Non-levy of wealth-tax on companies

(iii) Incorrect valuation of assets

(iv) Incorrect computation of net wealth

(v) Incorrect exemptions

(vi) Mistakes in application of rate of tax/ calculation of tax

(vii) Non-levy/Short-levy of additional wealth-tax

(viii) Non-levy of penalty and interest

(ix) Delay in completion of assessment.

A few important cases illustrating these mistakes are given in the following paragraphs. 7 of these cases were checked by the Internal Audit of the department, but the mistakes were not detected by it.

5.04 Wealth escaping assessment

1. The need for a proper co-ordination amongst the assessment records pertaining to direct taxes to ensure overall improvement in the administration of these taxes has been repeatedly emphasized by the Public Accounts Committee (Paragraphs 4.12 and 4.13 of 186th Report—Fifth Lok Sabha and Paragraph 1.19 of 61st Report—Sixth Lok Sabha). The Central Board of Direct Taxes have also issued instructions (November 1973 and April 1979) for proper co-ordination amongst assessment records pertaining to different direct taxes with a view to bring to tax cases of evasion of tax.

(i) The wealth-tax assessments of five Hindu undivided families for the assessment year 1983-84 (valuation date 31 March 1983) were completed in December 1987 and January 1988 by the Inspecting Assistant Commissioner (Assessment). The income-tax records of these assessees disclosed that the assessees were partners in a partnership firm upto 31 December 1981 with equal share. The firm was dissolved on 31 December 1981 and the business of manufacture and sale of biris was taken over by a private company, but the right to four different 'trade marks' of the dissolved firm was retained by the assessee partners. On the next day, viz., 1 January 1982, the assessees made an agreement with private company according to which the private company was permitted to use two of the four 'trade marks' for its business for a period of five years with stipulation to extend it for another five years, on payment of royalty at the rate of 50 paise per 1000 biris sold. The amount of royalty was agreed to be paid individually to each of the five assessees in equal share.

The amount of royalty paid by the company to the assessee during the previous year ending 31 March 1983 relevant to the assessment year 1983-84 was Rs. 19,80,866 and the average income in this respect during the five years was Rs. 20,28,930. Since 'trade marks' were assets having monetary value, their value was chargeable to wealth-tax. It was noticed in audit (March 1989) that neither the assessees had showed them in their returns of net wealth nor were they included by the assessing officer while completing the assessments for the assessment years 1982-83 and 1983-84. If the average income of Rs. 20,28,930 is capitalised by taking a multiplier of at least five, the fair market value of the two 'trade marks' alone under 'income capitalisation method of valuation' would be Rs. 1,01,44,650 apart from the value of the other two 'trade marks' to be determined. Omission to correlate wealth-tax cases with those of income-tax records thus resulted in escapement of wealth of Rs. 1,01,44,650 with consequent short levy of tax of Rs. 5,07,230 in the hands of all the five Hindu undivided families for the assessment year 1983-84. Further. penalty provisions for concealment of wealth were also attracted. The value of 'trade marks' will also be required to be taxed in assessment year 1982-83.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(ii) Audit scrutiny of the income-tax records of an individual for the assessment years 1981-82 to 1987-88 revealed (May 1988) that his main sources of income were from four proprietory concerns and that he had huge credit balances in those concerns. Though the taxable wealth was approximately Rs. 9.09 lakhs, Rs. 12.13 lakhs, Rs. 15.59 lakhs, Rs. 18.70 lakhs, Rs. 14.25 lakhs, Rs. 25 lakhs and Rs. 32.60 lakhs for the seven assessment years respectively, neither the assessee had filed any wealth-tax returns nor had the department initiated any wealth-tax proceedings. Omission to act on the basis of information available in the income-tax records resulted in wealth aggregating to Rs. 127.36 lakhs escaping assessment, resulting in non-levy of tax of Rs. 1,96,956, besides levy of interest and penalty for these years.

The paragraph was referred to the Ministry of Finance for comments in February 1989; the reply from the Government has not so far been received (October 1989).

2. Where assets are held by a trustee on behalf of some other persons wealth-tax shall be levied upon and recoverable from the trustee in like manner and to the same extent as it would be leviable from the person for whose benefits the assets are held.

(i) A private trust was created in February 1980 by a company for the benefit of its employees. The trust filed its return of income for assessment years 1982-83 to 1985-86 and was assessed in the status of an association of persons in the assessments completed between March 1985 and February 1986. Audit scrutiny, however, revealed (January 1987) that the assessee had not filed any wealth-tax return for these assessment years nor had the department initiated any wealth-tax proceedings.

On being pointed out in audit in January 1987, the department completed the wealth-tax assessment in February 1988 raising an aggregate wealth-tax demand of Rs. 1,75,869.

The paragraph was referred to the Ministry of Finance for comments in February 1989; the reply from the Government has not so far been received (October 1989).

(ii) The income-tax assessment records of an individual for the assessment years 1971-72 and 1979-80 to 1983-84 disclosed numerous additions on account of unexplained cash credits, fictitious liability in the balance sheet and interest thereon being made to the relevant assessment holding that these represented assessee's own income from undisclosed sources. Though the additions so made in the income-tax assessments were assessable to wealth-tax, it was, however, noticed in audit (December 1988) that such additions to the tune of Rs. 12,60,000, Rs. 20,95,000 and Rs. 6,83,500 were not charged to wealth-tax in the wealth-tax assessment for the assessment years 1979-80, 1982-83 and 1983-84 completed in March 1984, March 1987 and February 1988 respectively. The omission resulted in escapement of wealth of Rs. 40,38,500 and short levy of tax of Rs. 1,74,700.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3. Wealth-tax shall not be payable by an assessee in respect of any property held by him under a trust or other legal obligation for any public purpose of a charitable or religious nature in India. However, when such property is used or applied directly or indirectly for the benefit of any person mentioned in this behalf in the Act, wealth-tax becomes leviable.

(i) The income-tax assessment records of a charitable trust disclosed that the trust funds had been diverted in favour of the porhibited persons, mentioned in the Income-tax Act, 1961, during the previous year relevant to the assessment year 1983-84 and the exemption earlier granted to the assessee trust under the Income-tax Act, 1961, had been withdrawn in the re-assessment made in March 1987. The assessee trust thus became liable to wealth-tax. It was, however, noticed that the trust had not filed any return of wealth nor had any action been initiated by department to call for any return and complete the assessment. The capital of the trust as on valuation date relevant to the assessment year 1983-84 being Rs. 38,45,500, wealth to that extent has escaped assessment resulting in short levy of tax of Rs. 1,36,982.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(ii) The wealth-tax assessments of an individual for the assessment years 1985-86 and 1986-87 were completed in November 1986 on a taxable wealth of Rs. 3,57,800 and Rs. 4,89,900 accepting the wealth as returned by the assessee. For assessment year 1984-85, no wealth-tax return was filed by the assessee claiming the entire lands owned by him as agricultural land and exempt from wealth-tax although on sale of 27.5 cents of land for Rs. 2,87,250 in February 1984, the assessee was subjected to capital gain tax in the assessment year 1984-85. The claim of the assessee was, however, accepted by the department. Scrutiny of records (June 1987) revealed that the assessee inherited in July 1975, five acres ninety seven and a half cent of land through a family partition. Under a family arrangement in June 1983, the assessee valued the entire land at Rs. 12,50,000 and after setting apart Rs. 2,00,000 for the marriage of minor daughter, the balance of Rs. 10,50,000 was shared equally among his wife and minor son. The entire land was, however, taken over by the assessee by executing pronotes in favour of his wife and minor son for their respective one-third share in the land. It was noticed that the assessee had returned only one-third share in the value of land as his wealth for assessment years 1985-86 and 1986-87, although he was the owner of the entire land. On the basis of sale value in February 1984, the market value of the entire land would work out to Rs. 62,38,758 and after allowing Rs. 9,00,000 towards liability for pronotes executed, the net taxable wealth which escaped assessment would be Rs. 51,28,580 involving an aggregate short levy of tax of Rs. 6,30,540 for the three assessment years 1984-85 to 1986-87.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(iii) An assessee and her husband were joint owners of a fixed deposit of Rs. 45,00,000. The said fixed deposit was assessed in the hands of husband upto the assessment year 1981-82 and in the hands of the assessee herself in the assessment for the assessment year 1983-84. Consequent upon the death of her husband in May 1981, the value of the said fixed deposit along with accrued interest thereon amounting to Rs. 49,50,000 was includible in the net wealth of the assessee for the assessment year 1982-83. However, neither the assessee disclosed this sum in her wealth-tax return for the assessment year 1982-83 nor did the assessing officer consider the same in the assessment completed in January 1987. This resulted in escapement of net wealth of Rs. 48,00,000 (after allowing exemption of Rs. 1,50,000 involving non-levy of tax of Rs. 1,86,085.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(iv) The wealth-tax assessment of an assessee, for the assessment year 1980-81 was completed in November 1984. The comparison of the returns filed by the assessee, for the assessment years 1979-80 and 1980-81 revealed that against 6,406 shares valued at Rs. 9,36,557 returned for the assessment year 1979-80, only 246 shares valued at Rs. 35,726 were returned for the assessment year 1980-81. Difference of 6,160 shares valued at Rs. 8,94,617 in the returns of two years was reported by the assessee as having been transferred to a smaller Hindu undivided family as a result of partial partition of the family. Though the partial partition was not recognised by the department, yet the Wealth-tax Officer omitted to include the value of the shares in the net wealth of the assessee. Besides, the assessee had shown a reserve of Rs. 2,50,000 as 'marriage fund' of his child in the return for the assessment year 1979-80 but the same was not added to the net wealth of the Hindu undivided family while completing the assessment for the assessment year 1980-81. The omissions to add back the above amounts in the wealth of the assessee for assessment year 1980-81 resulted in total under assessment of wealth of Rs. 11,44,617 and short levy of wealth-tax of Rs. 53,910. Both the omissions were repeated in the assessment for the year 1981-82 resulting in further under assessment of net wealth of Rs. 11,31,619 and consequent short levy of tax of Rs. 42,633. The total short levy of wealth-tax thus worked out to Rs. 1,01,907.

On the omissions being pointed out in Audit in December 1986, the department created additional demands of Rs. 45,595 and Rs. 44,531 for the assessment years 1980-81 and 1981-82 respectively in June and November 1987.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

4. The value of a tax payer's right to receive an annuity purchased by him or purchased by another person in pursuance of a contract with the tax payer, will be reckoned as his asset irrespective of whether the annuity is commutable or not. Further, the value of the assessee's right or interest in any policy of insurance will be exempt from wealth-tax, if the premia thereon are payable for a period of 10 years or more. Where the premium or other payment is payable for a period of less than 10 years, proportionate exemption is admissible.

In the wealth-tax assessments of an individual, a film artiste, for the assessment years 1982-83 to

1984-85 completed in March 1987, the value of the annuities purchased by the producers on his behalf and held by him, was omitted to be included in the wealth returned by him and thus escaped assessment. Adopting the present value of the annuity policies as furnished by the assessee (in the absence of the details of each and every annuity on record) the omission resulted in short levy of tax of Rs. 83,913 for the three assessment years.

The Ministry of Finance have accepted the objection.

5. Under the Wealth-tax Act, 1957, in computing the net wealth of an individual, there shall be included as belonging to that individual, the value of assets which, on the valuation date, are held by his/her spouse or by the son's minor children, to whom such assets have been transferred directly or indirectly, otherwise than for adequate consideration.

(i) In August 1980, an individual sold her immovable property to a trust created by her husband for the benefit of her two grand children for a declared consideration of Rs. 2,75,000 as against the value determined by the Departmental Valuation Officer at Rs. 5,78,000 (November 1980). For the purpose of income-tax assessment the said trust was held to be not genuine and its corpus and income were assessed in the hands of its author. Accordingly, the value of the property was assessable in the hands of the assessee in the assessments concluded in March 1986, March 1987 and March 1988 for the assessment years 1981-82, 1982-83 and 1983-84 respectively, but the value of the property was not included in the wealth of the assessee. The trust also has not filed any return of wealth for these assessment years. The omission resulted in under assessment of wealth of Rs. 5,78,000 for each of the three assessment years leading to an aggregate non-levy of tax of Rs. 78,744.

The Ministry of Finance have accepted the objection in principle.

(ii) The wealth-tax assessments of three assessees for the assessment years 1984-85 and 1985-86 and of one assessee for the assessment year 1984-85, were completed between June 1985 and February 1986. The assessees were partners in a firm, each having one-fifth share. The firm was dissolved in March 1983. The firm had encashed fixed deposit of Rs. 20,69,999 on the date of its dissolution. The assessees however, did not include their one-fifth share of Rs. 4,14,000 each in the said fixed deposit in their respective wealth-tax returns for the above mentioned assessment years. The department did not also include it in the assessments made for the assessment years 1984-85 and 1985-86. The omission resulted in under-assessment of wealth aggregating to Rs. 28,98,000 involving short levy of tax of Rs. 73,258.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

6. In the case of an individual being a citizen of India or a resident and ordinarily resident in India under the provisions of the Income-tax Act, 1961, the assets and debts located outside India are to be included in the computation of net wealth. It has been judicially held (53 ITR 547) that for the purposes of being resident in India a member of a Hindu undivided family will be deemed to have maintained a dwelling place in India during the relevant previous year if the Hindu undivided family had maintained a dwelling place. The tax in respect of the foreign wealth is, however, subject to certain rebates.

