Report of the Comptroller and Auditor General of India

for the year ended March 2008

UNION GOVERNMENT
(DIRECT TAXES)
NO. CA 21 OF 2009

Laid on the table of Lok Sabha/Rajya Sabha on 10 जुलाई 2009

CONTENTS

CHAPTER III

CORPORATION TAX

CHAPTER IV

PART-A: INCOME TAX

PART-B: WEALTH TAX

PREFACE

This report for the year ended March 2008 has been prepared for submission to the President under Article 151(1) of the Constitution of India.

Audit of Revenue Receipts - Direct Taxes of the Union Government is conducted under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971.

The report presents the results of audit of receipts under direct taxes comprising corporation tax, income tax, wealth tax, etc., and is arranged in the following order: -

(i) Chapter I include information on the arrangements for audit of direct taxes and mention the results thereof;

(ii) Chapter II incorporates important statistical information on tax administration;

(iii) Chapter III mentions issues arising out of the test check of assessments of corporation tax;

(iv) Chapter IV is divided into two parts: Part A highlights the results of the test check of income tax assessments and Part B the results of the test check of wealth tax assessments.

The observations included in this report have been selected from the findings of the test check conducted during 2007-08 and in earlier years which could not be covered in the previous reports.

OVERVIEW

CHAPTER I: INTRODUCTION

The Comptroller and Auditor General of India conducts the audit of revenues from direct taxes of the Union Government under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971.

Audit issued 879 observations with a tax effect of Rs. 1,603.84 crore to the Ministry as individual draft paragraphs, including 506 observations involving revenue impact of Rs. 1,085.67 crore that has arisen from local audit conducted in earlier years. Of these, 860 observations involving revenue impact of Rs. 1,572.08 crore have been included in this report. There was loss of revenue of Rs. 1,257.29 crore due to timely remedial action not being taken in 6,086 cases.

Recovery of Rs. 216.74 crore was made at the instance of audit in respect of 1,474 cases during 2007-08.

Audit analysis of 99,845 scrutiny assessment records out of 1,11,664 assessments completed during 2006-07 in respect of selected units and audited in 2007-08 in seven states revealed 6,412 'assessment records with errors' having money value of Rs. 8,362.75 crore. In these seven states, percentage of 'assessments with errors' to 'assessments checked in audit' in scrutiny assessments ranged from 4.77 per cent (Rajasthan) to 10 per cent (Karnataka).

Out of a target of 1,70,900 cases for disposal during 2007-08 only 86,486 cases were seen by internal audit.

Department did not produce to audit 42,923 cases (63 per cent) of 68,014 cases, not produced during earlier audits and requisitioned again in 2007-08, which included 505 cases (0.74 per cent) not produced in three or more consecutive audit cycles in Andhra Pradesh, Gujarat, Jharkhand, Karnataka, Madhya Pradesh, Maharashtra and Orissa charges and hence, could not be audited. Out of 7,48,313 current records requisitioned during the year, 55,645 cases (7.44 per cent) were not produced.

CHAPTER II: TAX ADMINISTRATION

Total collections from Direct Taxes increased from Rs. 1,05,089 crore in 2003-04 to Rs. 3,12,213 crore in 2007-08 at an average annual rate of growth of 30.44 per cent.

In the case of corporate assessees, 82.03 per cent of gross collections were made at the pre-assessment stage (Tax Deducted at source, Advance Tax and Self Assessment), of which 57.20 per cent was by way of advance tax. In the case of non-corporate assessees, 88.81 per cent of the gross collection was made at the pre-assessment stage, of which 53.66 per cent was by way of TDS.

The total number of assessees for direct taxes increased by 7.56 per cent from 312.96 lakh in 2006-07 to 336.63 lakh in 2007-08. Non-corporate assessees constituted 98.52 per cent of the total assessees whereas corporate assessees comprised 1.48 per cent.

The number of cases selected for scrutiny during 2007-08 was higher at 6.42 lakh as compared to 3.41 lakh in 2006-07. The total pendency (scrutiny and summary assessments) has increased from 57.89 lakh cases (21.16 per cent) in 2003-04 to 191 lakh cases (45.48 per cent) in 2007-08. In fact, there has been a progressive decline in the percentage of completion of assessments from 78.84 per cent in 2003-04 to 54.52 per cent in 2007-08, although in absolute terms these figures had increased.

Uncollected amount of Rs. 1,24,274 crore in respect of corporation tax and income tax comprised demand of Rs. 86,859 crore of earlier years and current demand of Rs. 37,415 crore for 2007-08. The uncollected amount of corporation tax increased from Rs. 55,098 crore in 2005-06 to Rs. 68,662 crore in 2007-08 and that for income tax from Rs. 40,289 crore in 2005-06 to Rs. 55,612 in 2007-08 respectively.

During 2007-08, against Rs. 36,057.56 crore certified by TRO for recovery, only Rs. 8,612.62 crore (23.89 per cent) could be recovered. There was an improvement in recovery from 14.01 per cent in 2005-06 to 24.20 per cent in 2006-07 and a marginal decline to 23.89 per cent in 2007-08.

Payment of interest on refunds amounting to Rs. 4,444 crore was treated as reduction in revenue in violation of accounting precepts as interest was never collected in the first instance. No provision for 'interest on refunds' was made in the budget estimates for 2007-08.

CHAPTER III: CORPORATION TAX

Receipts from corporation tax amounted to Rs. 1,92,911 crore which constituted 61.79 per cent of the total collection from direct taxes during 2007-08. The number of corporate assessees as on 31 March 2008 was 4.98 lakh which represented an increase of 24.63 per cent over the previous year. In respect of corporate assessees, 624 draft paragraphs involving undercharge of tax of Rs. 1,375.15 crore and 25 draft paragraphs involving overcharge of tax of Rs. 166.21 crore were issued to the Ministry of Finance for comments. Out of these, 605 draft paragraphs involving under charge of Rs. 1,342.49 crore and 25 cases involving overcharge of Rs. 166.21 crore have been included in this report.

The irregularities as observed by audit relate to mistakes in computation of business income, income under special provisions, carry forward/set off of losses, adoption of correct figures/arithmetical errors, application of correct rate of tax/surcharge, allowance of capital/non-business expenditure, deductions under Chapter VIA and other than under Chapter VIA, assessments while giving effect to appellate orders, capital gains, depreciation, provisions, deduction/liability not supported by actual payment, exemptions and reliefs, refund/interest on refund, non/short levy of interest and summary assessments.

The Ministry has accepted the observations in 39 cases involving aggregate revenue impact of Rs. 22.98 crore till the preparation of this report (December 2008).

CHAPTER IV:

PART A – INCOME TAX

Receipts from income tax amounted to Rs. 1,02,655.08 crore which constituted 32.88 per cent of the total collection from direct taxes during 2007-08. The number of income tax assessees as on 31 March 2008 was 3.32 crore, which represented an increase of 7.34 per cent over the previous year. In respect of income tax assessees, 167 draft paragraphs involving undercharge of tax of Rs. 59.71 crore and 15 draft paragraphs involving overcharge of tax of Rs. 1.97 crore were issued to the Ministry of Finance for comments. Out of these, 159 draft paragraphs involving under charge of Rs. 56.80 crore and 15 cases involving overcharge of Rs. 1.97 crore have been included in this report.

The irregularities as observed by audit relate to mistakes in computation of business income, carry forward/set-off of losses, adoption of correct figures, levy of interest, depreciation, deductions in respect of export profits, computation of tax, allowance of liabilities, computation of capital gains/loss, assessment of salary income, levy of surcharge, summary assessments, cases of over assessment/overcharge and income not assessed.

The Ministry has accepted the observations in 10 cases involving aggregate revenue impact of Rs. 84.01 lakh till the preparation of this report (December 2008).

PART B – WEALTH TAX

Out of the 47 draft paragraphs issued to the Ministry, 42 draft paragraphs of irregularities involving revenue impact of Rs. 77.25 lakh on account of various irregularities in wealth tax assessments such as wealth not assessed due to non-correlation of records of different taxes, non-inclusion of taxable assets in the net wealth and mistakes in valuation of assets have been included in this chapter.

The Ministry has accepted the observations in six cases involving aggregate revenue impact of Rs. 6.05 lakh till the preparation of this report (December 2008).

CHAPTER I
INTRODUCTION

Contents	Page

Chapter Summary

Comptroller and Auditor General of India conducts audit of revenues from direct taxes of the Union Government under section 16 of the Comptroller and Auditor's General of India (Duties, Powers and Conditions of Service) Act, 1971, through test check of assessments and other records maintained by the Income tax Department and Ministry of Finance. He examines the systems and procedures laid down by the department/Government in critical areas of tax administration to assess the effectiveness of their working and evaluates the degree of compliance with tax laws, rules and judicial pronouncements in the assessment, demand and collection of tax revenues from various assessees.

(Paragraph 1.2)

Field offices under the Comptroller and Auditor General of India issued 19,694 audit observations on underassessment involving tax effect of Rs. 12,091.82 crore and 85 cases of overassessment involving tax effect of Rs. 20.23 crore during 2007-08 to the assessing officers of the Department relating to corporation tax, income tax and other direct taxes. A total of 879 cases with tax effect of Rs. 1,603.84 crore were issued to the Ministry as individual draft paragraphs, out of which 860 cases involving tax effect of Rs. 1,572.08 crore are included in this report.

(Paragraphs 1.4.1 and 1.7)

During 2007-08, the Department made recovery of Rs. 216.74 crore in respect of 1,474 audit observations included in local audit reports/system reviews.

(Paragraph 1.6.1)

Audit analysis of 99,845 scrutiny assessment records out of 1,11,664 assessments completed during 2006-07 in respect of selected units and audited in 2007-08 in seven states revealed 6,412 'assessment records with errors' having money value of Rs. 8,362.75 crore. In these seven states, percentage of 'assessments with errors' to 'assessments checked in audit' in scrutiny assessments ranged from 4.77 per cent (Rajasthan) to 10 per cent (Karnataka).

(Paragraph 1.8)

There was loss of revenue of Rs. 1257.29 crore due to timely remedial action not being taken in 6,086 cases.

(Paragraph 1.12.1)

Out of a total target of 1,70,900 cases for disposal during 2007-08, only 86,486 cases were seen by internal audit.

(Paragraph 1.13)

Over 63 per cent of cases not produced during earlier audits and requisitioned again in 2007-08, were not produced to audit. 55,645 cases (7.44 per cent) out of 7,48,313 current records requisitioned during 2007-08, were not produced

(Paragraph 1.15.1 and 1.15.2)

CHAPTER I

INTRODUCTION

General

1.1 Direct taxes levied by Parliament comprise:

- **Corporation tax**
- **Income tax**
- **Wealth tax**
- **Fringe Benefit tax**
- **Securities Transactions tax and**
- **Banking Cash Transactions tax**

Laws relating to direct taxes are administered by the Central Board of Direct Taxes (hereinafter called 'the Board'). The Board is under the overall control of the Department of Revenue, Ministry of Finance. Revenue collection from direct taxes during 2007-08 was Rs. 3,12,213 crore. Time series data on revenue from various direct taxes and other related statistical information on tax administration are presented in Chapter II.

Statutory audit

1.2 Audit of direct taxes by the Comptroller and Auditor General of India is carried out under section 16 of the Comptroller and Auditor General of India (Duties, Powers and Conditions of Service) Act, 1971. Audit covers the field offices and the Board and involves examination of :

(a) assessments through test check;

(b) rationale for issue of instructions and circulars, and

(c) efficacy and adequacy of systems and procedure of tax collection, appeals and overall tax administration.

1.3 After completion of audit of each assessment unit, audit observations are conveyed to the Department through a local audit report. In the case of important observations, a statement of facts is issued to the Department for verification of facts and obtaining their comments. Important audit findings are forwarded to the Board and the Ministry of Finance in the form of draft paragraphs. Finally, the Audit Report on direct taxes is forwarded to the Parliament through the President of India as provided in Article 151 of the Constitution of India.

Present report

1.4 The preface describes the arrangement of this report. The Ministry's response, where furnished has been indicated in each case. Where the reply of the Ministry is not acceptable, the reasons have been mentioned along with the gist of the reply.