In the case of an assessee individual, who was a citizen of India and who left India in December 1976 and thereafter made periodical visits to India, his residential status under the Income-tax Act for the assessment years 1978-79 to 1982-83 was determined as non-resident on the grounds that he did not stay in India for 182 days or more in any of the previous years and he did not maintain a dwelling place in India. Audit scrutiny (February 1988) of income-tax assessment records of the assessee disclosed that the assessee was member of a resident Hindu undivided family which maintained a dewelling place in India and by virtue of which the assessee's presence in India for 30 days or more would make him resident in India for the assessment years 1980-81 to 1982-83. For the assessment year 1978-79, the assessee had one source of income for which he was resident and in consequence he should be deemed to be resident for all other sources of income for that year. Further, since the assessee was a resident in nine of the ten previous years with reference to the relevant assessment years and was in India for a period in all amounting to 730 days or more during the seven previous years preceding the relevant previous years, he should be deemed to be resident and ordinarily resident in India for the assessment years 1978-79 and 1980-81 to 1982-83. However, in the wealth-tax assessments for the assessment years 1978-79 and 1980-81 to 1982-83, completed in March 1983, February 1985 and March 1985, considering the status of the assessee as non-resident incorrectly, assets located outside India were excluded from the net wealth. The incorrect determination of residential status of the assessee resulted in escapement of wealth of Rs. 45,30,030 with consequent undercharge of tax of Rs. 62,789 (approximately).

The Ministry of Finance have accepted the objection.

5.05 Non-levy of wealth-tax on companies

Companies, other than companies in which the public are substantially intesested, are liable to wealth-tax from the assessment year, 1984-85 at a flat rate of 2 per cent of the market value of the specified assets including building or land appurtenant thereto other than building or part thereof used by the assessee as factory, godowns, warehouse, hotel or office for the purposes of its business and their value which shall be estimated to be the price which in the opinion of the Wealth-tax Officer, they would fetch if sold in the open market on the valuation date.

1. In the income-tax assessments of a private limited company for the assessment years 1984-85 and 1985-86 completed in February 1988, the claim of the company that income by way of rent received by it on letting out of its immovable property was assessable as business income, was rejected by the assessing officer on the ground that the business of the assessee had come to an end long time back and the rental income was assessable to income-tax as 'income from house property'. Since the immovable property was not being used by the assessee for its business purposes, its market value was assessable to wealth-tax from assessment year 1984-85 onwards under the provisions of the Finance Act, 1983. The book-value of the immovable properties on the valuation date(s) relevant to the assessment years 1984-85 and 1985-86 was Rs. 7,21,979. However, on the basis of the rent of Rs. 2,12,594 and Rs. 2,96,450 received in these two years, the net maintainable rent came to Rs. 1,60,932 and Rs. 2,25,785 capitalising the net maintainable rent by the multiple of 10, the fair market value of the properties under 'rent capitalisation method' for the assessment years 1984-85 and 1985-86 would work out to Rs. 16,10,000 and Rs. 22,58,000 respectively. The fair market value for the subsequent years, viz., assessment years 1986-87 and 1987-88, would not be less than the value of Rs. 22,58,000 for the assessment year 1985-86 (the rent figures for these years were not available on record). Thus, the amount of wealth escaping assessment for the assessment years 1984-85 to 1987-88 worked out to Rs. 83,84,000 on which wealth-tax payable was Rs. 1,67,680. Penalty provisions for non-filing of the returns were also attracted. The company did not file the wealth-tax returns for the assessment years 1984-85 to 1987-88 nor did the department initiate any wealth-tax proceedings.

The Ministry of Finance have accepted the objection.

2. The income-tax assessment records of a private limited company (a closely held company) for the assessment year 1987-88 indicated that the company owned lands and buildings of net aggregate value of Rs. 82 lakhs (approximately) on which the company was liable to pay wealth-tax. The company, however, did not file its return of wealth nor did the department take action to call for the same. The omission resulted in escapement of wealth of Rs. 82 lakhs and non-levy of tax of Rs. 1,64,000. The company was also liable to pay tax for the earlier assessment year 1986-87.

The Ministry of Finance have accepted the objection.

5.06 Incorrect valuation of assets

1. *Immovable properties*

Under the Wealth-tax Act, 1957, the value of any property shall be estimated to be the price which it would fetch if sold in the open market on the valuation date.

The methods generally adopted to estimate the market value of buildings are 'land and building method' and 'income capitalisation method'. It has been judicially held (100 ITR 621) that the 'income capitalisation method' is ideally suited for valuation of commercial properties.

(i) In the wealth-tax assessment of non-resident individual for the assessment years 1984-85 to 1986-87 completed in July 1986 and January 1987, the value of a building let out for commercial purposes was taken at Rs. 20,11,920 on the basis of the report of a registered valuer valuing the land on the land and building method. A scrutiny of the income-tax assessment records of the assessee disclosed that the building in question was let out at a rent of Rs. 48,105 per month. Since the 'income capitalisation method' is ideally suited for estimating the fair market value of a commercial building, the fair market value of the buiding with a net maintainable rent of Rs. 4,56,000 per annum would work out to Rs. 50,66,000 as against the value of Rs. 20,11,920 adopted. As the value of the asset returned on the basis of the estimate made by a registered valuer was far less than its fair market value, the matter should have been referred to the Departmental Valuation Cell for determining the correct market value. The omission to do so resulted in under-assessment of wealth by Rs. 91,62,240 and aggregate short levy of wealth-tax of Rs. 3,31,000.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

(ii) Two individuals having one-third share each in a house property in a metropolitan city returned the value of their share as Rs. 3,53,334 as on 31 December 1984 and 31 December 1985 relevant to assessment years 1985-86 and 1986-87. Accepting the value, the assessing officer completed the wealth-tax assessments of the individuals for assessment years 1985-86 and 1986-87 in October 1986 and October 1987/November 1987 respectively. A scrutiny of the income-tax records of the assessee revealed (June 1988) that the property had been let out for commercial purposes and that the rental income derived by each assessee from the property was Rs. 2,49,933 per annum. The fair market value of the building should, therefore, have been determined under income capitalisation method and on this basis the value of one-third share would work out to Rs. 23,14,188 as against Rs. 3,53,334 returned and adopted. Omission to adopt the correct value of the property resulted in under assessment of wealth by Rs. 19,60,854 involving an aggregate short levy of wealth-tax of Rs. 1,54,842 for the two assessment years in the hands of both the assessees.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

(iii) Two individuals representing the Hindu undivided family were equal partners in a registered firm during the assessment year 1984-85. Two more partners were admitted to the firm from the assessment year 1985-86 and the profit sharing ratios were changed to one-fourth each. The firm owned several godowns which were let out to a corporation at an average yearly rent of Rs. 3,65,990. The book value of the above godowns was shown in the balance sheets of the firm at Rs. 14,58,311 Rs. 13,93,395, Rs. 13,31,724 and Rs. 12,73,139 relevant to the assessment years 1984-85 to 1987-88 respectively. But under the income capitalisation method, the fair market value of the properties in each of the assessment years would work out to Rs. 29,70,540. While completing the wealth-tax assessments of these assessees for the assessment years 1984-85 to 1987-88 (assessments completed between September 1985 and August 1987), the assessing officer had taken into account the book value of these godowns instead of adopting the market value as prescribed under the Act. Failure to adopt the correct market value of the immovable properties resulted in total undercharge of wealth-tax of Rs. 82,354.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(iv) While completing the wealth-tax assessment of an assessee in February 1986 and September 1987, the department adopted the value of an immovable property in a metropolitan city at Rs. 3,80,000 and Rs. 7,50,000 for the assessment years 1980-81 and 1981-82 respectively. However, in the wealth-tax return for the assessment year 1982-83 filed in March 1987, the assessee had himself returned the value of the same property at Rs. 50,50,000 on the basis of a transaction of sale registered in July 1982. In view of the considerable difference between the value adopted for earlier assessment years and the value declared by the assessee on the basis of his own sale transaction for the assessment year 1982-83, the Wealth-tax Officer should have re-opened the assessments for the earlier assessment years to bring to tax the wealth escaping assessment. Assuming that the value of the property appreciated at 10 per cent every year, the under-assessment of wealth for the assessment years 1980-81 and 1981-82 was Rs. 37,93,554 and Rs. 38,40,909 respectively with consequent aggregate short levy of wealth-tax of Rs. 3,07,931 for the two assessment years.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

(v) The provisional wealth-tax assessment for assessment year 1982-83 of a specified Hindu undivided family was completed in April 1984 on a net wealth of Rs. 11,86,500 as returned by the assessee in April 1983. The net wealth returned and assessed included two pieces of land valued at Rs. 2,50,000 and Rs. 1,30,000 respectively. Audit scrutiny of wealth-tax records for assessment year 1983-84 revealed that for the same properties, the assessee had returned a value of Rs. 21,00,000 and Rs. 5,25,000 in the return filed in March 1984 and that value had been accepted and adopted in the assessment order. For the assessment year 1982-83, there was, therefore, an aggregate under valuation of property to the extent of Rs. 22,45,000 in the provisional assessment resulting in short levy of wealth-tax of Rs. 1,06,637. Verification of the assessment records in March 1989, however, revealed that the regular assessment had not yet been completed and the case had become time barred. The omission to complete the regular assessment for assessment year 1982-83 before the time limit prescribed under the Act adopting value of the two sites as returned by the assessee for the assessment year 1983-84 had resulted in a loss of revenue to the extent of Rs. 1,06,637.

The Ministry of Finance have accepted the objection.

(vi) The Wealth-tax Act, 1957, provides that Wealth-tax Officer may make a reference to the Departmental Valuation officer for the valuation of assets where the value as returned on the basis of registered valuer's report, in his opinion, is less than its fair market value and the fair market value of the asset exceeds the value of the asset as returned, by more than 33⅓ per cent or Rs. 50,000. The Act also provides that the order of the Valuation Officer in respect of the asset shall be binding on the assessing officer. As per executive instructions issued by the Central Board of Direct Taxes (June 1970), where the value of the property in respect of any assessment year is more than 25 per cent of the declared consideration in respect of any earlier year, the assessment of the earlier years should be re-opened for re-valuation of the property.

(a) For the assessment years 1981-82 and 1982-83, the assessee returned value of immovable properties at Rs. 2,44,650, which included the value of 1,08,900 square ft. of land with some buildings thereon at Rs. 1,04,650. At the time of assessments for the assessment years 1981-82 and 1982-83, completed in March 1986 and March 1987 respectively the assessing officer adopted the value of above land at Rs. 4 lakhs and house property thereon was valued at Rs. 44,500. Audit scrutiny revealed (December 1987) that the case was referred to the Valuation Officer in August 1984 for valuation of properties on the valuation dates relevant to assessment years 1975-76 to 1981-82. Though the actual valuation could not be made due to non-cooperation of the assessee, the Valuation Officer intimated (February 1986) that the fair market value of land on the valuation date (March 1981) would be Rs. 12 per square ft. and that of house property at Rs. 72 per square ft. On this basis, the value of 1,08,900 square ft. of land would work out to Rs. 13,06,800 and the value of 6,350 square ft. of built-up area thereon would amount to Rs. 2,28,600, after allowing 50 per cent depreciation for old construction, against which the value of property was adopted as Rs. 4,44,500 in assessment for both the assessment years even though valuer's intimation was received much before the completion of assessments.

Further, the assessments for the assessment years 1979-80 and 1980-81 were completed in March 1984 and March 1985 determining the value of the property at Rs. 5,87,200 and Rs. 4,25,650 respectively. But the assessments for these two years were not re-opened for re-valuation as per executive instructions, though the value shown by the valuer for subsequent years was much higher. On the basis of the values determined for assessment years 1981-82 (as per rates of the valuer) the value of this property, considering a 10 per cent appreciation in value each year and working backwards would come to Rs. 12,43,670 and Rs. 13,81,860, on the valuation dates relevant to assessment years 1979-80 and 1980-81 respectively. Non-adoption of the value intimated by the Valuation Officer and omission to re-open the assessments for re-valuation of properties for earlier years resulted in under-assessment of wealth of Rs. 37,94,480 in aggregate and short levy of tax of Rs. 1,04,989.

The paragraph was referred to the Ministry of Finance for comments in June 1989, the reply from the Government has not so far been received (October 1989).