1.4.1 The present report contains 860 out of 879 audit observations referred to the Ministry of Finance. Table below contains the details of draft paragraphs[1] (DPs) issued to the Ministry and included in the report.

Table no. 1.1: Draft paragraphs issued to the Ministry during 2007-08

Category of tax	Number of draft paras issued to the Ministry	Tax effect (Rs. in crore)	Number of draft paras included in the report	Tax effect (Rs. in crore)
Corporation Tax	649	1,541.36	637	1,510.62
Income Tax	182	61.68	178	60.68
Wealth Tax	47	0.79	45	0.78
Gift Tax	1	0.01	0	0
Total	**879**	**1,603.84**	**860**	**1,572.08**

1.4.2 Out of the above, 373 observations involving tax effect of Rs. 518.17 crore had arisen out of local audit conducted during 2007-08 and the remaining 506 observations involving tax effect of Rs. 1,085.67 crore were noticed during local audit conducted in earlier years.

1.5 A separate Performance Audit Report no. 25 PA of 2009 (Performance Audit) containing the results of system appraisals has been prepared on the following subjects :

- Exemptions, deductions and allowances to shipping and related sectors
- Deductions of profit and gain from certain undertakings other than infrastructure development undertakings (Deduction under section 80-IB of IT Act, 1961)
- IT audit of e TDS system of the Income-tax Department

Board's comments on draft paragraphs

1.6 Cases with substantial tax effect are brought to the notice of the Income-tax Department and the Ministry in the form of 'draft paragraphs'. As per Ministry of Finance (Department of Expenditure) O.M. No. F 12(9) E. (Coord)/67, draft paragraphs should be disposed off as expeditiously as possible and the comments of the Ministry intimated to audit within a period not exceeding six weeks. The replies of the Board to the draft paragraphs are considered before finalisation of this report. Table below contains the position of replies received from the Ministry along with follow up action taken on them and recoveries made till the finalisation of the report.

(Rs. in crore)

Table no. 1.2: Follow up action on DPs by the Ministry and recoveries made

Year of Audit Report	DPs issued to the Ministry		Paragraphs accepted				Replies not received		Recoveries made					
			Pre printing		Post printing				Pre printing		Post printing		Total	
	No.	Amount	No.	Amount	No	Amount	No	Amount	No	Amount	No	Amount	No	Amount
2007-08	879	1,603.84	55	23.88	0	0	798	1,561.97	14	3.84	0	0	14	3.84
2006-07	961	1,749.97	295	729.90	180	87.31	272	709.65	31	11.11	9	2.74	40	13.85
2005-06	905	1,971.33	340	328.28	107	83.92	265	1,348.62	29	13.75	30	45.46	59	59.21
2004-05	688	3,490.55	36	9.28	305	788.17	287	2,609.06	9	1.29	83	221.90	92	223.19
2003-04	931	1,852.65	74	59.68	427	69.58	170	734.58	16	4.62	85	34.76	101	39.38

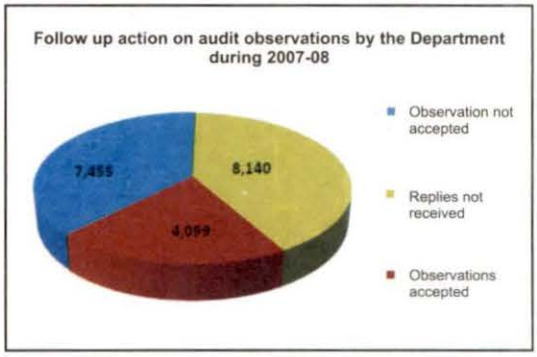
[1] An audit observation issued to the Ministry seeking their comments

Recovery at the instance of audit

1.6.1 In respect of 14 out of 879 DPs issued to the Ministry during 2007-08, recovery of Rs. 3.84 crore has been made by the Department. The list of these DPs is given in **Appendix 1**. During 2007-08, department made recovery of Rs. 216.74 crore in respect of 1,474 audit observations included in local audit reports/systems reviews during 2007-08 and earlier years.

Results of test audit in general

1.7 Audit of assessments of all direct taxes conducted between 1 April 2007 to 31 March 2008 revealed 19,694 cases of underassessment and 85 cases of overassessment involving revenue effect of Rs. 12,091.82 crore and Rs. 20.23 crore respectively. Assessing officers accepted 4,099 audit observations (20.81 per cent), did not accept 7,455 observations (37.86 per cent) and did not respond to 8,140 observations (41.33 per cent) involving tax effect of Rs. 968.46 crore, Rs. 5,169.11 crore and Rs. 5,954.25 crore respectively of underassessment.



Audit observations and revenue effect in audit of scrutiny assessments

1.8 Audit of direct taxes is conducted on the basis of test check of assessment units and records. A near to cent per cent check is done of scrutiny assessment records. Audit analysis of 99,845 scrutiny assessment records out of 1,11,664 assessments completed during 2006-07 in respect of selected units and audited in 2007-08 in seven states[2] revealed 6,412 'assessment records with errors' having money value of Rs. 8,362.75 crore. In these seven states, percentage of 'assessments with errors' to 'assessments checked in audit' in scrutiny assessments ranged from 4.77 per cent (Rajasthan) to 10 per cent (Karnataka) as detailed below:

Table no. 1.3: Audit observations and revenue effect in audit of scrutiny assessments

State	No. of assessments completed	No. of assessments checked in audit	No. of assessments with error	Total revenue effect of audit observations observed in the scrutiny assessments (Rs. in crore)	Percentage (Column 4/ column 3 x 100)
1	2	3	4	5	6
Andhra Pradesh	10,356	9,236	579	224.82	6.27
Delhi	22,828	18,529	1,345	1,643.46	7.26
Gujarat	20,359	17,977	982	108.15	5.46
Karnataka	3,596	3,351	335	113.27	10.00
Maharashtra	31,928	29,792	1,644	5,523.14	5.52
Rajasthan	8,568	7,754	370	99.02	4.77
West Bengal	14,029	13,206	1,157	650.89	8.76
Total	**111,664**	**99,845**[3]	**6,412**	**8,362.75**	

[2] Andhra Pradesh, Delhi, Gujarat, Karnataka, Maharashtra, Rajasthan and West Bengal.

[3] Difference of 11,819 from the no. of assessments completed is due to non- production of records.

In view of the in-depth and detailed analysis of facts during scrutiny assessments, the reasons for errors in these, needs to be investigated and addressed.

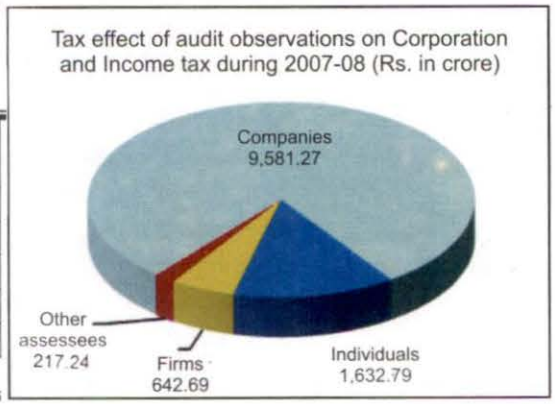
Corporation tax and income tax

1.9 The number of audit observations during 2007-08 relating to different categories of assessees with their tax effect on corporation and income tax is shown in Table below:

Table no. 1.4: Audit observations during 2007-08 on corporation and income tax

Sl. no.	Status of assessees	No. of audit observations
1	Companies	7,846 (41.67)
2	Individuals	6,462 (34.33)
3	Firms	3,513 (18.66)
4	Other assessees	1,005 (5.34)
	Total	**18,826 (100)**

(Figures in bracket represent per cent)



1.9.1 Audit of direct taxes is carried out with reference to provisions contained in the Income Tax Act such as those relating to exemptions, deductions, capital gains, international taxation, minimum alternate tax (MAT) etc. Table below provides a broad overview of audit observations on underassessment in terms of the nature of mistakes noticed by audit under individual sections of the Act.

(Rs. in crore)

Table no. 1.5: Nature of omissions in the assessment of income tax/corporation tax

Sl. no.	Category of audit observations	No. of cases	Tax effect
1	Incorrect computation of business income	5,357	4,081.29
2	Non/short levy of interest for delay in submission of returns, delay in payment of tax etc.	1,484	1,659.58
3	Irregular exemptions and excess relief given	1,945	1,428.57
4	Irregular computation of capital gains	516	1,187.73
5	Mistakes in computation of income and tax	1,512	934.29
6	Income not assessed	1,781	572.40
7	Incorrect application of rate of tax/surcharge etc.	563	536.36
8	Irregular set-off of losses	681	535.93
9	Irregularities in allowing depreciation	1,404	232.19
10	Omission/short levy of penalty	622	104.68
11	Avoidable or incorrect payment of interest by Government	107	22.41
12	Mistakes in assessments of firm	246	19.33
13	Excess or irregular refunds	311	17.77
14	Mistakes in assessments while giving effect to appellate orders	51	6.17

Sl. no.	Category of audit observations	No. of cases	Tax effect
15	Omission to club the income of spouse/minor child etc.	5	0.06
16	Others	2,241	735.23
	Total	**18,826**	**12,073.99**

1.9.2 Categories depicted at Sl. nos. 1 and 3 of the above Table namely 'Incorrect computation of business income' and 'Irregular exemptions and excess relief given' account for the maximum number of audit observations about which further details are depicted in Table below :

Table no. 1.6: Review of category wise objections

Category of omission	Per cent of total audit observations	Per cent of total tax effect	Charges with maximum number of audit observations		
			Charges	Number (in per cent)	Tax effect (in per cent)
Incorrect computation of business income	28	33	Maharashtra, West Bengal & Tamil Nadu	47	75
Irregular exemptions and excess relief given	10	12	Tamil Nadu, Maharashtra & West Bengal	59	92

Wealth tax

1.9.3 Similarly, 854 observations relating to wealth tax were issued involving tax effect of Rs. 17.46 crore. Table below contains an analysis of the nature of omissions.

(Rs. in crore)

Table no. 1.7: Categories of omissions in wealth tax

Sl. no.	Categories of audit observation	No. of cases	Tax effect
1.	Wealth not assessed	618	14.05
2	Incorrect valuation of assets	79	1.28
3.	Non-levy or incorrect levy of additional wealth tax	30	0.35
4	Non-levy or incorrect levy of penalty and non-levy of interest	43	0.39
5	Mistakes in computation of net wealth	51	0.39
6.	Mistakes in calculation of tax	6	0.34
7.	Incorrect status adopted	0	0
8	Irregular/ excessive exemptions	4	0.15
9.	Others	23	0.51
	Total	**854**	**17.46**

Other direct taxes

1.9.4 Audit issued 14 observations relating to interest tax and expenditure tax involving tax effect of Rs. 0.37 crore as mentioned in Table

(Rs. in lakh)

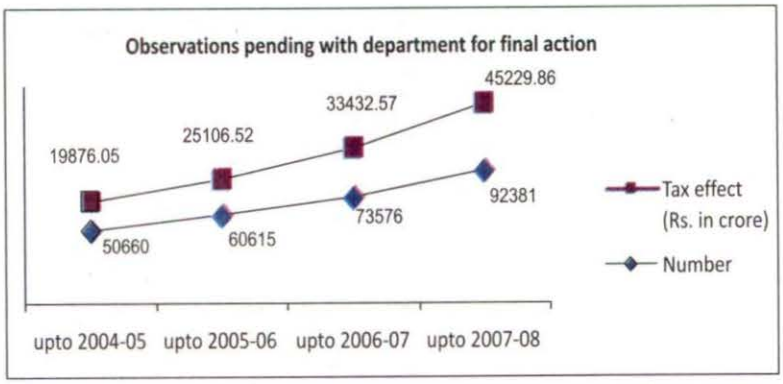
Table no. 1.8: Other direct taxes

Sl. no.	Category of tax	No. of cases	Tax effect
1	Interest tax	13	30.00
2	Expenditure tax	1	7.00
	Total	**14**	**37.00**

Outstanding audit observations

1.10 According to departmental instructions, observations of statutory audit are to be replied to within a period of six weeks. The Public Accounts Committee (Ninth Lok Sabha) in their 20th report underscored the fact that responsibility for settlement of audit observations rests with the Department and it cannot remain content merely with sending replies to audit observations. In their action taken note, the Ministry of Finance had stated that they would endeavour to see that the targets for settlement of audit observations were achieved. However, large numbers of audit observations made in 2007-08 and earlier years are still to be settled.

1.10.1 As on 31 March 2008, 92,381 observations involving revenue effect of Rs. 45,229.86 crore were pending. The Chart depicts the increasing trend of pendency of observations.



(Rs. in crore)

Table no. 1.9: Observations pending with the Department for final action

Year	Income tax and corporation tax		Other direct taxes[4]		Total	
	No. of cases	Tax effect	No. of cases	Tax effect	No. of cases	Tax effect
Upto 2004-05	45,344	19,559.70	5,316	316.35	50,660	19,876.05
2005-06	9,542	5,215.85	413	14.62	9,955	5,230.47
2006-07	12,369	8,316.72	592	9.33	12,961	8,326.05
2007-08	17,937	11,779.46	868	17.83	18,805	11,797.29
Total	**85,192**	**44,871.73**	**7,189**	**358.13**	**92,381**	**45,229.86**

1.10.2 A total of 16,967 high value[5] audit observations relating to income tax/corporation tax and wealth tax constituted 18.36 per cent of the total

[4] includes wealth tax, gift tax, interest tax, expenditure tax and estate duty.

[5] Income tax and corporation tax cases having tax effect of Rs. 10 lakh or more and other direct taxes cases Rs. 5 lakh or more.

observations and accounted for Rs. 36,538.32 crore (80.06 per cent) of revenue effect of the total pending cases. Department needs to assign priority to settle observations with high tax effect.

1.11 Upto the year 2006-07, the Director of Income tax (Income tax & Audit) used to give detailed information regarding major statutory audit observations separately for current and arrear cases. During 2006-07, target for disposal of current cases was 4,317 i.e. 80 per cent out of 5,396 cases and for arrear cases it was 9,856 cases, i.e. 90 per cent of 10,951, achievement against which was 40.19 per cent and 48.54 per cent respectively. For 2007-08, only closing balance of 12,902 cases with a tax effect of Rs. 7,328.45 crore has been intimated. As the Department has not provided the detailed information regarding targets, opening balance, disposal etc., it has not been possible to assess the actual achievement during the year. In the absence of such information, it is not clear as to how the Department is monitoring the progress of disposal of cases.

Remedial action time barred

1.12 The Board has issued specific instructions for taking timely action on audit observations so as to avoid cases becoming barred by limitation of time and leading to loss of revenue. The Public Accounts Committee (150th Report-Eighth Lok Sabha) had also recommended that the Board review the old outstanding observations in consultation with Audit.

1.12.1 The status of audit observations was reviewed in 2007-08 and in some charges, several cases where remedial action had become time barred were noticed. Details of these cases have been forwarded to the respective Commissioners. Table below contains the number of such cases along with the tax effect.

(Rs. in crore)

Table no. 1.10: Remedial action which has become time barred

Sl. no.	Name of the State	Audit observation	
		Number	Tax effect
1.	Andhra Pradesh[6]	107	4.37
2.	Bihar	129	4.59
3.	Delhi	770	450.96
4.	Jharkhand	83	2.66
5.	Gujarat	225	23.60
6.	Harayana	32	0.78
7.	Kerala	99	3.97
8.	U.T.Chandigarh	56	1.38
9.	Madhya Pradesh	397	16.20
10.	Maharashtra	663	67.84
11.	Orissa	145	19.21
12.	Punjab	64	0.55
13.	Rajasthan	215	2.90
14.	Uttar Pradesh	3,101	658.28
	Total	**6,086**	**1,257.29**

[6] In Andhra Pradesh charge 447 cases (with money value of Rs. 8.37 crore) relating to the period 1974-75 to 1994-95 had become time time-barred for remedial action.

1.12.2 Further, during the period 1983-84 to 2007-08, 7,747 cases (with money value of Rs. 2,127.79 crore) in Delhi charge were noticed where remedial action had become time barred.

Internal Audit

1.13 Details of total auditable cases, total cases audited etc. were being intimated separately in earlier years. During 2006-07, there were 12,33,242 auditable cases, out of which only 3,66,621 cases were audited leaving a balance of 70.27 per cent. During 2007-08, the target for auditing the cases was fixed at 1,70,900[7] only. Out of these, only 86,486 cases were actually audited. As intimated by the Director of Income tax (Income tax & Audit), this year, the annual targets stipulated by the Board for disposal of auditable cases have not been taken as the basis for review of performance because the new Internal Audit System became functional in most charges only after September/October 2007.

1.13.1 Out of the 879 draft paras issued to the Ministry during 2007-08, only 51 (5.80 per cent of draft paras issued) had been seen by internal audit of the Department and the mistakes pointed out by statutory audit had not been detected by internal audit in the cases checked by them.

1.13.2 As per the data furnished by the Directorate of Income tax (Income tax & Audit), the closing balance of auditable cases as on 31 March of a financial year did not tally with the opening balance of auditable cases as on 01 April of the succeeding financial year.

Outstanding audit observations of internal audit

1.14 According to departmental instructions, internal audit observations are to be attended to by the assessing officer within three months. However, as on 31 March 2008, 8,409 audit observations of internal audit raised during 2007-08 involving a tax effect of Rs. 1,374.06 crore were pending.[8] .

1.14.1 Table below contains information on major observations of internal audit and their settlement.

Table no. 1.11: Performance of internal audit in respect of major observations

Financial year	No. of cases for disposal	No. of cases settled	Percentage of total cases disposed	No. of pending cases
2003-04	5,151 (1,936.90)	1,466 (275.63)	28	3,685(1,661.26)
2004-05	5,333 (941.02)	2,296 (485.17)	43	3,037 (455.85)
2005-06	3,592 (2,130.19)	1,533 (170.78)	43	2,059 (1,959.41)
2006-07	2,779 (702.35)	1,015 (299.24)	37	1,764 (403.11)
2007-08	2,229 (1,840.44)	39 (484.49)	1.7	2,190 (1,355.95)

(Figures in brackets indicate money value in rupees crore)

[7] As calculated by Audit on the basis of the Board's instruction No. 3 of 2007, @ 50 for each Additional CIT, 300 for each Special Audit Party and 600/700(Corporate/incorporate) for each Internal Audit Party. The number of auditable cases was not provided by the Director of Income tax (Audit). As such it was not possible to assess the shortfall in disposal with reference to total auditable cases.

[8] Source : Directorate of Income tax (Income tax and Audit)

1.14.2 The major cases settled during 2007-08 were only 39 (1.7 per cent). Opening balances for 2003-04 to 2007-08 do not tally with the closing balances for 2002-03 to 2006-07 respectively, which were still under reconciliation in the Department.

Table no. 1.12: Target and settlement of internal audit observations

	For disposal	To be settled as per targets fixed	Settled	Achieved (per cent)
Current	8,770 (1,858.96)	8,770 (1,858.96)	361 (484.90)	4.11
Arrears	6,688 (412.91)	6,688 (412.91)	0	0

(Figures in brackets indicate money value in rupees crore)

In respect of current cases, achievement was only 4.11 per cent. Regarding arrears, no case was settled during the year.

Records not produced to audit

1.15 Under the powers available under Section 18 of the Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971, assessment records are scrutinised in revenue audit with a view to securing an effective check on the assessment, collection and proper allocation of taxes and examining that regulations and procedures are being observed. It is incumbent on the Department to expeditiously produce records and furnish relevant information to audit.

1.15.1 Appendix 2 contains details of records not produced to audit in previous audit cycles which were requisitioned again in 2007-08. Over 63 per cent of cases not produced during earlier audits and requisitioned again in 2007-08, were not produced to audit. Consequently, audit of such cases could not be carried out. Risk of loss of revenue in such cases cannot be ruled out.

1.15.2 Out of 7,48,313 current records requisitioned during 2007-08, 55,645 cases (7.44 per cent) were not produced to audit. Table below contains state wise details where records were not produced to audit in three or more consecutive audit cycles. Consequently, audit of such cases also could not be carried out. Details of such cases were communicated to the Board in October 2008.

Table no. 1.13: Records not produced to audit in three or more audit cycles

Sl. no.	State	Number of records not produced		
		IT/CT	WT	Total
1	Andhra Pradesh	47	0	47
2	Gujarat	21	0	21
3	Jharkhand	3	0	3
4	Karnataka	82	0	82
5	Madhya Pradesh	20	0	20
6	Orissa	152	0	152
7	Maharashtra	180	0	180
Total		**505**	**0**	**505**

CHAPTER II
TAX ADMINISTRATION

Contents	Page

Chapter Summary

Total collections from Direct Taxes increased from Rs. 1,05,089 crore in 2003-04 to Rs. 3,12,213 crore in 2007-08 at an average annual rate of growth of 30.44 per cent. Overall direct tax collections as a percentage of GDP increased from 3.80 per cent in 2003-04 to 6.62 per cent in 2007-08. Overall tax buoyancy increased from 2.12 in 2003-04 to 2.60 in 2007-08.

(Paragraphs 2.5 and 2.5.3)

In the case of corporate assessees, 82.03 per cent of gross collections were made at the pre-assessment stage (Tax Deducted at source, Advance Tax and Self Assessment), of which 57.20 per cent was by way of advance tax. In the case of non-corporate assessees, 88.81 per cent of the gross collection was made at the pre-assessment stage, of which 53.66 per cent was by way of TDS.

(Paragraph 2.6.1)

The total number of assessees for direct taxes increased by 7.56 per cent from 312.96 lakh in 2006-07 to 336.63 lakh in 2007-08. Non-corporate assessees increased by 7.34 per cent from 308.96 lakh in 2006-07 to 331.65 lakh in 2007-08 and corporate assessees increased by 24.63 per cent from 4.00 lakh in 2006-07 to 4.98 lakh in 2007-08.

(Paragraphs 2.7, 2.7.1 and 2.7.2)

The number of cases selected for scrutiny during 2007-08 was higher at 6.42 lakh as compared to 3.41 lakh in 2006-07. The pendency under scrutiny and summary assessments has increased from 1.91 lakh cases (49.17 per cent) and 55.98 lakh cases (20.75 per cent) in 2003-04 to 5.91 lakh cases (59.19 per cent) and 185.09 lakh cases (45.15 per cent) in 2007-08 respectively as a result of which the total pendency (scrutiny and summary assessments) has increased from 57.89 lakh cases (21.16 per cent) in 2003-04 to 191 lakh cases (45.48 per cent) in 2007-08. In fact, there has been a progressive decline in the percentage of completion of assessments from 78.84 per cent in 2003-04 to 54.52 per cent in 2007-08 although in absolute terms these figures have increased.

(Paragraph 2.9, 2.9.1 and 2.9.2)

Uncollected amount of Rs. 1,24,274 crore in respect of corporation tax and income tax comprised demand of Rs. 86,859 crore of earlier years and current demand of Rs. 37,415 crore for 2007-08. The uncollected amount of corporation tax increased from Rs. 55,098 crore in 2005-06 to Rs. 68,662 crore in 2007-08 and that for income tax from Rs. 40,289 crore in 2005-06 to Rs. 55,612 in 2007-08 respectively.

(Paragraph 2.10.1)

During 2007-08, against Rs. 36,057.56 crore certified by TRO for recovery, only Rs. 8,612.62 crore (23.89 per cent) could be recovered. There was an improvement in recovery from 14.01 per cent in 2005-06 to 24.20 per cent in 2006-07 and a marginal decline to 23.89 per cent in 2007-08.