(b) In the case of an assessee the value of a hotel building for wealth-tax purposes was taken as Rs. 13,64,306 for the assessment years 1971-72 to 1976-77 and 1980-81 while finalising the assessments in March 1985. The income-tax assessment records for these assessment years disclosed that the Departmental Valuation Officer had assessed the cost of building at Rs. 14,59,958 after allowing deduction of Rs. 1,18,375 at the rate of seven and half per cent of the cost on account of supervision, etc. done by the assessee himself. The value of an undeveloped piece of land was assessed by him at Rs. 1,61,254. Non-adoption of value of properties as determined by the Departmental Valuation Officer resulted in under assessment of wealth of Rs. 3,75,300 with consequent short levy of tax of Rs. 76,050.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(c) A Hindu undivided family owning two pieces of land adjacent to each other, within the municipal limits of a capital city, constructed four buildings consisting of six flats each on one of the plots and returned the value of the property at Rs. 3.30 lakhs as on the valuation date relevant to assessment year 1976-77. The Wealth-tax Officer adopted the value at Rs. 7.40 lakhs in assessment completed. In the fresh assessment completed in March 1987 to give effect to the order of Commissioner of Wealth-tax (Appeals), the Wealth-tax Officer arrived at a value of Rs. 15.60 lakhs in respect of the property as on 31 March 1976. On the basis of the valuation made by the District Valuation Officer in December 1980 at Rs. 7.40 lakhs as on 31 March 1973, and the sale price realised in 1979 in respect of one of the twenty four flats and actual sale of a portion of the land made by the assessee in 1982, (the agreement for sale of which had been entered into in 1981), the Wealth-tax Officer had arrived at a value of Rs. 29.40 lakhs as on 31 March 1981, in respect of this property. By spreading over the increase in value of Rs. 22 lakhs from 31 March 1973 to 31 March 1981 evenly, the value of Rs. 15.60 lakhs as on 31 March 1976 had been arrived at. However, it was noticed in audit that the value of this property had been determined at Rs. 16 lakhs in the assessments for the assessment years 1978-79, 1979-80 and 1980-81 completed in March 1988. It was pointed out in Audit that on the principle followed in the re-assessment for assessment year 1976-77 made in March 1987, when the value of the properties in question was determined at Rs. 15.60 lakhs by the Wealth-tax Officer, the same should be considered at Rs. 21 lakhs, Rs. 23.75 lakhs and Rs. 26.50 lakhs respectively for the assessment years 1978-79 to 1980-81. Failure to adopt such progressively increased values resulted in under assessment of wealth of Rs. 5 lakhs, Rs. 7.75 lakhs and Rs. 10.50 lakhs respectively for the aforesaid three assessment years involving an aggregate short levy of tax of Rs. 92,950.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

2. *Unquoted/quoted equity shares*

(i) Under the Rules framed under the Wealth-tax Act, any amount representing tax deducted at source appearing in the asset side of the balance sheet of an assessee is to be included for determining the value of total assets for the purpose of valuation of unquoted equity shares.

The net wealth of two individuals and a Hindu undivided family (specified) for the assessment years 1981-82 and 1982-83 included value of 12,000 unquoted equity shares of a private limited company. In completing the assessments for the assessment years 1981-82 and 1982-83 in February 1986 and March 1987, the assessing officer while valuing the shares of the company omitted to include the sum of Rs. 59,63,260 and Rs. 73,96,697 respectively representing tax deducted at source in the total value of assets of the company. Non-inclusion of these sums resulted in undervaluation of break-up value of shares by Rs. 253.47 and Rs. 314 per share for the assessment years 1981-82 and 1982-83 respectively. The incorrect valuation of shares resulted in aggregate under assessment of wealth of Rs. 41,95,495 and short levy of tax of Rs. 2,18,932.

The Ministry of Finance have accepted the objection in all the cases.

(ii) Under the Wealth-tax Rules, 1957, the market value of unquoted equity shares of company is to be computed with reference to the balance sheet drawn up on the relevant valuation date and where there is no such balance sheet, the balance sheet drawn up on a date immediately preceding the valuation date and in the absence of both, the balance sheet drawn up on a date immediately after the valuation date.

(a) The net wealth of an individual, inter alia, included 3,750 unquoted equity shares of a company for the assessment years 1979-80 and 1980-81 and 7,500 shares for the assessment years 1981-82 and 1982-83, while for the assessment years 1980-81 to 1982-83 it also included house sites measuring 13,673 square yards. The assessee returned the value of the sites at Rs. 1.84 per square yard approximately for the assessment years 1980-81 to 1982-83 and the value of unquoted equity shares at Rs. 16.20 per share for the assessment year 1979-80 and at Rs. 18 per share for the assessment years 1980-81 to 1982-83 and the values so returned were accepted by the assessing officer. It was, however, observed from the wealth-tax assessment records of another assessee, assessed in another ward in the same circle that the market value of the equity shares of the same company was worked out as Rs. 40.41 per share and Rs. 50.34 on the valuation dates 31 March 1979 and 31 March 1981, while the market value of house site in the same locality was adopted at Rs. 75 per square yard for the assessment year 1981-82. Failure to adopt the correct market values of the house sites and equity shares in the case of the assessee resulted in short levy of wealth-tax of Rs. 99,567.

The Ministry of Finance have accepted the objection.

(b) For the purpose of wealth-tax assessment, according to the instructions issued by the Central Board of Direct Taxes in September 1957 if an assessee is assessed within a State in which there is a recognised stock exchange the rate of shares quoted in that stock exchange should be adopted as the value of such shares. However, if there is no recognised stock exchange in that State the price quoted in the recognised stock exchange located in a State nearest to the State in which the assessee is assessed may be adopted.

Three assessees held shares in a limited company called 'Motor and General Finance Company', New Delhi, in the State of Punjab and the shares of this company were being quoted between Rs. 30.50 to Rs. 35 per share at Delhi Stock Exchange on the valuation date relevant to the assessment years 1983-84 to 1987-88. While completing the assessment of wealth-tax in respect of these assessees the value of the shares was, however, taken at Rs. 12 to Rs. 13, based on a quotation in respect of a company called 'MGF Bombay' at Bombay Stock Exchange. The valuation adopted at such a low quotation of another company resulted in under assessment of wealth to the extent of Rs. 51.99 lakhs and on aggregate short levy of tax of Rs. 61,732. On this audit point of view the Department maintained that 'Motor and General Finance Company' and 'MGF' are one and the same company and therefore it did not accept the audit point of view. This, however, only goes to strengthen the point of view of Audit.

As the assessees were based in Punjab, the quotation in Delhi Stock Exchange in respect of the relevant shares should be the right quotation for assessing the value of the shares. On the contrary the quotation in Bombay Stock Exchange which is not the nearest to the State in which the assessees were assessed might be due to a kind of distress sale, otherwise there could not have been such a wide variation in the value of the shares. In the light of Board's instructions, 1957 the higher quoted rates of shares at Delhi Stock Exchange which is nearest to assessees' assessment charge should have been adopted.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3. *Partner's share interest in partnership firm*

Under the Wealth-tax Act, 1957, where an assessee is a partner in a firm, the value of his interest in the net assets of the firm is to be included in his net wealth. The Wealth-tax Rules, 1957, provide that where the market value of any asset exceeds its book value by more than 20 per cent the market value is to be substituted for the book value. The Act also provides that the valuation done by the Departmental Valuation officer on a reference by the assessing officer is binding on the Wealth-tax Officer.

A firm, inter alia, owned an immovable property. For the purpose of wealth-tax assessments of one of the partners of the firm, the assessing officer referred the matter of valuation of the aforesaid property to the Departmental Valuation Cell which determined the value of the property at Rs. 1,51,74,100 and Rs. 1,53,16,300 as on 31 March 1982 and 31 March 1983 relevant to the assessment years 1982-83 and 1983-84 respectively. Though the department had taken into account the aforesaid value of property in the case of other partners, in the case of three partners while completing their wealth-tax assessments for the assessment years 1982-83 and 1983-84 between November 1986 and March 1987, the Wealth-tax Officer took the book value of Rs. 15,27,801 and Rs. 15,30,185 of the property and did not adopt the higher market value of the firm's property determined by the Departmental Valuation Cell for the purpose of valuation of their share interest in the firm. The incorrect adoption of the book value of the property instead of the market value of assets of the firm for valuation of share interest of three assessees, resulted in aggregate under-assessment of net wealth of Rs. 43,23,574 (except in one case in which the assessment was pending) with consequent short levy of tax of Rs. 1,59,724.

The department has accepted the mistake in principle.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

5.07 Incorrect computation of net wealth

1. An individual, who was one of the co-owners of an estate, agreed (May 1982) to sell his one-half share for a consideration of Rs. 28,00,000. In his wealth-tax assessments for the assessment years 1983-84, 1984-85 and 1985-86 completed in July 1986, the assessee claimed and was allowed a deduction of Rs. 15,00,000 each towards 'indemnity liability' on the ground that he was liable to pay Rs. 15,00,000 to the vendees, in view of the suit pending before the Supreme Court regarding the title to the property. As this was not a subsisting obligation and the amount would become payable only in the event of an adverse judgment, the deduction allowed was not in order. Further, in the wealth-tax assessments for the assessment years 1981-82 and 1982-83, also completed in July 1986 (valuation dated 31 March 1981 and 31 March 1982 respectively), the assessee's then one-fourth share in the estate was valued at Rs. 1,62,500 which was far below the market value as half of the estate had fetched Rs. 28,00,000 in May 1982. The above mistakes resulted in under-assessment of wealth of Rs. 69,75,000 and short levy of wealth-tax of Rs. 2,41,692.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. An assessee individual was assessed on total wealth of Rs. 1,22,55,500 for the assessment year 1981-82. Audit scrutiny revealed that while computing the net wealth of the assessee in November 1986, the value of shares amounting to Rs. 14,14,343 (after allowing exemption of Rs. 1.50 lakhs) and difference between value of share of a private limited company as determined by the Departmental Valuer and as returned amounting to Rs. 1,59,160 was not added to the net wealth of the assessee. The omission resulted in under assessment of wealth of Rs. 15,73,503 and short levy of tax of Rs. 78,675.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

5.08 Incorrect exemption

Under the provisions of the Wealth-tax Act, 1957, assets comprising the estate of a deceased person held by a legal heir on any valuation date are to be included in the wealth of such legal heir on that valuation date. Further, under the Act, ibid, the maximum exemptions in respect of specified financial assets should not exceed one hundred and fifty thousand rupees upto the assessment year 1982-83.

An individual, the wife of an ex-ruler, inherited the estate of her deceased husband (April 1980) which included 32 pieces of gold takas (Idols) weighing 5,000 grams, as the sole legal heir. While completing her wealth-tax assessment for the assessment year 1982-83 in March 1987, the assessing officer omitted to include the aforesaid gold takas valued at Rs. 8,50,000 in her net wealth though the same had been included in the taxable wealth of her husband for the earlier assessment year 1981-82. Further, the assessing officer incorrectly allowed exemption of Rs. 1,50,000 twice in respect of specified financial assets in the case of assessee's own wealth and the wealth inherited from her husband. The above mistakes resulted in under-assessment of wealth of Rs. 10,00,000 and short levy of tax of Rs. 50,000.

The Ministry of Finance have accepted the objection.

5.09 Mistakes in application of rate of tax/calculation of tax

1. *Mistakes in application of rate of tax*

Under the provisions of the Wealth-tax Act, 1957, where shares of beneficiaries in a private trust are indeterminate or unknown, wealth-tax is levied as if the persons on whose behalf or for whose benefit the assets are held are an individual at the rates specified in the Schedule to the Act or at the flat rate of three per cent, whichever is more beneficial to revenue. Further, such private trusts are, under certain specified circumstances, not entitled to exemption in respect of specified investments admissible to other assessees upto a ceiling limit of Rs. 1.50 lakhs (upto assessment year 1982-83) and Rs. 1.65 lakhs (assessment year 1983-84 onwards) in regard to their investments in company shares, assets of industrial undertaking, etc.

In the wealth-tax assessments of three such trusts, completed for the assessment years 1980-81 to 1984-85, between March 1985 and February 1987, the assessing officer applied the normal rates of tax prescribed in the Schedule of the Act instead of the flat rate of three per cent which was more beneficial to revenue. Further, exemption of Rs. 1.50 lakhs/Rs. 1.65 lakhs against the value of investments in company shares comprising their net wealth was incorrectly allowed. Further, tax liability totalling to Rs. 59,391 (Rs. 30,268 + Rs.29,123) and remaining outstanding for more than twelve months on the relevant valuation date, was deducted in determining net wealth of two of the three assessee trusts in respect of assessment year 1980-81 and value of shares for the assessment year 1982-83 in one case, was adopted short by Rs. 5,208. These mistakes led to total short levy of tax of Rs. 2,17,714 in the aggregate.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

2. *Mistakes in calculation of tax*

(i) As per Schedule to the Wealth-tax Act, 1957, applicable to assessment year 1983-84 where the net wealth of an individual assessee exceeds Rs. 15,00,000 tax leviable in Rs. 28,750 plus 5 per cent of the amount by which the net wealth exceeds Rs. 15,00,000.