(Paragraph 2.11.2)

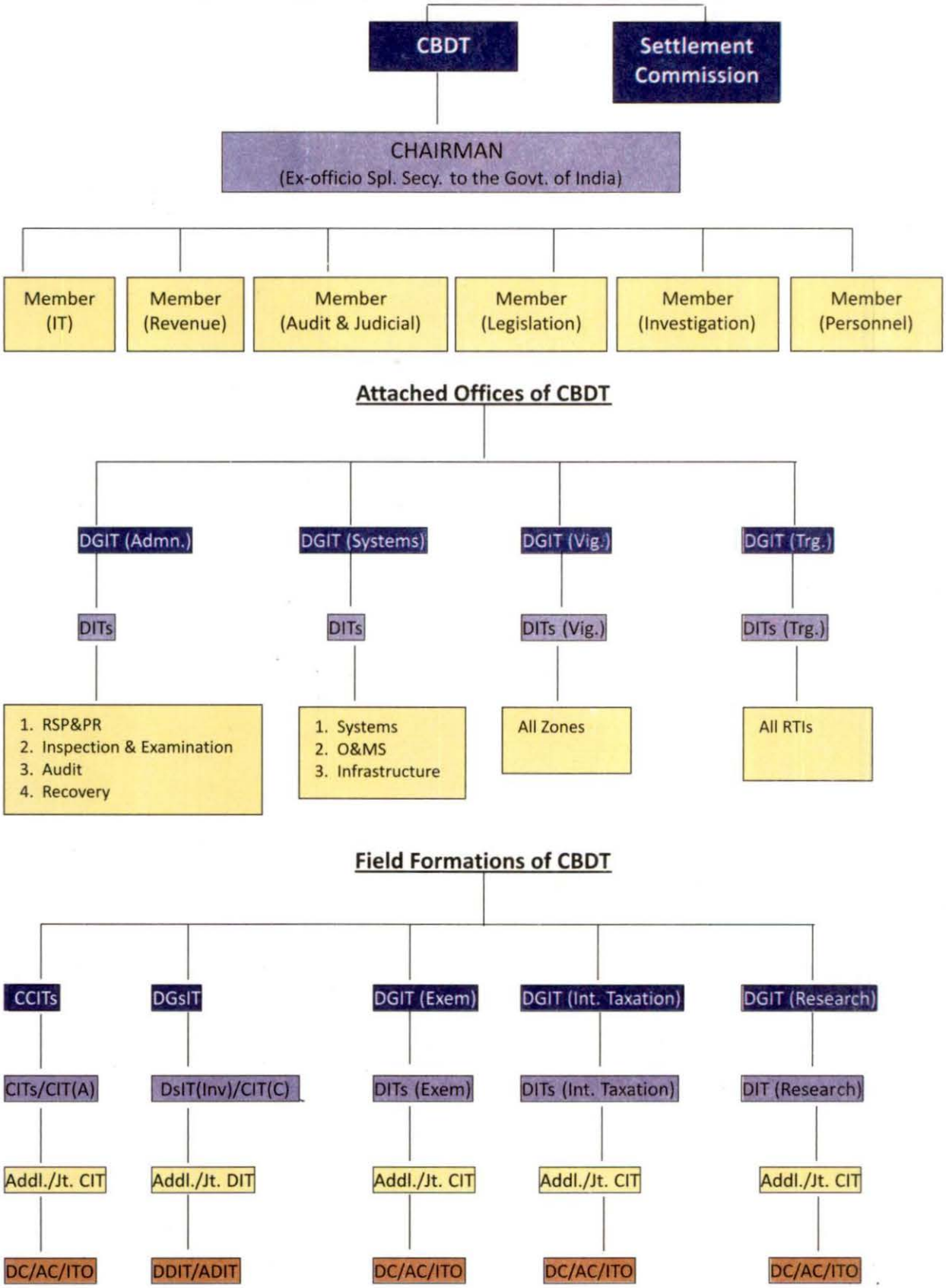
Payment of interest on refunds amounting to Rs. 4,444 crore was treated as reduction in revenue in violation of accounting precepts as interest was never collected in the first instance. No provision for 'interest on refunds' was made in the budget estimates for 2007-08.

(Paragraph 2.14.4)

Cost of collection as worked out by the department was 0.11 paisa per rupee of collection for corporation tax and 1.31 paise per rupee of collection for income tax. It was Rs. 4,157 and Rs. 405 per assessee for corporation tax and income tax respectively.

(Paragraph 2.15)

Chart 1: Organisational set up of the Income Tax Department



CHAPTER II

TAX ADMINISTRATION

Administration of direct taxes

2.1 Income tax, corporation tax and wealth tax constitute the principal elements of direct taxes. Income tax is chargeable on the total income of the previous year of every person. The term 'person' includes an individual, a Hindu undivided family (HUF), a company, a firm, an association of persons (AOP), a body of individuals (BOI), a local authority and an artificial juridical person. Income tax paid by companies is categorised as corporation tax.

Wealth tax is charged for every assessment year on the 'net' wealth on the relevant valuation date of every individual, HUF and company at specified rates on certain specified assets. No wealth tax is payable in respect of net wealth valued below Rs. 15 lakh with effect from the assessment year 1993-94.

Broad functional profile of the Department of Revenue

2.2 The overall responsibility for the administration of direct taxes lies with the Department of Revenue which functions through the Income-tax Department. The Income-tax Department has a staff strength of around 59,000, with the Central Board of Direct Taxes (Board) at its apex.

2.2.1 Chart 1 shows the organisational set up of the Income-tax Department. The Board consists of a Chairman and six members, and has several attached and subordinate offices throughout the country. These offices function under 116 Directors General of Income tax and Chief Commissioners of Income tax who oversee the work of the Directors/Commissioners of Income tax in their respective charges. Chief Commissioners of Income tax are stationed at different locations all over the country. They are in charge of the supervision, control and administration of their respective regions. Also, Directors General of Income tax (Investigation) stationed in different parts of the country are in overall charge of the investigation machinery in respect of their regions for curbing tax evasion and unaccounted money. The Chief Commissioners of Income tax/Directors General of Income tax are assisted by Commissioners of Income tax/Directors of Income tax in their respective jurisdictions. The first appellate machinery comprises Commissioners of Income tax (Appeals) who perform the work of disposal of appeals against the orders of the assessing officers.

2.2.2 The tables and figures below in this chapter have been compiled from the statistical data made available to audit by the Board and attached offices such as the Directorate of Income tax (Public Relations, Printing, Publications & Official Language), Directorate of Income-tax (Organisation & Management Services), Pr. Chief Controller of Accounts and Settlement Commission. Audit has endeavoured to present a macro picture of the tax administration of the Income-tax Department. Discrepancies noticed by Audit in the data provided by the department have been indicated by appropriate footnotes.

Sanctioned and working strength of officers

2.3 Table below shows the sanctioned strength and working strength of the officers of the Income tax Department as on 31 March 2008.

Table no. 2.1: Sanctioned strength of officers

Post	Sanctioned strength	Working strength
CCIT	116	97
CIT	723	700
Addl. CIT/ Addl DIT Joint. CIT/ Joint DIT	1,253	823
Dy CIT/ Dy .DIT/ Assistant CIT/ Assistant DIT	2,092	1,708
ITO	4,448	3,925
Total	**8,632**	**7,253**

2.3.1 Out of working strength of 2,531 Addl. CsIT/Addl. DsIT, Joint CsIT/ Joint DsIT, and Dy. DsIT/Dy. CsIT and Assistant DsIT/Assistant CsIT, 952 and 348 were engaged in assessment and non-assessment duties respectively. Out of working strength of 3,925 Income Tax Officers, 2,266 and 602 were engaged in assessment and non-assessment duties respectively[1].

Actual receipts vis-à-vis Budget estimates

2.4 A comparative position of the budget estimates and actual collections of Corporation tax and Taxes on income other than corporation tax is indicated in Table below.

2.4.1 The actual collection during 2007-08 has been higher than the budget estimates in case of corporation tax and taxes on income other than corporation tax by 14.55 per cent and 3.93 per cent respectively.

(Rs. in crore)

Table no. 2.2: Comparative position of actual receipts vis-à-vis budget estimates[2]

Year	Budget Estimates	Actual collections	Surplus(+)/ Shortfall (-)	Percentage of surplus/Shortfall
0020-Corporation tax				
2005-06	1,10,573.00	1,01,277.16	(-) 9,295.84	(-) 8.41
2006-07	1,33,010.00	1,44,317.95	(+) 11,307.95	(+) 8.50
2007-08	1,68,401.00	1,92,910.88	(+) 24,509.88	(+) 14.55
0021-Taxes on income other than corporation tax				
2005-06	66,239.00	55,984.62	(-) 10,254.38	(-) 15.48
2006-07	77,409.00	75,079.31	(-) 2,329.69	(-) 3.01
2007-08	98,774.00	1,02,655.08	(+) 3,881.08	(+) 3.93

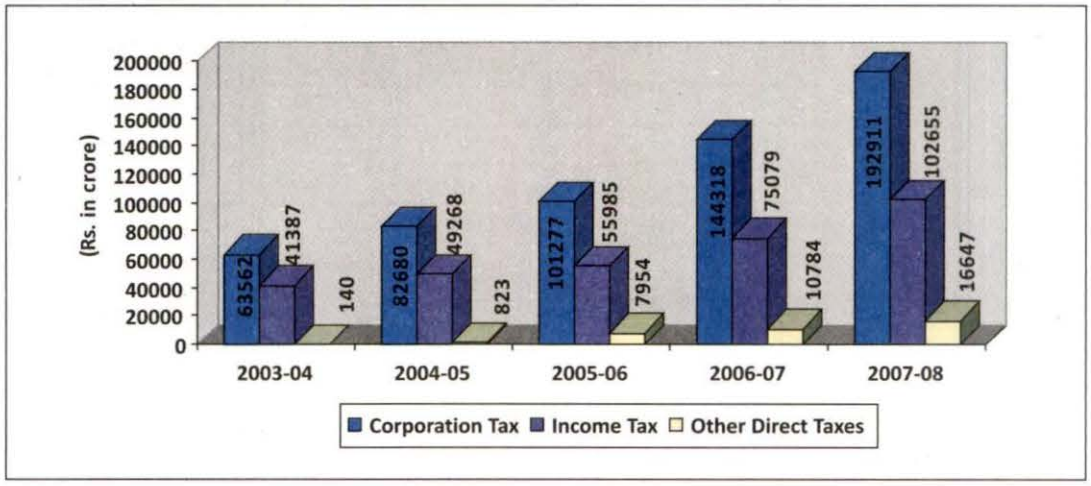
[1] Data provided by the Directorate of Income Tax (Legal &Research), Research & Statistics Wing till 20 November 2008. Information from some charges under CCIT Mumbai and Lucknow were still awaited till 20 November 2008.

[2] Minor head wise details given in Appendix 3.

Direct tax collections - recent trends

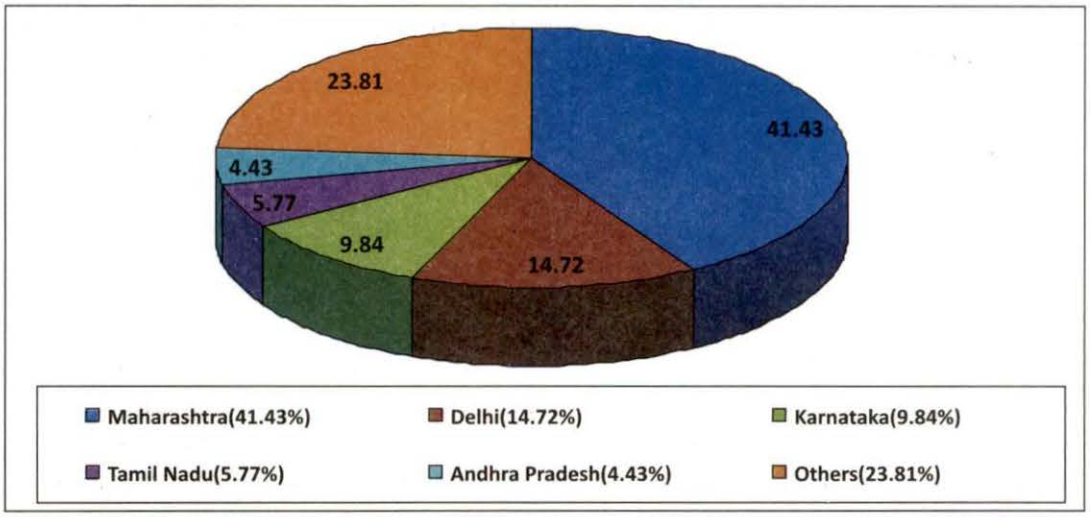
Direct tax collections, as shown in Chart 2 below, increased from Rs. 1,05,089 crore in 2003-04 to Rs. 3,12,213 crore in 2007-08 at an average annual rate of growth of 30.44 per cent. The rate of growth increased from 26.48 per cent in 2003-04 to 39.32 per cent in 2006-07 and decreased to 35.64 per cent in 2007-08. Direct Taxes constituted 53 per cent of total tax revenue receipts.