While completing the wealth-tax assessment of an individual for the assessment year 1983-84 in February 1988, on a net wealth of Rs. 54,97,744, the assessing officer incorrectly calculated the wealth-tax as Rs. 48,496 instead of the correct amount of tax of Rs. 2,17,748. The mistake in calculation of tax resulted in a short levy of wealth-tax of Rs. 1,69,252.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in February 1989; the reply from the Government has not so far been received (October 1989).

(ii) From the assessment year 1974-75, the Schedule to the Wealth-tax Act, 1957, was amended to provide for a higher rate of tax for every Hindu undivided family (specified category) having at least one member with assessable net wealth exceeding rupees one lakh upto the assessment year 1979-80 and rupees one lakh and fifty thousands from the assessment year 1980-81 and subsequent years. Other cases of Hindu undivided family attract tax at lower rates.

In the wealth-tax assessments of two Hindu undivided families, for the assessment years 1975-76 to 1980-81 completed in March 1988, the prescribed higher rates of tax were not applied on the total assessed net wealth even though in one of the cases, one of the members of Hindu undivided family had taxable wealth and was assessed to wealth-tax in another ward for these assessment years. In another case the specific declaration to the effect that none of the members of Hindu undivided family had a taxable wealth had not been furnished with the return. In the absence of specific declaration the assessee was chargeable to tax in the status of Hindu undivided family (specified) at the higher rate instead of normal rate applicable to Hindu undivided family (ordinary). The mistake resulted in short levy of tax of Rs. 1,32,156 in the aggregate in the two cases for the assessment years 1975-76 to 1980-81.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the government has not so far been received (October 1989).

(iii) The Wealth-tax Act, 1957, provides that in the case of an individual assessee who is not a citizen if India and who is not resident in India, the wealth-tax payable by him in respect of any assessment year, computed in accordance with the rates specified in Schedule I of the Act, shall be reduced by an amount equal to 50 per cent thereof.

While completing the wealth-tax assessments of a non-resident individual for the assessment years 1985-86, 1986-87 and 1987-88 in February 1988, the assessing officer incorrectly allowed a rebate of Rs. 30,382, Rs. 9,283 and Rs. 18,067 being 50 per cent of tax payable by the assessee though he was a citizen of India. The irregular allowance of rebate resulted in short levy of tax of Rs. 57,732.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(iv) The wealth-tax assessment of an individual for the assessment year 1976-77 was revised in March 1987. While calculating the tax leviable on the net wealth of Rs. 19,95,930 the department incorrectly applied rates of tax applicable for the assessment year 1977-78. Applying the rates of tax for the assessment year 1976-77, the amount of wealth-tax leviable worked out to Rs. 73,771 as against Rs. 31,610 levied by the department. The mistake in application of rates of tax resulted in short levy of tax of Rs. 42,161.

The Ministry of Finanie have arcepted tht objection.

5.10. Non-levy/short-levy of additional wealth-tax

1. Under the Wealth-tax Act, 1957, before its amendment by the Finance Act, 1976, where the net wealth of an individual or a Hindu undivided family included buildings or lands (other than business premises) or any rights therein situated in an urban area, additional wealth-tax was leviable on the value of such urban assets exceeding the prescribed limits.

In seven Commissioner of Income-tax charges, the assessing officer had not levied/short levied the additional wealth-tax on the value of urban properties included in the net wealth of following eight assessees resulting in total short levy of tax of Rs. 10,58,831.

Sl. No.	Status of assessee	CIT's Charge	Assessment year Date of Completion of assessment	Value of Urban properties	Tax effect
				Rupees	Rupees
1	Individual	A	1976-77 (March 1987)	63,97,663	4,02,836
2	Individual	B	1976-77 (March 1987) (Revised)	45,64,993	2,74,550
3	Two individuals	C	1975-76 & 1976-77 (March and September 1980) (Revised in March 1988)	18,98,495	1,40,699
4	Individual	D	1976-77 (March 1987)	22,03,579	1,02,250
5	Individual	E	1971-72 to 1975-76 (March 1986)	8,58,375	51,697
6	Individual	F	1975-76 to 1976-77 (March 1980 revised in March 1988)	19,88,700	49,465
7	Hindu undivided family	G	1969-70 to 1971-72 and 1976-77 (March 1987 and March 1988)	18,73,400	37,334

The department has accepted the objection in seven cases.

The Ministry of Finance have accepted the objection in three cases; the reply from the Government has not so far been received in the remaining five cases (October 1989).

2. In the computation of value of an urban asset, any debt incurred for the purpose of acquiring, improving, constructing, repairing, renewing or reconstructing such assets shall be deducted from the gross value of such asset. However, other debts which are deductible in computing the net wealth shall be deducted from the gross value of such assets only if, and to the extent that such debts exceed the aggregate gross value of assets other than urban assets.

The net wealth of an individual, for the assessment years 1972-73, 1973-74, 1974-75 and 1975-76 was determined in January 1987 at Rs. 594.54 lakhs, Rs. 409.42 lakhs, Rs. 357.06 lakhs and Rs. 302.24 lakhs respectively which included urban assets of Rs. 262.22 lakhs, Rs. 104.84 lakhs, Rs. 114.63 lakhs and Rs. 39.42 lakhs. However, for the purpose of levy of additional wealth-tax, the value of the urban assets was incorrectly reduced by the additional wealth-tax liabilities amounting to Rs. 16.73 lakhs, Rs. 6.43 lakhs, Rs. 7.57 lakhs and Rs. 2.16 lakhs respectively, even though such tax liability was not liable to be considered as other debts against the urban assets since the assessee's aggregate assets other than urban assets far exceeded the allowable debts. The mistake resulted in short levy of additional wealth-tax of Rs. 2,32,321.

The Ministry of Finance have accepted the objection for the assessment years 1972-73, 1973-74 and 1975-76.

5.11 Non-levy interest and penalty

1. *Interest*

Under the Wealth-tax Act, 1957, if the amount specified in the notice of demand is not paid within thirty five days of the service of notice of demand, the assessee is liable to pay simple interest at twelve per cent per annum prior to 1 October 1984 and fifteen per cent per annum thereafter.

In the wealth-tax assessment of an individual, a demand of Rs. 21,13,765 was raised by the department on 3 March 1988 for the assessment year 1981-82 which was required to be paid by him on or before 5 May 1986. The assessee however, paid the demand in instalments, on various dates between April 1987 and March 1988 which made him liable to pay interest under the provisions of the Act. However, no interest was levied by the department. The omission resulted in non-levy of interest of Rs. 3,81,499.

The Ministry of Finance have accepted the objection.

2. *Penalty*

Under the Wealth-tax Act, 1957, if any assessee fails to pay the self assessment tax, the assessing authority may impose a penalty calculated at the rate of two per cent of such tax remaining unpaid for every month during which the default continued. The Central Board of Direct Taxes clarified in March 1974, that in cases where penal action is not initiated, the assessing officer should properly record the reasons in the order sheet or append a note to the assessment order giving reasons therefor.

An assessee individual filed his wealth-tax return for the assessment year 1982-83 showing net wealth of Rs. 20,04,800 in June 1982. On the basis of the returned wealth he was required to pay wealth-tax of Rs. 53,990. As the assessee had not paid this tax, he was liable to pay penalty of Rs. 60,480 for the default upto the date of assessment (March 1987), which was not levied while completing the assessment in March 1987. No reasons for not levying the penalty were recorded by the assessing officer.

The Ministry of Finance have accepted the objection.

5.12 Delay in completion of assessment

Following the decision of a High Court, a body of individuals filed its returns of income for the assessment years 1976-77 to 1983-84 in July 1986, showing 'Nil' wealth for all the aforesaid years. In July 1986, the assessing officer completed the assessments for the assessment years 1982-83 and 1983-84 determining the net wealth at Rs. 2,54,11,453 and Rs. 2,85,85,564 respectively. The assessments for the assessment years 1976-77 and 1977-78 were concluded in September 1987, determining the net wealth at Rs. 66,60,457 and Rs. 76,74,511 respectively. No action was, however, taken by the department to complete the assessments for the intervening four assessment years 1978-79 to 1981-82 even though a stay order granted by the High Court was vacated in November 1987. On the basis of wealth assessed for the assessment years 1977-78, viz., Rs. 76.75 lakhs and without considering any increase in the value of the assets, the wealth-tax leviable for the assessment years 1978-79 to 1981-82 would be Rs. 11,11,100.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the government has not so far been received (October 1989).

B-GIFT-TAX

5.13 In the financial years 1984-85 to 1988-89, gift-tax receipts vis-a-vis the budget estimates were as given below:—

Year	Budget Estimates	Actuals	Variation (Percentage)
		(In crores of rupees)	
1984-85	8.50	10.86	27.76
1985-86	10.00	11.66	16.60
1986-87	15.00	9.26	(—)38.27
1987-88	11.00	8.23	(—)25.18
1988-89	10.00	6.74*	(—)32.60

*Provisional.

5.14 Particulars of cases finalised, assessments pending and demands in arrears, for the five years 1984-85 to 1988-89 are as given below:—

Year	Number of assessments completed during the year	Number of cases pending assessment at the end of the year	Arrears of demand pending collection at the end of the year
			(In crores of rupees)
1984-85	83,537	38,185	26.62
1985-86	80,017	38,063	36.33
1986-87	76,154	39,097	19.46
1987-88	64,375	30,517	22.02
1988-89*	70 642	21,327	24.47

*Provisional.

5.15 During the test audit of assessments made under the Gift-tax Act, 1958, conducted during the period 1 April 1988 to 31 March 1989, the following types of mistakes were noticed:—

(i) Gift escaping assessment.

(ii) Non-levy of tax on deemed gift.

(iii) Incorrect valuation of gifted properties.

(iv) Mistakes in calculation of gift-tax.

(v) Non-completion of assessment within time-limit.

A few important cases illustrating these mistakes are given in the following paragraphs.

5.16 Gift escaping assessment

1. The Central Board of Direct Taxes had issued instructions in November 1973 and April 1979 emphasising the need for proper coordination amongst the assessment records pertaining to different direct taxes, with a view to preventing cases of evasion of tax.

According to the provisions of Gift-tax Act, 1958, gift-tax shall not be charged in respect of gifts of movable property situated outside the taxable territories unless the donor, being an individual is a citizen of India and ordinarily resident in the taxable territories to which the Act extends. The residential status of the assessee is determined in accordance with the provisions of Income-tax Act, 1961, which *inter alia* specifies that where an assessee is a 'resident' in respect of one source of income, he will be deemed to be a resident in respect of all the sources of income. Further, it has ben judicially held (53 ITR 547) that when a person is a member of a Hindu undivided family which maintains a dwelling place in India, he will be deemed to have maintained a dwelling place in India during the relevant previous year, for the purpose of determination of residential status.

(i) A scrutiny of income-tax assessment records of an assessee disclosed that he was a member of a resident Hindu undivided family which maintained a dwelling place in India by virtue of which the assessee's presence in India for 30 days or more made him resident in India for the assessment years 1980-81 to 1982-83. For the assessment year 1978-79, the assessee had one source of income for which he was resident and in consequence he should be deemed to be resident for all other sources of income for that year. Further, since the assessee was a resident in nine out of the ten previous years and was in India for a period in all amounting to 730 days or more during the seven previous years preceding the relevant previous year he should be deemed to be resident and ordinarily resident in India for the assessment years 1981-82 and 1982-83. The assessee made gifts of movable properties of Rs. 5,80,000 and Rs. 90,000 situated outside the taxable territories during the previous year relevant to assessment years 1981-82 and 1982-83 but neither the assessee filed any gift-tax return, nor the department initiated any gift-tax proceedings treating the assessee as non-resident. Incorrect adoption of status resulted in non-levy of gift-tax of Rs. 1,54,500.

The Ministry of Finance have accepted the objection.

(ii) The income-tax assessment records of an individual disclosed that during the previous year relevant to the assessment year 1985-86, the assessee had received two gifts of $ 19,000 each from her relative which were credited to her bank account in Indian currency at Rs. 2,09,713 on 26 May 1984 and at Rs. 2,48,691 on 13 March 1985. It was noticed in audit (July 1987) that the assessing officer did not examine as to whether the donor had filed any gift-tax return for these gifts. The information of making the gifts was also not passed on to the assessing officer having jurisdiction to assess the donor. No gift-tax proceedings were initiated by the department. This resulted in escapement of gift of Rs. 4,58,404 and non-levy of gift-tax of Rs. 94,850.

The department has accepted the objection in principle.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(iii) The income-tax assessment records of an individual for the assessment year 1984-85 (the assessment of which was completed in January 1988, disclosed that during the previous year relevant to the assessment year 1984-85 the assessee had gifted an immovable property valued at Rs. 3,33,000. But neither the assessee had filed any gift-tax rtturn in respect of this gift nor had the department called for the same. The gift of Rs. 3,33,000 had thus escaped assessment resulting in non-levy of gift-tax of Rs. 63,500.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. Gifts made by any person to any institution established for charitable purpose are exempt from gift-tax, if the gifts made to such institution qualified for deduction under the Income-tax Act, 1961.

An assessee in his gift-tax return, for the assessment year 1982-83 did not include the value of twenty eight items of gold ornaments with stone and one silver utensil, amounting to Rs. 2,59,020 on the ground that those constituted gift made to a charitable trust in July 1981. Scrutiny of wealth-tax and gift-tax assessment records revealed that the trust to which the donation was made did not qualify for deduction under the Income-tax Act, 1961, and as such the gift was liable to gift-tax. While completing the gift-tax assessment for the assessment year 1982-83 in November 1986, the assessing officer failed to include the value of gift of Rs. 2,59,020 made to the trust resulting in escapement of gift of the like amount with consequent short levy of gift-tax of Rs. 56,275.

The Ministry of Finance have accepted the objection.

5.17 Non-levy of tax on deemed gift

1. Under the Gift-tax Act, 1958, where property is transferred otherwise than for adequate consideration, the amount by which the market value of the property on the date of the transfer exceeds the declared consideration, shall be deemed to be a gift made by the transferor and is chargeable to gift-tax. The Act further provides that the value of the property shall be estimated to be the price which it would fetch, if sold in the open market on the date on which the gift is made.

(i) In the previous year relevant to the assessment year 1985-86, a hotel building in the names of an individual and his wife was sold by two separate registered sale deeds for a total consideration of Rs. 6,11,000. The income-ttx and wealth-tax records of the individual revealed that the income/wealth in respect of the entire building was shown in the individuals own hands. On a reference made by the Inspecting Assistant Commissioner (Acquisition), the fair market value of the building on the date of sale, was determined by the Departmental Valuer at Rs. 18,98,300 (August 1985). The difference of Rs. 12,87,300 between the market value (Rs. 18,98,300 and the value at which the building was sold Rs. 6,11,000) constituted deemed gift attracting levy of gift-tax. Although the information regarding determination of the market value of the building by the Departmental Valuation Officer at Rs. 18,98,300 was communicated by the Inspecting Assistant Commissioner (Acquisition) in December 1986 and was received by the assessing officer in January 1987, no gift-tax proceedings for levy of gift-tax were initiated by the department. The omission resulted in escapement of gift of Rs. 12,87,300 and non-levy of gift-tax of Rs. 3,69,420. Besides tax, penalty provisions for non-filing of the gift-tax return were also attracted.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) A firm of four partners was constituted on 14 June 1977 to carry on the business of exhibition of films. The firm was dissolved on 29 November 1979 and all the assets and liabilities of the firm were assigned to and taken over by one of the partners (who had a share of 30 per cent) at their book value. The difference between the market value and book value of excess of total assets over the total liability of the firm which was foregone by the other partners in favour of the partner taking over constituted deemed gift liable to gift-tax. The assets of the firm included a cinema building, the book value of which on the date of dissolution was Rs. 7,29,910 (cost of land Rs. 80,000 plus cost of construction Rs. 6,49,910). As against the book value of cost of construction of Rs. 6,49,910, the Departmental Valuer determined (March 1985) the cost of construction at Rs. 10,42,000. The market value of the Cinema building was, therefore, not less than Rs. 11,22,000 (Cost of land Rs. 80,000 plus cost of construction as per Departmental Valuer Rs. 10,42,000) but it was assigned to the partner at the book value of Rs. 7,29,910. An amount of Rs. 2,74,460 i.e. 70 per cent of difference between the market value and book value amounting to Rs. 3,92,090, on this account alone was surrendered by the three partners in favour of the fourth partner and constituted deemed gift in the hands of the three partners. Neither the three partners had filed any return of gift-tax nor had the department called for the same. The omission resulted in escapement of gift of Rs. 2,74,460 and non-levy of gift-tax of Rs. 29,092 and penalty of Rs. 45,380 for not filing the returns for the assessment year 1981-82 was also leviable. Further, on 30 November 1979, a new firm was constituted in which the partner who took the assets and liabilities of the dissolved firm, became partner taking 22 per cent shares by transferring all the assets and liabilities he had taken over from the dissolved firm at their book value. Thus, the cinema building was transferred to the new firm for a consideration of Rs. 7,29,910 as against its market value of Rs. 11,22,000. The difference of Rs. 3,92,090 constituted deemed gift in the hards of the transferor partner. Neither the assessee filed any return of gift-tax nor did the department initiate any action to call for the same. The omission resulted in non-levy of gift-tax of Rs. 78,270 and a penalty of Rs. 1,22,880 for not filing the return for the assessment year 1981-82 was also leviable. The total revenue effect involved in the cases of the four partners was Rs. 2,75,622.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(iii) During the previous year relevant to the assessment year 1982-83 a closely held company converted land measuring 690 cents owned by it into stock-in-trade by adopting the fair market value of Rs. 5,000 per cent. Audit scrutiny of the income-tax assessment records revealed (January 1988) that during the previous year relevant to assessment year 1982-83, the assessee had sold 372.74 cents of land for a declared consideration of Rs. 9,15,740 as against the fair market value which worked out to Rs. 19,38,700 at Rs. 5,000 per cent. The difference in value amounting to Rs. 10,22,960 constituted deemed gift attracting levy of gift-tax but no such gift-tax proceedings were initiated by the department. The omission resulted in non-levy of gift-tax of Rs. 2,63,684.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

(iv) An individual sold in May 1983, his entire shareholding of 1,204 shares in a closely held company for a consideration of Rs. 3,01,000. Scrutiny of wealth-tax records of the assessee for assessment year 1983-84, however, revealed (April 1988) that the value of shares as on the valuation date of 31 March 1983 had been computed at Rs. 10,76,480 by the assessing officer in the wealth-tax assessment completed in January 1988. The difference of Rs. 7,46,480 between market value and sale price should, therefore, have been treated as deemed gift in the hands of the assessee for assessment year 1984-85 involving a gift-tax demand of Rs. 1,78,944. No gift-tax return had, however, been filed by the assessee nor was it called for by the department.

The paragraph was referred to the Ministry of Finance for comments in April 1989; the reply from the Government has not so far been received (October 1989).

(v) The income-tax assessment records of an assessee showed that she sold 3,000 shares of a private limited company during the previous year relevant to the assessment year 1984-85, between April 1983 and June 1983, for a declared consideration of Rs. 275 per share which was accepted by the department for levy of capital gains tax in the assessment for the assessment year 1984-85 completed in November 1986. Audit scrutiny in June 1988 revealed that as per the wealth-tax records, the market value of the shares as on 31 March 1983 was Rs. 433 per share. Since the shares were sold at a consideration less than the market value, the difference between the market value and the declared consideration received amounting to Rs. 158 per share for 3,000 shares sold constituted deemed gift. No gift-tax proceedings were, however, initiated by the department. The omission resulted in escapement of taxable gift of Rs. 4,74,000 with consequent non-levy of tax of Rs. 98,750.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. Under the Gift-tax Act, 1958, the value of transactions such as release, discharge, surrender forfeiture or abandonment of any debt or contract or other actionable claim or of any interest in property if not bonafide is deemed gift. The Central Board of Direct Taxes issued instructions in March 1976 and May 1977 clarifying that when a partnership firm is reconstituted either with the same old partners or on admission of new partners or on conversion of a sole proprietorship into a partnership and the profit sharing ratios of the partners are revised, any interest surrendered or relinquished by one or more such partners without adequate consideration in money or money's worth in favour of other partner would attract levy of gift-tax. It has been judicially held (166 ITR 124) that 'goodwill' is a property and in the event of admission of any new member in the business on its conversion or as partner on its re-constitution the right to the money value of the goodwill stands transferred and the transaction constitutes a gift under the Gift-tax Act.

(i) A partnership firm with three partners was reconstituted in July 1983 during the previous year relevant to assessment year 1985-86 and thirteen more partners were taken in. The assessee was one of the partners having 80 per cent share of interest in the firm before reconstitution. Consequent on the inclusion of more partners in the firm, the assessee had surrendered 40 per cent of his share in favour of the new partners. In November 1983, the assessee retired from the partnership receiving 40 per cent share in the net worth of the firm without taking into account the 'goodwill'. Audit scrutiny revealed (October 1988) that there were no provisions in the partnership deeds prohibiting partners' share in the goodwill of the firm. The firm was consistently making profits and the action of the assessee foregoing his share in the goodwill of the firm constituted deemed gift. However, no action was taken by the department to levy gift-tax. Taking into account three years' purchase value of the net average profits of the firm during the previous years relevant to assessment years 1981-82 to 1984-85 the goodwill of the firm worked out to Rs. 9,03,980 and the assessee's share therein amounted to Rs. 7,23,184. The omission to treat the amount as deemed gift resulted in non-levy of gift-tax of Rs. 1,71,955.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) In the previous year relevant to assessment year 1984-85, an assessee who was the sole owner of a proprietory concern converted his business into a partnership firm with his son and daughter as partners. The shares of the son and daughter were 25 per cent each and the assessee's share was 50 per cent. Audit scrutiny revealed (September 1985) that the assessee became one of the partners of the newly constituted firm foregoing his interest in the goodwill alongwith his interest in the difference between the market value and book value of the assets of the proprietory concern. The value of interest thus foregone constituted interest surrendered in favour of the other partners and constituted deemed gift in the hands of the assessee. However, no action was taken by the department to levy gift-tax. Taking into account three years' purchase value of net average profits of the proprietorship concern during the last five assessment years 1979-80 to 1983-84, the goodwill foregone alone amounted to Rs. 3,94,000 in the hands of the assessee which resulted in non-levy of gift-tax of Rs. 78,750. Further, the difference between the market value and book value of the assets surrendered in favour of the new partners taken was also required to be brought to gift-tax.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(iii) An individual, having 45 per cent share interest in a partnership firm retired from the firm on 8 November 1980, receiving the balance to his credit and foregoing the elements of his share in the difference between the market value and cost of the assets of the firm, in favour of his two sons, who joined the firm as partners on the same day. The value of the interest thus foregone constituted deemed gift attracting levy of gift-tax. However, the assessee did not file any return of gift, nor did the department initiate any action to levy the gift-tax on this deemed gift. Audit scrutiny (January 1988) revealed that the firm itself was dissolved on 31 December 1982 and the assets and liabilities of the firm were taken over by a company which had joined the same partnership in the year 1982. At the time of dissolution, the assets were revalued and a sum of Rs. 8,30,000 was determined as goodwill and the respective shares of the partners in the goodwill were credited to their accounts. Assuming the value of goodwill to be the same as at the time of retirement of the assessee on 8 November 1980, the value of deemed gift liable to tax which has escaped assessment worked out to Rs. 3,73,500 and the gift-tax leviable thereon worked out to Rs. 73,625.

The Ministry of Finance have accepted the objection.

(iv) The income-tax assessment records of a firm for the assessment year 1987-88 disclosed that one of its partners retired from partnership relinquishing his title in the assets and liabilities of the firm, including the balance of his capital account amounting to Rs. 1,26,157 as per the firm's balance sheet for 1986-87. This constituted deemed gift in favour of the other partner, vide testament dated 13 May 1986. However, neither the assessee had filed the gift-tax return nor had the department initiated gift-tax proceedings. The omission resulted in gift escaping assessment by Rs. 1,26,157 and non-levy of gift-tax of Rs. 31,848.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

5.18 Incorrect valuation of gifted properties

1. *Shares.*

Under the Gift-tax Act, 1958, the value of any property, other than cash, transferred by way of gift shall be the price which it would fetch if sold in the open market on the date on which the gift was made.

The Gift-tax Rules lay down that the value of unquoted equity shares in a private limited company should be ascertained with reference to the total assets of the company. The provisions of the Gift-tax Act, 1958, are pari-materia with those contained in Estate Duty Act, 1953, in regard to the valuation of unquoted equity shares. The instructions issued by the Central Board of Direct Taxes under the Estate Duty Act for the valuation of such shares are, therefore, equally applicable to gift-tax under the Gift-tax Act. According to the instructions issued under the Estate Duty Act (May and July 1965) the value of unquoted equity shares should be determined on the basis of market value and not the book value of assets of the company. These instructions of May and July 1965 were reiterated in October 1974 and May 1975.

(i) In the previous year relevant to the assessment year 1984-85, a private limited company sold (June 1983) 104 equity shares of its subsidiary company which held 100 per cent share capital in another subsidiary company to three individuals at a consideration of Rs. 1,000 per share as against the market value of Rs. 6,23,427 per share calculated on the basis of net assets of the company whose shares were sold. The difference between the market value of 104 equity shares amounting to Rs. 6,48,36,408 and sale consideration received for Rs. 1,04,000 constituted deemed gift under the Gift-tax Act, 1958, attracting levy of gift-tax in the hands of the assessee company. No gift-tax proceedings, were, however, initiated by the department. The omission resulted in escapement of deemed gift of Rs. 6,47,32,408 and non-levy of gift-tax of Rs. 4,77,52,056.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) A scrutiny of the income-tax assessment records of an individual for the assessment year 1985-86 revealed that the assessee sold (November 1984) 260 unquoted equity shares of a private limited company for a consideration of Rs. 2,60,000. The wealth-tax assessment records of the assessee, on the valuation date 31 March 1984 relevant to the assessment year 1984-85, however, disclosed that the value of shares of the company was determined under the Wealth-tax Rules at Rs. 3,400 per share. Even if the same value is adopted for gift-tax purposes, the value of the shares would work out to Rs.