CHART 2: DIRECT TAX COLLECTIONS FROM 2003-04 TO 2007-08



2.5.1 Chart 3 below depicts the percentage share of direct tax collections from different states for the year 2007-08. Maharashtra had the largest tax collection followed by Delhi, Karnataka, Tamil Nadu, Andhra Pradesh and others.

CHART 3: PER CENTAGE SHARE OF REVENUE COLLECTION OF STATES[3]



[3] All India collection figures of corporation tax and income tax are given in Appendix 4 and Head wise/State/UT wise break up of direct taxes is given in Appendix 5.

2.5.2 Overall direct tax collections, annual rates of growth, the ratio of direct taxes to GDP and their buoyancy are indicated in Table below.

GDP ratio

2.5.3 Overall direct tax collections as a percentage of GDP increased from 3.80 per cent in 2003-04 to 6.62 per cent in 2007-08. This increase was observed for both corporation and income tax. Overall tax buoyancy increased from 2.12 in 2003-04 to 2.60 in 2007-08.

(Rs. in crore)

Table no. 2.3: Broad parameters of direct tax collections[4]

	2003-04	2004-05	2005-06	2006-07	2007-08
Corporation Tax	63,562	82,680	1,01,277	1,44,318	1,92,911
Income Tax	41,387	49,268	55,985	75,079	1,02, 655[5]
Other Direct Taxes	140	823	7,954	10,784	16,647
Total Direct Taxes	1,05,089	1,32,771	1,65,216	2,30,181	3,12,213
GDP	27,65,491	31,26,596	35,80,344	41,45,810	47,13,148
Rate of growth (per cent)					
Corporation Tax	37.66	30.08	22.49	42.50	33.67
Income Tax	12.26	19.04	13.63	34.11	36.73
Total Direct Taxes	26.48	26.34	24.44	39.32	35.64
GDP	12.51	13.06	14.51	15.79	13.68
Tax Collections-GDP Ratio (per cent)					
Corporation Tax	2.30	2.64	2.83	3.48	4.09
Income Tax	1.50	1.58	1.56	1.81	2.18
Total Direct Taxes	3.80	4.25	4.61	5.55	6.62
Tax Buoyancy[6]					
Corporation Tax	3.01	2.30	1.55	2.69	2.46
Income Tax	0.98	1.46	0.94	2.16	2.68
Total Direct Taxes	2.12	2.02	1.68	2.49	2.60

Pre-assessment – post-assessment tax collections

2.6 Income tax is chargeable for every assessment year in respect of the total income of the previous year at the rates prescribed in the annual Finance Act. The Act provides for pre-assessment collection by way of deduction of tax at source, advance tax and payment of tax on self-assessment. Post-assessment collection is the additional demand arising after regular assessment is completed. Table below contains details of overall tax collected at the pre and post assessments levels and percentage of refunds in the last three years.

2.6.1 During 2007-08, in the case of corporate assessees, 82.03 per cent of gross collections were made at the pre-assessment stage (Tax Deducted at source, Advance Tax and Self Assessment) of which 57.20 per cent was by way of advance tax. In the case of non-corporate assessees, 88.81 per cent of the gross collection was made at

[4] Source: Tax collection figures – Pr. CCA, CBDT, New Delhi.
GDP – CSO, Press release dated 30 May 2008.

[5] This differs from the figure of Rs. 1,02,659 crore reflected in the Finance Accounts.

[6] Tax buoyancy is measured by the ratio of percentage change in tax revenues to percentage change in GDP.

the pre-assessment stage, of which 53.66 per cent was by way of TDS. Net collection (minus refunds) after deducting pre assessment collection in the case of corporation tax was Rs. 9,203 crore (4.77 per cent of net collection) and that in case of income tax was Rs. 2,377 crore (2.32 per cent of net collection).

2.6.2 Refunds as a percentage of total collections in respect of corporate assessees declined from 17.51 in 2006-07 to 13.86 in 2007-08 although in absolute terms these figures had increased. In the case of non corporate assessees it marginally increased from 8.10 per cent in 2006-07 to 9.08 per cent in 2007-08.

(Rs. in crore)

Table no. 2.4: Details of tax collections for companies and non-companies at pre- assessment and post-assessment stages

Year	Tax Deducted at source	Advance Tax	Self Assessment	Regular Assessment	Other Receipts	Total Collections	Refunds	Net Collections[7]
Corporate Assessees								
2005-06	21,429 (17.17)	66,625 (53.37)	5,549 (4.44)	18,624 (14.92)	12,610 (10.10)	1,24,837	23,560 (18.87)	1,01,277
2006-07	29,048 (16.60)	96,568 (55.20)	6,954 (3.98)	24,725 (14.14)	17,640 (10.08)	1,74,935	30,617 (17.51)	1,44,318
2007-08	44,148 (19.71)	1,28,105 (57.20)	11,455 (5.12)	18,518 (8.27)	21,715 (9.70)	2,23,941	31,030 (13.86)	1,92,911
Non-Corporate Assessees								
2005-06	32,409 (51.89)	18,127 (29.03)	6,069 (9.72)	3,488 (5.58)	2,364 (3.78)	62,457	6,472 (10.36)	55,985
2006-07	41,641 (50.96)	24,659 (30.18)	6,871 (8.41)	5,671 (6.95)	2,855 (3.50)	81,697	6,618 (8.10)	75,079
2007-08	60,593 (53.66)	30,015 (26.58)	9,670 (8.57)	7,202 (6.38)	5,430 (4.81)	1,12,910	10,255 (9.08)	1,02,655

Figures in brackets indicate percentage of total collection/refunds

2.6.3 Contribution from salaries to total TDS declined from 32.70 per cent in 2006-07 to the current level of 32.03 per cent although in absolute terms these figures had increased. Other important sources which contributed to TDS were interest, payments to contractors/sub-contractors and non-residents. These four sources together contributed about 95 per cent of total TDS collections as indicated in Table below:

Table no. 2.5: Category wise details of deduction of tax at source

Category	Amount of tax deducted (Rs in crore)			Per cent of total tax deducted		
	2005-06	2006-07	2007-08	2005-06	2006-07	2007-08
Salaries	17,941	23,121	33,553	33.32	32.70	32.03
Interest on securities	1,871	2,292	2,069	3.48	3.25	1.98
Dividends	752	834	774	1.40	1.18	0.74
Interest	10,585	14,557	21,465	19.65	20.60	20.49
Winnings from lottery or crossword puzzles	233	445	513	0.44	0.63	0.49
Winnings from horse races	17	27	19	0.03	0.04	0.02
Payments to contractors and sub-contractors	9,638	12,127	16,172	17.90	17.16	15.44

[7] Net collections = Total collections – Refunds.

Category	Amount of tax deducted (Rs in crore)			Per cent of total tax deducted		
	2005-06	2006-07	2007-08	2005-06	2006-07	2007-08
Insurance commission	967	1,218	1,718	1.80	1.72	1.64
Payment to non-residents and others	11,834	16,068	28,458	21.98	22.72	27.17
Total	**53,838**	**70,689**	**1,04,741**	**100**	**100**	**100**

Non corporate assessee

2.7 The total number of assessees for direct taxes increased by 7.56 per cent from 312.96 lakh in 2006-07 to 336.63 lakh in 2007-08. Non corporate assessees constituted 98.52 per cent of the total assessees whereas corporate assessees comprised 1.48 per cent.

2.7.1 Number of non-corporate assessees increased by 7.34 per cent from 308.96 lakh in 2006-07 to 331.65 lakh in 2007-08. Category wise details of the increase are indicated in Table below:

Table no. 2.6: Category wise increase of non corporate assessees

Income level	2006-07	2007-08[@]	Annual increase (Per cent)	Share in total assessees (Percentage)	
	(Number in lakh)			2006-07	2007-08[@]
A[8]	273.30	287.90	5.34	88.46	86.81
B[9]	27.87	41.47	48.79	9.02	12.50
C[10]	5.79	2.18	(-) 62.34	1.88	0.66
D[11]	2.00	0.10	(-) 95.00	0.64	0.03
Total	**308.96**	**331.65**	**7.34**	**100**	**100**

Corporate assessee

2.7.2 Number of corporate assessees increased by 24.63 per cent from 4.00 lakh in 2006-07 to 4.98 lakh in 2007-08. Category wise details of corporate assessees are indicated in Table below:

Table no. 2.7: Profile of corporate assessees

Income level	2006-07	2007-08	Annual increase (Per cent)	Share in total assessees (Percentage)	
	(Number in lakh)			2006-07	2007-08[@]
A[12]	2.05	3.16	54.15	51.25	63.45
B[13]	1.25	1.21	(-) 3.20	31.25	24.30
C[14]	0.68	0.59	(-)13.23	17.00	11.85
D[15]	0.02	0.02	00.00	0.50	0.40
Total	**4.00**	**4.98**	**24.63**	**100**	**100**

[@] Source : Directorate of Income Tax (Legal &Research),Research & Statistics Wing
[8] Category 'A' non corporate assessees- Assessments with income/loss below Rs. 2 lakh.
[9] Category 'B' non corporate assessees -Assessments with income/loss of Rs.2 lakh and above but below Rs.10 lakh.
[10] Category 'C' non corporate assessees- Assessments with income/loss of Rs.10 lakh and above.
[11] Category 'D' non corporate assessees- Search and seizure assessments.
[12] Category 'A' corporate assessees- Assessments with income/loss below Rs.50,000.
[13] Category 'B' corporate assessees- - Assessments with income/loss of Rs.50,000 and above but below Rs.10 lakh.
[14] Category 'C' corporate assessees- - Assessments with income/loss of Rs.10 lakh and above.
[15] Category 'D' corporate assessees- - Search and seizure assessments.

2.7.3 The number of companies limited by shares at work, according to the Ministry of Corporate Affairs (MCA) as on 31 March 2008, was 7,69,145 which included 6,87,335 private limited companies and 81,810 public limited companies. Therefore, there were 2.71 lakh companies which were registered with Registrar of Companies but were not on the records of the Income tax Department. This difference has decreased from 3.44 lakh in 2006-07. The Ministry should investigate the reasons for the difference between the number of companies registered with DCA and the number of companies on the records of the Income tax Department.

PAN applications

2.8 The Act has made it mandatory for every person to quote his/her Permanent Account Number (PAN) in documents pertaining to specified transactions. In order to comply with the provisions of the Act it is necessary to allot PAN at the earliest to persons who apply for it.

2.8.1 With a view to enhancing the efficiency of PAN services, the Income-tax Department had outsourced a part of the process for allotment of PAN to the UTI Technology Services Ltd. (UTITSL) and the National Securities Depository Ltd (NSDL) with effect from 1 July 2003. Table below shows statistics furnished by the Board relating to PAN allotment for the period 2005-06 to 2007-08. Out of 140.46 lakh applications due for disposal, 129.06 lakh PAN cards were dispatched during 2007-08. The closing balance shown at the end of the year in column 6 as calculated by audit does not tally with the closing balance in column 7 as shown by the Board. The reason for the very large differences in the figures requires to be investigated by the Board.