8,84,000 as against the declared consideration of Rs. 2,60,000 only. Thus the difference between the market value and the disclosed sale consideration amounting to Rs. 6,24,000 constituted deemed gift on which gift-tax of Rs. 1,42,200 was leviable. The tax liability would be higher if correct valuation is done on the basis of the market value of the assets of the company including also the value of its goodwill. However, neither had the assessee filed the return of the gift nor had the department initiated any gift-tax proceedings.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(iii) The provisions relating to the valuation of shares, under the Wealth-tax Act, 1957, and the Rules made thereunder are not applicable to valuation under the Gift-tax Act. The Board clarified in January 1982 that where the break-up value method is adopted to determine the value of unquoted equity shares, no discount on such value is allowable.

(a) During the previous year relevant to assessment year 1980-81 an assessee sold 20,000 unquoted equity shares of a closely held company, to another company at the rate of Rs. 7.50 per share. However, the value of each share under the break-up value method was determined by the assessing officer at Rs. 79.82 and the market value of each share was adopted at Rs. 67.82 after allowing a discount of 15 per cent. The difference between the market value (Rs. 67.82) and the actual sale price (Rs. 7.50) was treated as deemed gift and subjected to gift-tax in the assessment completed in January 1987. The allowance of the discount after computing the value of the share was not in accordance with the instructions of the Board and the incorrect allowance of discount resulted in the under-assessment of gift by Rs. 2,40,000 with a consequent short levy of tax of Rs. 96,000 for the assessment year 1980-81. Further, a sum of Rs. 24,000 would also be leviable for assessment year 1982-83 on account of aggregation of gifts for rate purposes.

The paragraph was referred to the Ministry of Finance for comments in February 1989; the reply from the Government has not so far been received (October 1989).

(b) An assessee in the previous year relevant to assessment year 1985-86, gifted 3,400 equity shares. In gift-tax assessment made (February 1988) these were valued at Rs. 3,91,000 by taking the value of each share at Rs. 115 (i.e. break-up value of Rs. 153.30 less 25 per cent thereof) worked out on the basis of Wealth-tax Rules, 1957. Under the Gift-tax Rules, there is no provision for adopting a discounted value on the analogy of Wealth-tax Rules. Omission to value the shares at full break-up value of Rs. 153.30 resulted in under-valuation of gift of Rs. 1,30,220 and short levy of tax of Rs. 32,555.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

(c) During the previous year relevant to the assessment year 1982-83, a Hindu undivided family of specified category sold 1,430 equity shares held by it in a private company for a consideration of Rs. 3,93,250 at the rate of Rs. 275 per share. The capital gain arising out of this transaction was also assessed to income-tax in the assessment for the assessment year 1982-83 completed in March 1985. Audit scrutiny in December 1986 revealed that the market value of the shares of the company as per the provisions of the Wealth-tax Rules, 1957, worked out to Rs. 650.73 per share. The difference between the market value as on the date of transfer and the value at which the shares were sold constituted deemed gift attracting levy of gift-tax. Neither the assessee had filed any return of gift nor had the department called for the same. The omission to do so resulted in non-levy of gift-tax of Rs. 1,17,940.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989. The reply from the Government has not so far been received (October 1989).

2. *Immovable property*

It has been judicially held (172 ITR 632) that on dissolution of a firm, if one partner takes less than his share entailing a corresponding increase in the value of assets of other partners, the transaction amounts to a gift attracting gift-tax.

A, B, C, and D were partners in a firm sharing profit in the ratio of 40, 20, 20 and 20. The assets of the firm, *inter alia,* included an immovable property the book value of which was Rs. 4.67 lakhs as on 31 March 1985. On the dissolution of the firm, on 1 April 1985, the balances in the capital accounts of the outgoing partners B, C and D were treated as loan to partner 'A' who continued the business of the firm. A scrutiny of the assessment records disclosed that the value of the immovable property owned by the firm was determined at Rs. 7.37 lakhs as on 31 August 1978 by a registered valuer. Taking into account the appreciation in value of the property during subsequent years the market value would not have been less than Rs. 10 lakhs in 1985. Thus the property valued at not less than Rs. 10 lakhs was given in specie to partner 'A' at book value (Rs. 4.67 lakhs) resulting B, C and D actually releasing their interest to the extent of their share of difference between market value and book value in favour of 'A'. As a result, an amount of Rs. 3.18 lakhs being 60 per cent of the difference of Rs. 5.33 lakhs (Rs. 10 lakhs minus Rs. 4.67 lakhs) was surrendered by B, C and D in favour of 'A' wihout adequate consideration which constituted deemed gift attracting levy of gift-tax. But no gift-tax proceedings were, however, initiated by the department. The omission resulted in non-levy of gift-tax of Rs. 35,100.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

3. *Goodwill and finished goods*

A partnership firm consisting of five partners with equal share was dissolved on 31 December 1981. The entire assets and liabilities (except immovable properties and trade marks) of the firm were transferred as a going concern to a newly formed private limited company at the book value. Audit scrutiny (March 1989) revealed that the assets and liabilities of the firm as on 31 December 1981 included value of goodwill (Rs. 10,10,000) stock-in-trade of finished goods (biris) valued at cost price (Rs. 37,61,840) and unpaid liability for leave with wages, provident fund and bonus (Rs. 1,22,53,730) not discharged for a long time. The market value of the net assets of the firm on the date of transfer to the company was not ascertained by the assessing officer to find out the quantum of deemed gift. On the basis of super-profit method of valuation of goodwill, the value of goodwill of the firm by taking three years' purchase of the average profits of past five years worked out to Rs. 70,64,000 as against the book value of Rs. 10,10,000. The market value of the finished products on the basis of gross profit rate of 9.75 per cent would work out to Rs. 41,28,820 as against the book value of Rs. 37,61,840. The unpaid liabilities of Rs. 1,22,53,730 were also required to be examined to know whether they ceased to exist or not. The difference between the market value and book value in respect of goodwill and finished goods alone as shown above was Rs. 64,20,780. This constituted deemed gift attracting levy of gift-tax in the hands of the partners of the dissolved firm. However, the department had not initiated any gift-tax proceedings. The omission resulted in non-levy of gift-tax of Rs. 40,18,335 for the assessment year 1982-83. Penalty provisions for non-filing of the return were also attracted.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

5.19 Mistakes in calculation of tax

1. Under the Gift-tax Act, 1958, with effect from 1 April 1976, taxable gifts by an assessee in a previous year are to be charged to tax after aggregating them with taxable gifts, if any, made during the preceding four previous years (excluding gifts made before 1 June 1973) at the rates of tax applicable to the assessment year in hand. From the gift-tax so computed, gift-tax on the taxable gifts of the preceding four previous years reckoned at the same rates will be deducted and the balance would represent the gift-tax payable for the year.

The gift-tax assessment of a Hindu undivided family for the assessment year 1983-84 was completed in March 1988, on a total value of gift of Rs. 20,01,495. Scrutiny of records (February 1989) revealed that the total value of gift had been arrived at after aggregation of value of gifted shares at Rs. 95,000 returned by the assessee in assessment year 1982-83. However, the value of these shares was determined at Rs. 6,32,294 in the gift-tax assessment for the assessment year 1982-83. The error in aggregation of gifts resulted in short-levy of gift-tax of Rs. 2,67,529.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. During the previous year relevant to assessment year 1975-76 an individual made taxable gifts valued at Rs. 4,15,242 on which a tax of Rs. 85,300 was leviable. However, while completing the gift-tax assessment in March 1987 the assessing officer incorrectly worked out the gift-tax as Rs. 53,810. The incorrect calculation of tax resulted in short levy of tax of Rs. 31,500. Further, the assessee did not pay the tax demanded in time, and was liable to pay interest of Rs. 19,125 which was not levied. These mistakes thus resulted in total short levy of tax of Rs. 50,625.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

C—ESTATE DUTY

5.20 The levy of estate duty was discontinued by the Estate Duty (Amendment) Act, 1985, in respect of estate passing on death occuring on or after 16 March 1985.

5.21 In October 1985, in view of the discontinuance of the estate duty, the Central Board of Direct Taxes issued instructions for completion of pending assessments with a returned principal value not exceeding Rs. 3 lakhs by 31 December 1985. The particulars of the assessment finalised, the assessments pending and estate duty demands in arrears in respect of the years 1984-85 to 1988-89 are as given below :

Year	No. of assessments		Arrears of tax demand
	completed	Pending	(In crores of rupees)
1984-85	36,856	34,399	41.12
1985-86	5,301	12,262	36.04
1986-87	14,663	9,251	33.95
1987-88	11,704	3,095	399.73
1988-39*	4,226	1,735	73.11

*Provisional

5.22 Receipts from the estate duty during the financial years 1984-85 to 1988-89 vis-a-vis the Budget estimates were as under :

Year	Budget estimates	Actual (In crores of rupees)	Percentage of variation
1984-85	20.00	24.37	(+)21.85
1985-86	22.50	22.26	(—)1.07
1986-87	15.00	13.39	(—)10.73
1987-88	10.00	8.02	(—)20.20
1988-89*	3.25	6.04	85.84

*Provisonal

5.23 During the test audit of assessments made under the Estate Duty Act, 1953, conducted during the period from 1 April 1988 to 31 March 1989, the following types of mistakes resulting in under-assessment of duty, were noticed :

(i) Incorrect computation of principal value of estate.

(a) Lack of correlation amongst various assessment records.

(b) Undervaluation of the principal value of estate.

(ii) Estate escaping assessment.

(iii) Incorrect valuation of assets—Immovable properties.

(iv) Incorrect grant of exemption/deduction.

(v) Non-levy of interest.

(vi) Mistake in calculation of estate duty.

A few instances of these mistakes are given in the following paragraphs. 4 of these cases were checked by the Internal Audit but mistakes were not detected by it.

5.24 Incorrect compulation of principal value of estate

1. *Lack of correlation amongst various assessment records*

The need for correlation of assessment made under various direct taxes has been consistently, stressed upon by the Public Accounts Committee (101st Report-Seventh Lok Sabha—1981-82). The Central Board of Direct Taxes have also issued instructions emphasising the need for such correlation in November 1973 and April 1979, with a view to preventing cases of evasion of estate duty. Despite these, mistakes in incorrect computation of principal value of estate and undercharge of duty, were noticed in audit.

In the estate duty assessment made during March 1988 in respect of a person who died in September 1978, the following mistakes were noticed :

(a) The provisional assessment concluded in December 1985 was revised in December 1986, to include the addition of Rs. 1,83,671 to the value of certain properties offered for estate duty. However, while completing the regular assessment in March 1988, the addition of Rs. 1,83,671 was omitted to be considered, resulting in corresponding under assessment of estate.

(b) A scrutiny of the wealth-tax assessment of the Hindu undivided family, as on the valuation date (31 March 1978) revealed that interest of the joint family in a partnership firm was Rs. 11,33,814 and one sixth share of the deceased therein worked out to Rs. 1,88,969. In the estate duty assessment, however, the value of the joint family's interest in the firm was incorrectly taken as Rs. 4,77,003 only and consequently the share of the deceased therein included in the principal value of the estate was only Rs. 79,500. This mistake resulted in under-assessment of estate by Rs. 1,09,469.

The above mistakes resulted in aggregate under-assessment of estate duty by Rs. 2,93,140 with consequent duty effect of Rs. 99,424.

The Ministry of Finance have accepted the objection.

2. *Undervaluation of the principal value of estate*

(i) In the estate duty assessment (December 1987) of a person who died in November 1983, the principal value of estate was short computed by Rs. 3,30,297 due to omission to include the following amounts in the estate.

(a) An amount of Rs. 1,61,623 representing deposit with accrued interest in a private limited company, orignally included in the return was excluded in the assessment on the plea of the accountable person that the holding had no value in view of the heavy losses suffered by the company. This view was not, however, tenable as the deceased had an enforecable claim for Rs. 1,61,623 during the existence of the company which was neither wound up nor under liquidation;

(b) An amount of Rs. 1,50,000, representing debt owed by the deceased for standing as surety for loan raised by the above company from a corporation was claimed and allowed as liability, considering it as an enforceable debt. The deceased person being a guarantor alongwith others, the liability was of the nature of a contigent liability to be discharged only in the event of the corporation being unable to realise its dues from the debtor company;

(c) An amount of Rs. 18,674 being the coffee pool divided for the crop season 1981-82 credited to the account of the deceased after his death was not included in the estate.

As a result of omission to include the above amount, the estate of the deceased was under-assessed by Rs. 3,30,297 with consequent short levy of duty of Rs. 2,80,752.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

(ii) Under the Estate Duty Act, 1953, the property taken under a disposition made by the deceased purporting to operate as an immediate gift intervivos, whether by way of transfer, delivery, declaration of trust, settlement upon persons in succession or otherwise, within a period of two years prior to death, shall be deemed to pass on death. Further, under the Act, ibid, estate duty is leviable on the principal value of all property that passes or is deemed to have passed on the death of the deceased.

In the estate duty assessment (August 1987), a deceased who died on 6 September 1983, paid Rs. 33,993 (Rs. 16,446 in 1981-82 and Rs. 17,547 in 1982-83) as insurance permia on the life policy of his son within two years prior to his death. These payments of Rs. 33,903 on behalf of the son constituted gift, but it was not added to the principal value of the estate. Also, the deceased was a partner in a firm. He transferred (May 1983) his interest in the firm to a Hindu undivided family comprising his wife and two sons for a consideration of Rs. 1,25,000 whereas his interest in the firm amounted to Rs. 3,96,923 which comprised of Rs. 1,25,000 as capital as on 30 June 1982, Rs. 2,00,000 as accretion in the value of building, Rs. 6,735 as share in the development rebate reserve and Rs. 65,188 as share in the proft of the firm to the date of transfer. The transfer for inadequate consideration to the extent of Rs. 2,71,923 (Rs. 3,96,923--Rs. 1,25,000) constituted gift but the same was not added back as estate of the deceased. Thus principal value was short assessed to the tune of Rs. 3,05,916 (Rs. 33,933 + Rs. 2,71,923) resulting in short levy of duty of Rs. 98,455.

The department has not accepted the objection, stating that the assessment was completed under summary assessment scheme.

The paragraph was referred to the Ministry of Finance for comments in July 1989 ; the reply from the Government has not so far been received (October 1989).

(iii) While computing (July 1987) the estate duty assessment of a person who died on 26 November 1976, his share of appreciation in the value of land and building, investment allowance reserve and goodwill, was taken at Rs. 87,568, Rs. 12,950 and Rs. 4,136 as against the actual share of Rs. 3,66,817, Rs. 51,849 and Rs. 16,545 respectively. Besides, loans advanced were taken at Rs. 16,225 against the actual loan of Rs. 17,500. These mistakes resulted in under-assessment of estate by Rs. 3,31,832 and short levy of duty of Rs. 95,605.

The department has not accepted the objection stating that the assessment was completed under summary assessment scheme.

The paragraph was referred to the Ministry of Finance for comments in July 1989 ; the reply from the Government has not so far been received (October 1989).

5.25 Estate escaping assessment

1. Property which the deceased was competent to dispose of at the time of his death shall be deemed to pass on his death and estate duty is leviable on the full value of such property. Share interest of a partner in a firm representing his capital in that firm and his share of surplus arising out of revaluation of the assets of the firm passes on death.

A person who died in July 1959, had 50 per cent share in a firm. The assessing officer, while completing the estate duty assessment in November 1987, revised in December 1987, included the deceased's share in the appreciated value of the assets over the book value of assets of the firm as on the date of death, whereas, the amount of capital to the tune of Rs. 8,16,004 standing at the credit of the deceased in the books of accounts of the firm on the date of death was not included in the principal value of estate of the deceased. This resulted in escapement of estate of Rs. 8,16,004 with consequent short levy of duty for Rs. 1,74,058,

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. Property passing under any settlement made by the deceased by deed or any other instrument not taking effect as a will whereby an interest in such property is reserved, either expressly or by implication, to the settlor, or whereby the settler may have reserve to himself the right by the exercise of any powers, to restore to himself or to reclaim the absolute interest in such property shall be deemed to pass on the settler's death.

The estate duty assessment of a person who died in February 1980 was completed in March 1986 on a principal value of Rs. 5,22,672 after excluding from the value of the estate a sum of Rs. 1 lakh settled on a trust founded by the deceased by a deed of October 1977 and certain other properties valued at Rs. 1,61,700 settled in favour of his two wives by separate deeds in March 1975 and August 1975. Audit scrutiny revealed (October 1986) that in all these settlements the deceased had retained the right to cancel the deeds of settlement at his option. The value of the movable and immovable properties settled aggregating to Rs. 2,61,700 was, however, not included in the dutiable estate of the deceased resulting in non-levy of estate duty of Rs. 95,510.

The local verification of assessment records revealed that the department had raised an additional demand of Rs. 1,05,120 based on the audit objection.

The paragraph was referred to the Ministry of Finance for comments in February 1989; the reply from the Government has not so far been received (October 1989).

3. In the case of a Hindu undivided family, consisting of a Kartha, his wife and his adopted major son, the kartha died in the year 1964 and the coparcenary interest of the late kartha vested equally in his wife and adopted major son. The aggregated value of the properties of the Hindu undivided family was Rs. 18,96,871. The widow's share in the Hindu undivided family properties by way of notional partition, immediately before the death of her husband worked out to Rs. 4,74,218. The widow died on 11 August 1983. Her interest in the Hindu undivided family property was not declared by the accountable person. Thus the interest of the deceased widow was omitted to be included in the net principal value of the estate in the assessment completed in October 1984. Taking into account, the deductions claimed by the assessee in the revised return and also the additions offered, the short computation of estate of the deceased widow worked out to Rs. 4,37,065 and this resulted in short demand of estate duty of Rs. 1,34,784.

The Ministry of Finance have accepted the objection.

4. In the estate duty assessment of a person who died in February 1981, completed in March 1987, the net principal value of estate was determined at Rs. 6,09,700 excluding the value of jewellery in view of declaration made by the accountable person that the deceased had no jewellery at the time of her death. Scrutiny of wealth-tax assessment for the assessment years 1980-81 (valuation date 31 March 1980) and 1981-82 (valuation date 31 March 1981), however, revealed that the Wealth-tax Officer had taken the market value of jewellery at Rs. 1,90,000 and Rs. 2,26,200 respectively. The omission to include jewellery valuing at Rs. 1,90,000 resulted in under-assessment of estate by Rs. 1,90,000 with consequent undercharge of duty of Rs. 57,000.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in June 1989; the reply from the Government has not so far been received (October 1989).

5. In the case of a person who died in October 1982, estate duty assessment was completed in November 1986 determining the principal value of the estate at Rs. 31,55,584. Audit scrutiny revealed (September 1988) that amounts aggregating to Rs. 51,017 representing the value of jewellery (Rs. 50,000) and bank balance (Rs. 1,017) returned by the accountable person, were omitted to be included in the principal value of the estate. The omission resulted in short levy of estate duty to the extent of Rs. 43,310.

The Ministry of Finance have accepted the objection.

5.26 Incorrect valuation of assets

Immovable properties

Under the provisions of the Estate Duty Act, 1953, the value of a property included in the principal value of estate is estimated to be price which it would fetch if sold in the open market at the time of deceased's death. According to the instructions issued by the Central Board of Direct Taxes in August 1974, the assessing officer should ordinarily take the value of an immovable property in the estate duty assessment in conformity with the value estimated by the Departmental Valuation Officer. In case the assessing officer disagrees with the value estimated by the Departmental Valuer, he may take up the matter with the Controller of Estate Duty who may issue necessary instructions in consultation with the Regional Valuation Officer.

1. In the case of a person who died in August 1976, the accountable person furnished the accounts of the estate of the deceased in February 1977. The

deceased was the owner of an immovable property (partly let out and partly self-occupied) constructed on a plot of land measuring 27 cotta 11 chattak 23 sft. in a posh area of a metropolitan city. In the return the accountable person had shown the value of the property at Rs. 4,00,000 valued by a registered valuer who took the average of the different values of the property arrived at under three different methods, viz., rent capitalisation method, land and building method and municipal valuation. The assessing officer referred the valuation of the property to the departmental valuer in May 1978, whereupon in August 1978, the departmental valuer, valued the property at Rs. 13,46,000 as on the date of death of the deceased. Thereafter, he reduced the value to Rs. 13,00,000 on some objection put forward by the accountable person.

In December 1987, i.e. after ten years from the date of submission of the return by the accountable person, the assessing officer completed the estate duty assessment in a summary manner accepting the principal value of the estate at Rs.5,90,601 which included the value of the aforesaid property at Rs. 4,00,000. As there was a huge difference of Rs. 9,00,000 between the two values, the assessing officer should have sought the instruction of the Controller of Estate Duty in terms of the Board's instructions of August 1974, before completing the assessment in a summary manner. The omission to do so resulted in under-assessment of estate by Rs. 9,00,000 and short levy of duty of Rs. 3,19,060.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. In the estate duty assessment of a person who died on 3 August 1976, completed in June 1987 on a principal value of Rs. 4,75,836, the value of 8/35 share of the deceased in certain agricultural lands was adopted as Rs. 3,01,654 as returned by the accountable person. It was, however, noticed in audit in July 1988 that the valuation of the same property had been referred to the Departmental Valuation Officer who had valued the whole property in April 1976 at Rs. 19,30,305. On this basis, the value of the share of the deceased in the agricultural lands worked out to Rs. 4,41,213. Omission to adopt this value resulted in under-assessment of the estate by Rs. 1,39,559.

The Ministry of Finance have accepted the objection.

3. In the absence of rules, the valuation for the purpose of Estate Duty Act has to be determined in accordance with well recognised methods of valuation followed in India. The method of valuation prescribed in Wealth-tax rules, 1957 is the only statutorily recognised method of valuation of residential house property. It has been judicially held that it would not be wrong to adopt the method of valuation prescribed under the Wealth-tax Act for residential house for the purpose of estate duty.

A person who died in January 1975, was owner of an immovable property in a metropolitan city. The property was partly let out and partly occupied by the deceased for residence. In the estate duty assessment completed in December 1987, the value of the property was taken at Rs. 7,31,300 shown in return as determined by a registered valuer. It was noticed in audit that the value of the said property was taken at Rs. 13,87,900 (as determined by the District Valuation Officer of the department) in the wealth-tax assessment of the deceased for the assessment year 1974-75 (valuation date 31 March 1974). In the absence of rules of valuation for the purpose of estate duty assessment, the assessing officer was required to consider the value of the property at a Rs. 13,87,900 as taken in the wealth-tax assessment for the assessment year 1974-75 in place of Rs. 7,31,300 declared in the estate duty return. Incorrect value taken in the assessment made in a summary manner, resulted in under-assessment of estate by Rs. 6,56,600 with consequent duty effect of Rs. 2,61,494 including short levy of interest of Rs. 40,824 for belated submission of return.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

4. In the case of any settlement made by the deceased by deed or any other instrument, where the settlor has reserved any interest in such property for life, the whole of the property in which the interest so reserved will be deemed to pass on the death of the deceased.

A person who died in January 1981 settled before his death in a trust, his one-eight share in a joint property by a deed of settlement for the benefit of himself and his family members. The Estate Duty Officer, while completing estate duty assessment in June 1985, considered only the market value of life interest of the deceased, valued at Rs. 2,98,857. As the deceased did not surrender his interest at least two year before his death, the entire value of the property for Rs. 10,37,125 computed under the Wealth-tax rules 1957, was required to be included in the estate of the deceased. Omission to do so resulted in under-assessment of estate by Rs. 7,38,268 with consequent undercharge of duty for Rs. 2,58,596.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989 ; the reply from the Government has not so far been received (October 1989).

5. The Estate Duty Act 1953, provides for the levy of estate duty on the principal value of all property including agricultural land which passes on the death of a person at the rates prescribed under the Act.

In the estate duty assessment completed on 30 July 1984 in respect of a person who died on 4 August 1982, the value of agricultural lands consisting of cocount gardens in a village was computed at Rs. 30,000 per acre on the basis of valuation fixed by the Registration Department. The valuation was also upheld by the appellate authority on appeal. However, in the estate duty assessment completed in May 1984, in respect of the estate of another person who died on 3 April 1983, the value of agricultural land of 7.81 and 9.03 acres in the same village and also under coconut cultivation were computed at Rs. 16,000 per acre and Rs. 12,000 per acre respectively though the Income-tax Inspector initially indicated in his report, the value of the lands at Rs. 35,000 per acre after consulting the village revenue official. The Registration Department also fixed the market value as on the date of death, in respect of the above pieces of land owned by the deceased at Rs. 30,000 per acre. The under valuation of lands was also confirmed by the fact that the agricultural income therefrom for the assessment year 1983-84 was Rs. 41,000 as per income-tax assessment made in December 1983. Adopting the same value of Rs. 30,000 per acre as computed in the case of the estate duty assessment of the other deceased (died on 4 August 1982) as confirmed by the valuation of the Registration Department in respect of the land owned by the deceased, there was an under-assessment of estate of Rs. 2,71,880 with corresponding short levy of estate duty of Rs. 1,13,006.

The paragraph was referred to the Ministry of Finance for comments in June 1989 ; the reply from the Government has not so far been received (October 1989).

6. From 1 March 1981, the value of one residential house or part thereof owned and used by the deceased before his death, is to be taken as adopted in the wealth-tax assessment in respect of his 'net wealth' on the valuation date immediately preceding the date of his death.