Table no. 2.8: Allotment of PAN from 1.4.2005 to 31.3.2008 through UTIISL/ NSDL

Year	Opening balance	Applications received during the year	Total no. of applications due for disposal	PAN card dispatched	Closing balance (col. 4- col. 5)	Closing balance as shown by Board	Difference (col. 6- col. 7) (+) Excess (-) Shortage
1	2	3	4	5	6	7	8
2005-06	3,25,735	62,94,680	66,20,415	58,98,470	7,21,945	3,53,705	(-)3,68,240
2006-07	3,53,705	86,77,138	90,30,843	79,48,426	10,82,417	4,37,960	(-)6,44,457
2007-08	4,37,960	1,36,08,662	1,40,46,622	1,29,06,343	11,40,279	7,36,350	(-) 4,03,929

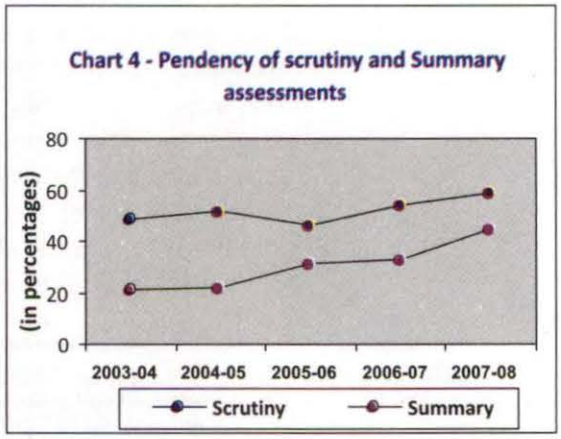
Position of assessments of income tax

2.9 The number of cases selected for scrutiny during 2007-08 was higher at 6.42 lakh as compared to 3.41 lakh in 2006-07 as indicated in Table below.

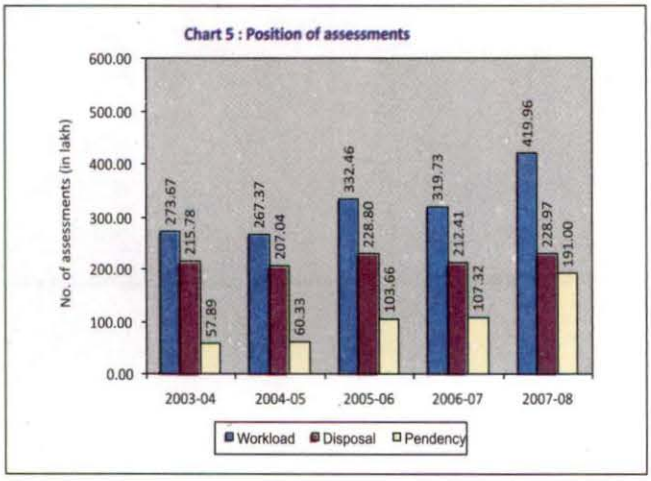
Table no. 2.9: Cases selected for scrutiny during the last 5 years

Financial year	Opening balance of scrutiny cases[16]	Cases selected for scrutiny `during the year	Total cases for disposal
2003-04	1,97,811	1,90,464	3,88,275
2004-05	1,93,017	2,46,241	4,39,258
2005-06	2,21,739	2,03,486	4,25,225
2006-07	1,86,056	3,40,949	5,27,005
2007-08	3,55,894	6,41,919	9,97,813

2.9.1 Under the Act, the time limit for the completion of assessments and reassessments is two years from the end of the assessment year in which the income was first assessable or one year from the end of the financial year in which a return or a revised return relating to the relevant assessment year is filed under section 139(4) and 139(5). Chart 4 indicates that pendency under scrutiny and summary assessments has increased from 1.91 lakh cases (49.17 per cent) and 55.98 lakh cases (20.75 per cent) in 2003-04 to 5.91 lakh cases (59.19 per cent) and 185.09 lakh cases (45.15 per cent) in 2007-08 respectively.



2.9.2 Chart 5 indicates that the total pendency (scrutiny and summary assessments[17]) has increased from 57.89 lakh cases (21.16 per cent) in 2003-04 to 191 lakh cases (45.48 per cent) in 2007-08. In fact, there has been a progressive decline in the percentage of completion of assessments from 78.84 per cent in 2003-04 to 54.52 per cent in 2007-08, although in absolute terms these figures had increased.



[16] Opening balance of pending cases under scrutiny does not tally with the closing balance of cases of previous year. This needs to be reconciled by the department.

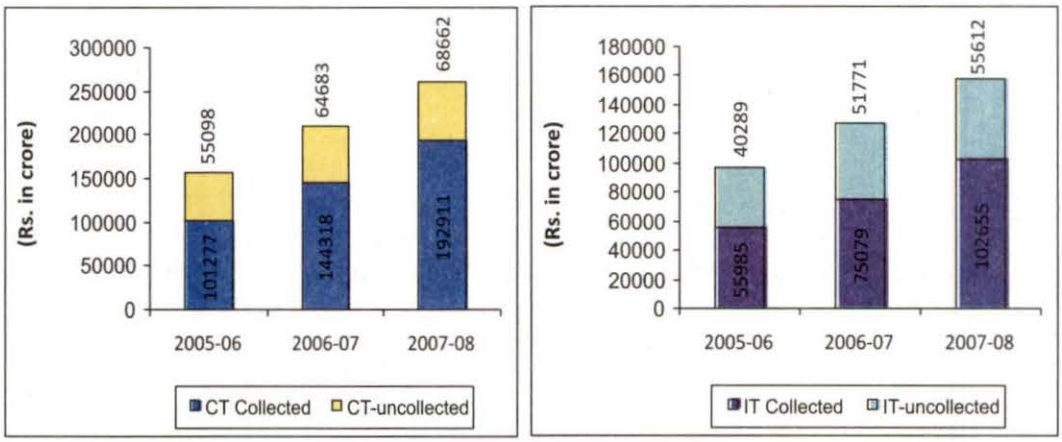
[17] Details of status wise break- up of income tax assessments completed is given in Appendix 6-Source: Directorate of Income Tax (Legal &Research), Research & Statistics Wing.

Arrears of demand

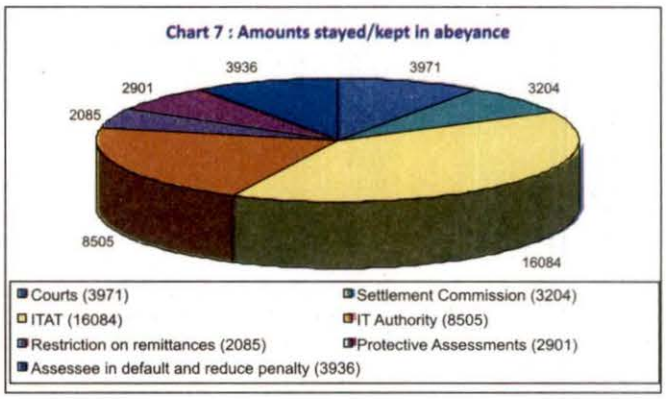
2.10 The Act provides that when any tax, interest, penalty, fine or any other sum is payable as a consequence of any order, a notice of demand shall be served upon the assessee. The amount specified in the notice has to be paid within 30 days unless the assessing officer, on application, extends the time for payment to be made by the assessee. The Act provides that an appeal against an assessment order would be barred unless tax on the returned income is paid before filing the appeal. The amount which remains unpaid becomes arrears of demand/uncollected amount.

2.10.1 Uncollected amount of Rs. 1,24,274 crore in respect of corporation tax and income tax comprised demand of Rs. 86,859 crore of earlier years and current demand of Rs. 37,415 crore for 2007-08. Chart 6 below indicates that the uncollected amount of corporation tax increased from Rs. 55,098 crore in 2005-06 to Rs. 68,662 crore in 2007-08 and that for income tax from Rs. 40,289 crore in 2005-06 to Rs. 55,612 crore in 2007-08 respectively.

Chart 6: Corporation Tax and Income Tax collected and remaining uncollected[18]



2.10.2 Chart 7 indicates that out of uncollected amount for corporation tax and income tax of Rs. 1,24,274 crore, an amount of Rs. 40,686 crore was stayed/kept in abeyance in 2007-08. This was lower than the corresponding figure of Rs. 47,274 crore in 2006-07.



[18] Source: CAPI Demand & Collection Statement along with Analysis for the month of March 2008.

Tax recovery machinery

2.11 Every demand of tax, interest, penalty or fine, should be paid within thirty days of the service of the notice of demand. In case an assessee defaults in payment, the Tax Recovery Officer may draw up a certificate specifying the amount of arrears due from the assessee and shall proceed to recover the amount. The TRO will serve a notice requiring the defaulter to pay the amount specified in the certificate within fifteen days. If the amount is not paid within the time specified in the notice or within the extended period, if any, the TRO shall proceed to realise the amount together with interest leviable for default in payment of tax demand by attachment and sale of the defaulter's movable property or by attachment and sale of the defaulter's immovable property or by arrest of the defaulter and his detention in prison or by appointing a receiver for management of defaulter's movable and immovable properties.

2.11.1 The administrative machinery of tax recovery has been strengthened by allocating one TRO exclusively for each range consequent to the implementation of the scheme of restructuring of the department.

2.11.2 During 2007-08, against Rs. 36,057.56 crore certified by TRO for recovery, only Rs. 8,612.62 crore (23.89 per cent) could be recovered[19]. There was an improvement in recovery from 14.01 per cent in 2005-06 to 24.20 per cent in 2006-07 and a marginal decline to 23.89 per cent in 2007-08.

2.11.3 As per Board's instruction no. 1567 of 1984, the amount of arrears and cases specified in the certificate involving Rs. 10,000 or below in respect of which recovery was not made for more than five years are to be identified and considered for possible write off. During 2007-08, the department identified Rs. 40.95 crore of such arrears for possible write off in respect of 1,35,047 assessees and Rs. 15.81 crore was thereafter written off in respect of 46,328 assessees.

Penalties

2.12 If an assessee fails to furnish return of income/wealth or files a false return or fails to produce accounts and documents, penalty is leviable. The assessee is also liable to be prosecuted for the offence. Penalty is also leviable for failure to deduct or pay tax. Table below indicates that out of 10.35 lakh cases where penalty proceedings were initiated, 0.70 lakh cases (6.74 per cent) were finalised during the year 2007-08 as compared to 0.59 lakh cases (6.90 per cent) in 2006-07. Total pendency has increased from 7.91 lakh cases at the end of 2006-07 to 9.65 lakh cases at the end of 2007-08.

Table no. 2.10: Income tax cases where penalty proceedings initiated, disposed off and pending

Year	Opening balance	Additions	Total	Disposal	Closing balance
2005-06	4,89,791	2,44,774	7,34,565	78,383	6,56,182
2006-07	6,56,182	1,93,495	8,49,677	58,610	7,91,067
2007-08	7,91,067	2,44,160	10,35,227	69,795	9,65,432

[19] Year wise break up of tax recovery certificates pending along with amount is given in Appendix 7.

2.12.1 Out of 69,795 penalty cases disposed off during the year, penalty was imposed in 38,975 cases (56 per cent). Fifty three per cent of the penalty cases disposed off related to concealment of income. The number of cases where penalties were imposed increased from 22,392 in 2006-07 to 38,975 in 2007-08 but amount of penalty imposed decreased from Rs. 2,947.84 crore to Rs. 2,069.77 crore during the same period. Details are given in Table below:

Table no. 2.11: Nature of offences and penalties imposed during 2007-08

Nature of offence	Cases disposed off	Penalties imposed	
		No. of cases	Amount (Rs. in crore)
Concealment	43,380	20,568	1780.73
Other than concealment	26,415	18,407	289.04
Total	**69,795**	**38,975**	**2069.77**

Search and seizure cases

2.13 Chapter XIV-B of the Act governs the special procedure for assessment of search cases. On failure to furnish in due time the return of total income which is required to be furnished by a notice given under section 158BC (a), (relating to search cases) proceeding may be initiated. Table below summarises the position of prosecutions launched, convictions obtained, offences compounded and acquittals allowed.

2.13.1 Only 279 cases (2.32 per cent) of a total of 12,011 cases for prosecution were disposed off during 2007-08. Of these 11 cases (4 per cent) resulted in conviction.