The value of a residential property owned by a person who died in September 1976 returned at Rs. 4,36,922 was reduced to Rs. 2,24,574 in the revised wealth-tax return filed in March 1988. While completing the estate duty assessment in March 1988, the reduced value of Rs. 2,24,574 was adopted on the ground that the same value had been adopted for wealth-tax purposes on the valuation date relevant to the assessment year 1976-77. As the amended provisions were effective only from March 1981, it had no application to cases where death took place prior to 1 March 1981. Incorrect application of the amended provisions resulted in the under-assessment of estate by Rs. 2,12,348 with consequential short levy of estate duty of Rs. 83,252.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

5.27 Incorrect grant of relief/deduction

Under the provisions of the Estate Duty Act, 1953, the allowance of debt and liabilities against the principal value of estate is limited to those for which the deceased was liable to at the time of death and any liability accruing after the death of the deceased on account of any default by accountable person is not an admissible deduction.

1. In the estate duty assessment completed in November 1987, in respect of the estate of a person who died in October 1977 the assessing officer allowed a deduction of Rs. 27,70,000 on account of income-tax and wealth-tax liability. The sum included interest liability of Rs. 5,82,000 for non-payment of income-tax and wealth-tax on due dates as levied by the tax recovery officer. It was noticed in audit that the aforesaid interest liability related to delay in payment of income-tax demands for the assessment year 1954-55 raised in September 1981 and wealth-tax demands for the assessment years 1975-76 to 1977-78 assessed in March 1980, March 1981 and January 1982 respectively. Under the provision of the Act, while tax liabilities on income and wealth assessable upto the date of death of the deceased but quantified after his death are allowable deductions, the aforesaid interest of Rs. 5,82,000 levied by the Tax Recovery Officer for delay in payment of quantified tax demands was not a debt owned by the deceased since it was not created by the deceased during his life time. Thus incorrect allowance of interest liability of Rs. 5,82,000 led to under-assessment of estate by like amount with consequent duty effect of Rs. 3,86,175.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

2. In the estate duty assessment concluded during March 1988 in respect of a person who died in November 1979, the net principal value of the estate inclusive of the interest of all the lineal descendants of the deceased in the joint family property of the Hindu undivided family was determined at

Rs. 24,15,940. On the lineal descendant's share of Rs. 11,80,341, rebate of Rs. 5,00,960 was allowed at 42.44 per cent and a net estate duty of Rs. 5,24,590 levied. A scrutiny of the assessment records revealed that two properties valued at Rs. 7,79,186 considered as property of the Hindu undivided family was not his inherited property but had actually been willed to the deceased by his uncle. Consequently, the share of the lineal descendants eligible for rebate was only Rs. 5,31,076 as against Rs. 11,80,341 incorrectly considered. This resulted in excess allowance of rebate of Rs. 2,75,570.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received (October 1989).

5.28 Short levy of interest

Under the provisions of the Estate Duty Act, 1953, the Central Government could, in addition to the kinds of property specified therein to be exempt, by notification in the official Gazette, any class of property from payment of estate duty, if it is of the opinion that the circumstances so warrant. Although no estate duty is payable in respect of such notified properties, the Act provides that the properties should be taken into account in determining the rate at which estate duty is leviable on the remaining part of the estate not so exempt.

The estate duty assessment of a deceased person, completed in September 1986, was revised in January 1987, to exclude, from the dutiable estate, forest lands and agricultural lands owned by the deceased valued at Rs. 38,47,480 notified by the Central Government to be exempt from payment of duty. These lands were, however, not taken into account in determining the rate at which duty is to be levied on the remaining part of the estate. Further, interest for delay in payment of provisional duty, chargeable at the rate of 6 per cent per annum as per a direction of the Supreme Court, was also not levied. The mistake resulted in a total short levy of duty of Rs. 61,042 including interest.

The Ministry of Finance have accepted the objection.

5.29 Mistake in calculation of estate duty

In the estate duty assessment completed in September 1987, in respect of the estate of a person who died in September 1980, the assessing officer determined the net principal value of estate at Rs. 7,76,600. While calculating duty the assessing officer calculated duty leviable on first five lakhs of estate at Rs. 27,500 instead of the correct amount of Rs. 72,000 as prescribed in the schedule of rates. This led to undercharge of duty for Rs. 44,412 after allowing admissible rebate on gift of Rs. 1,500.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in July 1989; the reply from the Government has not so far been received. (October 1989).

D—INTEREST TAX

5.30 Under the Interest-tax Act, 1974, read with the Finance Act, 1983, interest-tax was being levied at the rate of three and a half per cent (seven per cent upto 31 March 1983) on the total amount of interest received by scheduled banks on loans and advances made in India. Interest on Government securities, as also debentures and other securities issued by local authorities, companies and statutory corporations are not, however, included in the tax base. Interest received on loans and advances made to other scheduled banks are also, likewise exempted from the levy. The levy of interest-tax was extended to the specified All India Industrial Finance Institutions in respect of interest accruing or arising after 30 June 1980. The interest-tax was abolished with effect from 1 April 1985.

A few important cases noticed during test-check of assessments of interest-tax during 1988-89 are given in the following paragraphs. 3 of these cases were checked by the Internal Audit of the department but the mistakes were not detected by it.

5.31 Under-assessment of interest tax due to omission to obtain modified orders from Appellate Authorities

1. In the interest-tax assessments of a nationalised bank for the assessment years 1976-77, 1977-78 and 1978-79 made in December 1983, interest amounts of Rs. 20,44,070, Rs. 28,59,509 and Rs. 1,52,60,784 on sticky loans were added to the chargeable interest and assessed to interest-tax on the ground that the accounts were kept on mercantile basis. Based on appeal by the assessee, the Commissioner of Income-tax (Appeals), relying on a judicial (127 ITR 572) interpretation given by the Madras High Court in April 1980 deleted the above additions to chargeable interest. Pursuant to these

orders, the assessments were revised in November 1984. However, in the light of the judicial interpretation (158 ITR 102) of the Supreme Court in January 1986 that interest on sticky loans would be assessable as interest received in the case of assessees maintaining their accounts on mercantile system, the department failed to take any action to obtain modified orders of the appellate authority till the date of audit (February 1987). The omission resulted in aggregate under-assessment of interest-tax of Rs. 14,11,505 for these years.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. The original interest-tax assessments of a nationalised bank for the assessment years 1976-77, 1977-78 and 1978-79 made in March 1984, in which interest of Rs. 23,97,809, Rs. 25,37,091 and Rs. 29,80,614 due to sticky loans was assessed to interest-tax. Based on appeal by the assessee, the Commissioner of Income-tax (Appeals) in his orders (January 1985) held that interest-tax was not leviable on such amounts, based on a judicial interpretation (127 ITR 572) of the Madras High Court. The assessments for these years were revised in February 1985 to give effect to Commissioner of Income-tax (Appeals)'s order deleting the above additions. However, in the light of the judicial (158 ITR 102) interpretation given by the Supreme Court in January 1986, holding that interest on sticky loans would be assessable as income in the case of assessee's keeping their accounts on mercantile basis, the department failed to obtain modified orders of the appellate authority till the date of audit (February 1987). The omission resulted in undercharge of interest-tax for these years to the extent of Rs. 5,54,085.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

5.32 Delay in making interest-tax assessments

Under the Interest-tax Act, 1974, there is no statutory time limit for completion of interest-tax assessments. The Central Board of Direct Taxes issued instructions in December 1981 that interest-tax assessment should, as far as possible, be completed alongwith the income-tax assessments.

1. The income-tax assessments of a nationalised bank, for the assessment years 1981-82 and 1984-85 were completed in June 1984 (revised in January 1986) and February 1988 on a total income of Rs. 28,88,375 and Rs. 3,15,82,457 respectively. Though, the assessee had filed the returns under the Interest-tax Act, for the above assessment years in July 1981 and June 1984 returning interest income of Rs. 33,78,56,503 and Rs. 1,09,51,45,722 and paying advance tax of Rs. 2,25,00,000 and Rs. 4,72,33,312 for the two assessment years respectively, the interest-tax assessments were not completed till the end of audit i.e. March 1988. This resulted in postponement of collection of revenue of Rs. 28,15,012 due to the Government.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

2. The income-tax assessments of a nationalised bank, for the assessment years 1981-82, 1982-83 and 1984-85 were completed in July 1984 (revised in April 1988), March 1985 (revised in December 1988) and January 1988 on total income of Rs. (—) 61,55,495, Rs. (—) 2,35,64,012 and Rs. (—) 34,88,02,591 respectively. Though the assessee had filed the returns under the Interest-tax Act, for the above assessment years in November 1981, November 1982 and November 1984 returning interest income of Rs. 32,52,55,890, Rs. 72,64,90,582 and Rs. 85,82,16,094 and paying advance tax of Rs. 2,27,67,912, Rs. 5,18,30,100 and Rs. 3,83,31,635 respectively, the interest-tax assessments were not completed till the date of audit i.e. March 1988. This resulted in postponement of collection of revenue of Rs. 47,27,941 due to the Government.

The department has accepted the objection.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

3. A banking company filed its return of interest-tax for the assessment years 1982-83 and 1983-84 in July 1982 and June 1983 and paid advance interest-tax of Rs. 5,54,60,581 and Rs. 6,21,65,726 respectively. Though the income-tax assessments of

the company for the two assessment years were completed in January 1985 and February 1986 after allowing deductions towards the advance interest-tax paid, the interest-tax assessments were not completed. Audit scrutiny (February 1987) revealed that taking into account, the interest on sticky loans of Rs. 39,40,301 assessed as income for the assessment year 1982-83 and interest on sticky loans assessed as interest income for assessment year 1983-84 aggregating to Rs. 80,76,864, the assessee was liable to pay a further interest-tax of Rs. 2,75,821 and Rs. 5,65,380 for these two assessment years which was not levied by the department. The omission to make interest-tax assessment resulted in postponement of collection of revenue of Rs. 8,41,201 due to the Government.

The paragraph was referred to the Ministry of Finance for comments in August 1989; the reply from the Government has not so far been received (October 1989).

NEW DELHI
The 13 MAR 1990

T. S. Madhavan

(T. SETHUMADHAVAN)
Director of Receipt Audit
(Direct Taxes)

Countersigned

T. N. Chaturvedi

NEW DELHI
The 13 MAR 1990

(T. N. CHATURVEDI)
Comptroller and Auditor General of India

H

ERRATTA

Page No.	Para No.	Column No.	Line	For	Read
X	X(V)	2	2 from bottom	ceas	case
5	1.05(ii)	1	18 from top	(iii) Rs.100000	(iii) Rs. 1,00,001
21	1.15(v)	1	16 from top	cquired	acquired
24	1.20(i)	2	5 from top in the table	—	Amount may be read (In crores of rupees)
25	1.20(ii)(c)	2	20 from bottom	122-06	122.13
35	2.01.15	2	5 from bottom	deduction at source	deduction
41	Annexure	4	9 from top	price	prize
41	Annexure Item D		24 from top	1379.00	1379.80
45	2.02.6	1	5 from top	source	At source
58	2.02.14	2	20 from bottom	(vi)	(v)
59	2.02.14	1	13 from top	(vii)	(vi)
60	2.02.14	2	30 from top	15.75	15
61	2.02.14	2	2 from top	15	14
61	2.02.14	2	5 from top	Rs. 3,929	Rs. 2,688
61	2.02.14	2	5 from top	Rs. 62,373	Rs. 29,239
68	2.02.23	2	20 from bottom	upon	upto
73	2.03.7	2	27 from top	1.7	7.7
77	2.03.12	2	5 from bottom	costing	amounting to
80	2.03.16	2	15 from top	1,04,496	1,04,469
85	3.06(ii)		25 from bottom	28.1.1987	23.1.1987
85	3.06(ii)		24 from bottom	1,01,570	41,01,570
95	3.17.1(1)	1	6 from bottom	allowing	disallowing
95	-do-	2	3 from top	August 1988	August 1989
97	3.17	1	12 from bottom	to leading	leading to
103	3.25	1	18 from top	1985-86	1984-85
106	3.27.6	1	—	—	Insert this at the end of para 6. The Ministry of Finance have accepted the objection.
106	3.27.10	2	13 from bottom	2,15,494	2,15,496
117	3.30.12	1	15 from top	14,98,129	14,98,192
138	3.42.11	1	4 from bottom	competed	completed
141	3.43	2	2 from bottom	Gobernment	Government
151	3.50(details)		12 from bottom	on	of
155	3.53.4	1	5 from bottom	7,48,606	7,48,666
155	3.54.4	2	2 from top	2,21,574	3,21,574
163	3.60	1	4 from top	of	or
164	3.62.2	Item no. 2	13 from top	Interest on interest on excess	Interest on excess
167	3.65	—	Top heading	Not	Non
170	3.69.3(ii)	1	18 from top	(ii)	(iii)
183	4.13.2(i)	2	11 from bottom	taxes admissible	Taxes was admissible
195	4.22.4	1	3 from bottom	1,15,187	1,45,187
198	4.25.4	2	13 from top	owing	owning
220	5.06.2 (ii)(b)	2	21 from bottom	Rs. 51.99	Rs. 51.59
232	5.24(ii)	1	10 from bottom	33,903	33,993
232	5.24(ii)	2	9 from top	33,933	33,993