Table no. 2.12: Prosecutions launched, convictions obtained, offences compounded and acquittals

Year	Number of prosecutions launched			Disposal of cases				Cases pending
	Opening balance	Additions	Total	Convictions	Compounding	Acquittals	Total	Balance
2005-06	11,545	326	11,871	1	85	39	125	11,746
2006-07	11,746	71	11,817	1	40	28	69	11,748
2007-08	11,748	263	12,011	11	13	255	279	`11,732

Refund cases and interest paid on refunds

2.14 Where the amount of tax paid exceeds the amount of tax payable, the assessee is entitled to a refund of the excess amount. Simple interest at the prescribed rate is payable on the amount of such refund. Refund of any amount as a result of any order passed in appeal or other proceedings is also admissible along with simple interest at the prescribed rate. Pendency of direct refund claims results in outflow of revenue from government by way of interest.

2.14.1 Thirty one per cent of the refund claims remained outstanding at the end of March 2008 as compared to 24 per cent at the end of March 2007. Details are given in Table below:

Table no. 2.13: Cases of direct refunds for which claims were made[20]

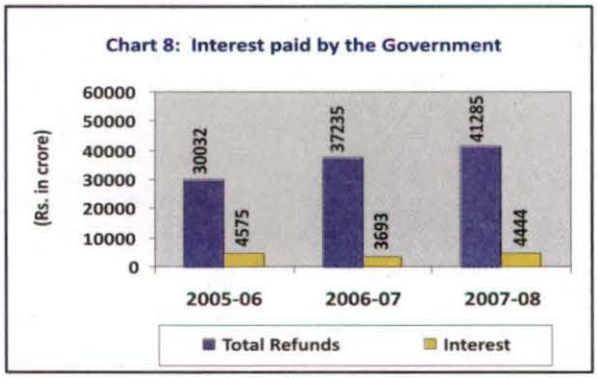
Financial year	Opening balance	Claims received during the year	Total	No. of claims disposed off	Balance outstanding
2005-06	5,24,329	20,05,364	25,29,693	19,60,138	5,69,555
2006-07	5,69,555	12,28,175	17,97,730	13,64,078	4,33,652
2007-08	4,33,652	22,80,154	27,13,806	18,78,723	8,35,083

2.14.2 Disposal of refund cases resulting from appellate orders and revision orders etc. has declined from 29,296 cases (93 per cent) in 2005-06 to 18,603 cases (87 per cent) in 2007-08. Details are given in Table below:

Table no. 2.14: Cases resulting in refund as a result of appellate orders and revision orders, etc [20]

Financial year	Opening balance	Addition	Total	Disposal	Closing balance
2005-06	2,191	29,178	31,369	29,296 (93%)	2,073
2006-07	2,073	15,565	17,638	16,127 (91%)	1,511
2007-08	1,511	19,934	21,445	18,603 (87%)	2,842

2.14.3 Chart 8 indicates that the Government refunded Rs. 41,285 crore from gross collection of Rs. 3,36,851 crore in respect of corporation tax and income tax (Table no. 2.4) and paid interest amounting to Rs. 4,444 crore (11 per cent of the amount refunded) during 2007-08 as compared to Rs. 3,693 crore[21] (10 per cent of the amount refunded) in 2006-07.



Incorrect accounting of interest on refunds

2.14.4 Audit had earlier commented in Audit Reports of 2004, 2005, 2006, 2007 and 2008 that the government was following an incorrect procedure of accounting for interest paid on refunds. Interest payment is a charge on the Consolidated Fund of India and is, therefore, payable through a proper budgetary mechanism. Accordingly, Minor Head "interest on refunds" is operated under the Major Head "2020-Collection of Taxes on Income and Expenditure". However, no budget provision for 'interest on refund' was made in the budget estimates for 2007-08 and the expenditure on interest on refunds amounting to Rs. 4,444 crore was treated as reduction in revenue. Accounting of interest on refund as reduction in revenue is incorrect as this interest

[20] Data furnished by Directorate of Income Tax (Legal & Research), Research & Statistics Wing is provisional.

[21] Only on 15 December 2008, the Department has intimated that the figure for interest on refund for the year 2006-07 has been revised from Rs. 17,004 crore to Rs. 3,693 crore.

was never collected in the first instance. Interest on belated refunds of excess tax should be budgeted as an expenditure item which, in fact, was done in the Budget Estimates 2001-02 when Rs. 92 crore was provided in the demand of 'Direct Taxes' under the Major Head '2020 – Collection of taxes on Income & Expenditure' towards interest on belated refund of excess tax. However, subsequently at the Revised Estimates stage the earlier practice of showing the interest on excess refund as deduct receipt was reverted to. The incorrect practice is still being followed and needs to be rectified.

Cost of collection of taxes

2.15 The overall cost of collection of income and corporation taxes increased from Rs. 1,108 crore in 2003-04 to Rs. 1,551 crore in 2007-08. However, cost per rupee of corporation tax collected declined from 0.21 paisa in 2003-04 to 0.11 paisa in 2006-07 and 2007-08. For income tax, the cost of collection per rupee declined from 2.37 paise in 2003-04 to 1.31 paise in 2007-08. Cost of collection per assessee, however, increased for corporation tax and income tax during the year as compared to the previous years. The position of cost of collection as depicted by the department needs to be viewed against the background that 88.88 per cent and 81.97 per cent of gross collections during 2007-08 from non corporate and corporate assessees respectively, were realised at the pre-assessment stage i.e., in the form of advance tax, TDS and self assessment tax. Annual fluctuations in the cost of collection of corporation and income tax are indicated in Table below.

Table no. 2.15: Cost of collection of corporation and income tax

Nature of tax	2003-04	2004-05	2005-06	2006-07	2007-08
Cost of collection (Rs. in crore)					
Corporation Tax	129	141	147	162	207
Income Tax	979	1077	954	1054	1344
Cost of collection per rupee of tax collected (in paisa)					
Corporation Tax	0.21	0.17	0.15	0.11	0.11
Income Tax	2.37	2.19	1.70	1.40	1.31
Cost of collection per assessee (in rupees)					
Corporation Tax	3468	3,710	3,740	4050	4157
Income Tax	340	402	325	341	405

Appeals, revision petitions and writs

2.16 If an assessee is not satisfied with his assessment or refund order, he can file an appeal with the Commissioner (Appeals) and thereafter with the Income Tax Appellate Tribunal (ITAT). On any question of law arising out of such order an assessee may appeal to the High Court and Supreme Court. The assessee can also initiate writ proceedings under Article 226 of the Constitution.

2.16.1 Clauses 6A to section 250 and 2A to section 254 have been inserted in the Act, with effect from 1 June 1999, indicating the time limits for disposal of an appeal, which are one year for CIT (A) and four years for ITAT.

2.16.2 As per the instructions of the Board, each CIT (Appeal) is required to dispose off a minimum of 60 appeals per month, and a total of 720 appeals annually. Thus, about 1.91 lakh appeals could have been disposed off during the year on the basis of the working strength of 265 CIT (Appeals). Table below shows that only 0.64 lakh appeals were disposed off and the average annual disposal per CIT (A) during 2007-08 was only 240 appeals.

Table no. 2.16 Appeals pending with the Commissioners (Appeals) during 2007-08

	Total appeals	With demand of Rs. 1-10 lakh	With demand of Rs. 10-25 lakh	With demand of Rs. 25 lakh and above
Appeals for disposal	1,94,003	68,942	16,033	18,769
Disposal	63,645	25,494	6,490	7,361
Pending	1,30,358	43,448	9,543	11,408

2.16.3 Table below gives the details of appeals, references and writ pending with Supreme Court/High Court/ Income Tax Appellate Tribunal during 2007-08.

Table no. 2.17 Appeals, references and writ pending with Supreme Court/High Court/ Income Tax Appellate Tribunal during 2007-08

Authority with whom pending	Cases for disposal	Cases disposed	Cases pending
Supreme Court	3,422	78	3,344
High Court	34,354	2,764	31,590
ITAT	44,290	9,623	34,667

Cases settled by settlement commission

2.17 An assessee may, at any stage of a case relating to him, make an application to the Settlement Commission to have the case settled. While making such an application, an assessee shall make full and true disclosure of his income (not disclosed before the assessing officer) and the additional amount of income tax payable on such income. The Settlement Commission admits/rejects the application after calling for a report from the Commissioner. Out of 3,909 cases pending before the Settlement Commission, 1,845 cases (47.20 per cent) were settled. Percentage of disposal in respect of income tax and wealth tax, as shown in Table below increased during the year as compared to 2005-06 and 2006-07.

Table no. 2.18: Cases settled by the Settlement Commission

Year	Opening balance	Addition	Total cases for disposal	Number of cases settled	Per centage of cases settled	Number of cases pending
Income Tax (including corporation tax)						
2005-06	2,822	477	3,299	301	9.12	2,998
2006-07	2,998	601	3,599	349	9.70	3,250
2007-08	3,250	592	3,842	1,830	47.63	2,012

Year	Opening balance	Addition	Total cases for disposal	Number of cases settled	Per centage of cases settled	Number of cases pending
Wealth Tax						
2005-06	65	2	67	0	0	67
2006-07	67	1	68	1	1.47	67
2007-08	67	0	67	15	22.39	52

2.17.1 Table below indicates that about 418 cases i.e. 20 per cent out of a total of 2,064 pending cases relating to income tax and wealth tax were either pending admission with Settlement Commission or held up for want of comments from the department.

Table no. 2.19: Cases pending admission/held up with Settlement Commission

Nature of cases	31 March 2007	31 March 2008
Cases pending admission before Settlement Commission	880	24
Cases held up with Settlement Commission for want of comments of the department	479	394

Revenue demand written off

2.18 A total revenue demand of Rs. 60.19 crore was written off during 2007-08 on the grounds of the assessee having died leaving behind no assets, becoming untraceable or being alive but with no attachable assets/amounts etc. Out of the above, 81 per cent pertained to cases where the assessees were untraceable and about 16 per cent pertained to cases where the assessees were alive but had no attachable assets/amounts being petty/amounts written off as a result of scaling down of demand and other reasons. Table below contains the details.

Table no. 2.20: Category-wise details of revenue demands written off during 2007-08

Category	Company cases		Non-company cases		Total cases	
	No.	Amount	No.	Amount	No.	Amount
(a) Assessees having died leaving behind no assets/become insolvent/gone into liquidation or are defunct.	3	0.02	2,344	0.89	2,347	0.91
(b) Assessees were untraceable.	93	0.57	8,187	40.39	8,280	48.96
(c) Assessees having left India	1	0.01	899	0.44	900	0.45
(d) Assessees were alive but had no attachable assets/amounts being petty/amounts written off as a result of scaling down of demand and other reasons	7	0.00	27,920	9.86	27927	9.86
(e) Amount written off on grounds of equity or as a matter of international courtesy, or where time, labour and expense involved in legal remedies for realisation are considered disproportionate to the recovery.	0	0	348	0.01	348	0.01
Total	**104**	**0.60**	**39,698**	**59.59**	**39,802**	**60.19**

CHAPTER III
CORPORATION TAX

Contents	Page

Chapter Summary

Corporation tax constituted 61.79 per cent of the total collection from direct taxes in 2007-08. There were 4,98,065 corporate assessees as on 31 March 2008, which represented a slight increase of 24.63 per cent over the previous year.

(Paragraphs 3.1 and 3.2)

Audit issued 649 observations to the Ministry of Finance involving revenue impact of Rs. 1,541.36 crore highlighting various irregularities, omissions and mistakes for comments. The Ministry accepted 39 observations involving revenue impact of Rs. 22.98 crore till December 2008.

(Paragraphs 3.4 and 3.5)

Audit noticed mistakes in:

- computation of business income in 16 cases involving revenue impact of Rs. 201.64 crore.

  (Paragraph 3.6.3)

- allowance of capital/non-business expenditure in 71 cases involving revenue impact of Rs. 172.66 crore.

  (Paragraph 3.7.3)

- allowance of deduction towards depreciation in 68 cases involving revenue impact of Rs. 112.59 crore.

  (Paragraph 3.8.5)

- adoption of correct figures, allowance of provisions and application of correct rate of tax/surcharge in 86 cases involving revenue impact aggregating Rs. 299.71 crore.

  (Paragraphs 3.9.2, 3.10.2 and 3.11.3)

- allowance of deduction not supported by actual payment, computation of income under special provisions and computation, carry forward and set-off of losses in 112 cases involving revenue impact aggregating Rs. 225.64 crore.

  (Paragraphs 3.12.3, 3.13.2 and 3.14.4)

- implementation of appellate orders, allowance of exemptions and excess relief and non/short levy of interest in 68 cases involving revenue impact aggregating Rs. 84.08 crore.

  (Paragraphs 3.16.3, 3.17.3 and 3.18.2)

- allowance of deductions under Chapter VIA, refund/interest on refund, computation of capital gains and income not assessed in 76 cases involving revenue impact aggregating Rs. 74.24 crore.

(Paragraphs 3.19.3, 3.20.3, 3.21.3 and 3.22.2

Assessees had availed unentitled benefit in summary assessments in 93 cases involving revenue impact of Rs. 102.18 crore.

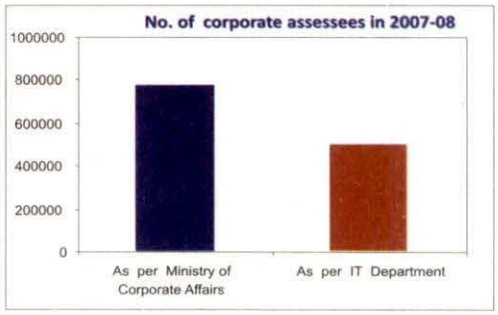
(Paragraph 3.23.2)

CHAPTER III

CORPORATION TAX

Number of companies vis-à-vis company assessees

3.1 Records of the Ministry of Finance, the Ministry of Corporate Affairs, indicated that there were 7,69,145 companies limited by shares at work as on 31 March 2008, which included 6,87,335 private limited companies and 81,810 public limited companies. As per the records of the Income Tax Department, the number of company assessees as on 31 March 2008 was 4,98,065 as compared to 3,99,627 as on 31 March 2007.



3.1.1 The difference between the number of companies as per records of the Ministry of Corporate Affairs vis a vis the records of the Income Tax Department requires investigation as this may help in widening the tax base.

Receipts from corporate tax

3.2 During 2007-08, corporation tax receipts were Rs. 1,92,911 crore (as against Rs. 1,44,318 crore in 2006-07) constituting 61.79 per cent of the total direct taxes collection. Table no. 2.3 of chapter II of this report shows the details.

Status of assessments

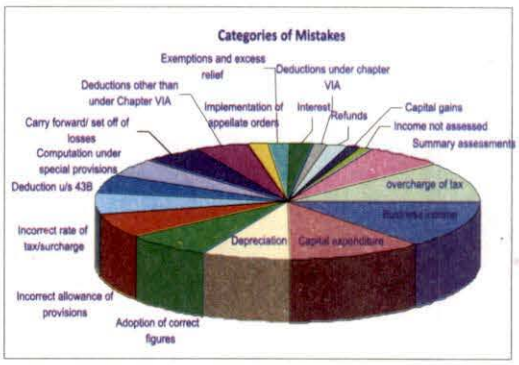
3.3 Chart 5 of paragraph 2.9 of this report contains particulars of assessments due for disposal, assessments completed and assessments pending.

3.4 RESULTS OF AUDIT

Results of audit

3.4.1 Audit issued 649 draft paragraphs, of which 624 draft paragraphs involved undercharge of tax of Rs. 1,375.15 crore and 25 draft paragraphs involved overcharge of tax of Rs. 166.21 crore, to the Ministry of Finance between May 2008 and October 2008 for comments. The internal audit of the department had seen 38 of these cases and had not noticed the mistakes pointed out in this report.

3.4.2 Out of the 649 draft paragraphs issued to the Ministry, 630 cases have been included in this chapter. Of these, 605 draft paragraphs involve under charge of Rs. 1,342.49 crore and 25 cases involve overcharge of Rs. 166.21 crore. Each category of mistake starts with a suitable preamble followed by combined/ consolidated revenue impact of all observations of similar nature.



3.5 STATUS OF REPLIES RECEIVED FROM MINISTRY OF FINANCE

Status of replies received from Ministry of Finance

3.5.1 The Ministry of Finance has accepted audit observations in 39 cases involving aggregate revenue impact of Rs. 22.98 crore. In 17 cases, the Ministry has not accepted the audit observations. In the remaining cases, replies have not been received. Replies of the Ministry have been examined and suitably incorporated in the report.

3.6 MISTAKES IN COMPUTATION OF BUSINESS INCOME

Mistakes in computation of business income

3.6.1 The income of an assessee under the head 'profits and gains of business or profession' shall be computed in accordance with the method of accounting regularly employed by the assessee. Where the assessee follows mercantile system of accounting, the annual profits are worked out on due or accrual basis i.e. after providing for all expenses for which a legal liability has arisen and taking credit for all receipts that have become due regardless of their actual receipt or payment. Only such expenses are allowable as deduction from a previous year's income as are relevant to that year.

3.6.2 It has been judicially held that

- the facility of filing of revised return cannot be availed for change of method of accounting[1].
- the value of closing stock declared to a bank for the purpose of loan or over draft cannot be relied upon[2].

3.6.3 Mistakes in application of provisions resulted in short levy of tax aggregating **Rs. 201.64 crore** in 16 cases in Andhra Pradesh, Delhi, Maharashtra, Orissa, and West Bengal. Three cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.6.3.1 In West Bengal, CIT II Kolkata charge, the assessment of a company, **M/s. Coal India Ltd.**, for the assessment year 2003-04 completed after scrutiny in July 2005, was revised in February 2006 determining an income of Rs. 575.65 crore. Audit examination revealed that while computing taxable income the assessee did not consider interest receivable and apex charges aggregating Rs. 267.27 crore for the year on the ground of critical financial position of the payer, although the assessee was maintaining his accounts on mercantile basis. As the right to receive such amount accrued during the year, the receivable amount of Rs. 267.27 crore should have been disclosed as part of taxable income in the year of accrual. The omission resulted in underassessment of income of Rs. 267.27 crore involving tax effect of Rs. 127.01 crore including interest.

3.6.3.2 In Orissa, Sambalpur charge, the assessment of a company, **M/s. Mahanadi Coal Fields Ltd.**, for the assessment year 2001-02 was completed after scrutiny in March 2004. Audit examination revealed that the assessee went in appeal against

[1] M/s Deepnarian Nagu &Co vs CIT [1986] 157 ITR 37 (MP)
[2] M/s Indian Motor parts & Accessories (P) ltd vs CIT [1966] 60 ITR 531 (Madras)

certain additions, some of which were deleted by the CIT (A) in September 2004. While giving effect to the appeal order in July 2005, the assessing officer reduced the value of the closing stock to Rs. 56.79 crore stating that the matter of uniform accounting policy was discussed at the level of holding company, M/s. Coal India Limited (CIL) to facilitate obtaining loans from World Bank and other international financial institutions. Accordingly, CIL had taken a decision to value the stock at lower of the cost or market value from the assessment year 1997-98 onwards. The assessing officer could not suo-moto alter the figures in the accounts of the assessee or change the valuation of closing stock on his own accord without a revised return from the assessee. The statements made by the assessee during the assessment proceedings could not be construed as a revised return. Revision of return is also not permissible for change in method of accounting as per the judicial pronouncement. Further, the value of closing stock declared to a bank for the purpose of loan or overdraft could not be accepted in Income tax proceedings. In view of the above, the action of the assessing officer in changing the value of the closing stock was not in order which resulted in under assessment of income of Rs. 51.72 crore involving short levy of tax of Rs. 40.41 crore including interest.

3.6.3.3 In Delhi, CIT IV charge, the assessment of a company, **M/s. Indian Airlines Ltd.,** for the assessment year 2003-04 was completed after scrutiny in March 2006 determining an income of Rs. 45.78 lakh. Audit examination revealed that the assessee claimed and was allowed prior period expenditure of Rs. 44.79 crore which was required to be disallowed as the assessee was following mercantile system of accounting. The omission resulted in underassessment of income of Rs. 44.79 crore involving short levy of tax of Rs. 22.60 crore including interest.

3.7 INCORRECT ALLOWANCE OF CAPITAL/NON-BUSINESS EXPENDITURE

Incorrect allowance of capital/ non-business expenditure

3.7.1 Any expenditure, not being in the nature of capital expenditure laid out wholly or exclusively for the purpose of business, is allowable as deduction in computing the income chargeable under the head 'profits and gains of business or profession'. It has been judicially held that

(i) expenditure incurred in connection with setting up a new project which has been later abandoned is capital expenditure and hence not allowable as deduction[3].

(ii) where a business is taken over along with liabilities, discharge of such liability is to be treated as payment in the nature of purchase consideration only so that it has to be treated as on capital account[4].

(iii) interest liability up to the stage of commencement of production should be capitalised[5].

(iv) the loss on repossessed assets is not allowable as deduction because it is basically a capital loss[6].

[3] M/s EID Parry (India) Ltd. vs. CIT 257 ITR 253 (Madras HC)
[4] CIT Vs M/s Garden Silk Mills (P) Limited (2001)252 ITR 804 (Guj.)
[5] M/s Challapalli Sugars Ltd Vs CIT(1975)98 ITR 167 (SC)
[6] M/s Motor and General Sales (P) Ltd. Vs. CIT (1997) (226 ITR 137) (Alld)}

3.7.2 The Income Tax Act, 1961 provides that for the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral oils in relation to which the central government has entered into an agreement with any person for the association or participation of the central government or any person authorized by it in such business (which agreement has been laid on the table of each House of Parliament), there shall be made in lieu of or in addition to the allowances under the Act, such allowances as are specified in the agreement in relation to the expenditure incurred by the assessee whether before or after the commercial production, in respect of drilling or exploration activities. The allowances shall be admissible after the beginning of commercial production. Further, such allowances shall be computed and made in the manner specified in the agreement itself.

3.7.3 Incorrect allowance of capital expenditure in working out taxable income resulted in short levy of tax aggregating **Rs. 172.66 crore** in 71 cases in Delhi, Gujarat, Karnataka, Maharashtra, Orissa, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Six cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.7.3.1 In Rajasthan, CIT II Jodhpur charge, the assessment of a company, **M/s. Cairn Energy Hydrocarbon Limited,** for the assessment year 2004-05 was completed after scrutiny in December 2006 determining a loss of Rs. 129.11 crore after disallowing fifty per cent of the exploration expenses of Rs. 31.10 crore. The exploration expenses of Rs. 231.39 crore as at the end of March 2004 were capitalized in the balance sheet. The assessee claimed exploration expenditure of Rs. 143.43 crore incurred during the year (which was included in the amount capitalized in the balance sheet). It was also stated in the assessment order that the exploration expenditure is allowable to the assessee in the year of commencement of production. As the assessee had not commenced the business, it was thus not entitled to claim the exploration expenditure before commencement of production. Besides, the expenditure which was capitalized in the balance sheet could not be claimed as loss. Therefore, the income of the assessee was assessable at nil instead of loss of Rs. 129.11 crore. The mistake resulted in over computation of loss by the like amount involving potential tax effect of Rs. 54.23 crore.

3.7.3.2 In Tamil Nadu, CIT III Chennai charge, the assessment of a company, **M/s. SPIC Ltd.,** for the assessment year 2003-04 completed after scrutiny in March 2006 determining a loss of Rs. 342.35 crore, was revised in March 2006 reducing the loss to Rs. 236.62 crore. Audit examination revealed that the assessee claimed and was allowed deductions of Rs. 77.60 crore towards interest on loan borrowed for a proposed project and Rs. 38.67 crore towards exchange fluctuation loss related to such interest. The deductions were claimed on the basis that the proposed project was not envisaged during the current year. As the expenditure relating to abandoned projects is capital in nature it was required to be disallowed. Omission resulted in overassessment of loss by Rs. 116.27 crore involving potential short levy of tax of Rs. 42.73 crore.

3.7.3.3 In Delhi, CIT IV charge, the assessment of a company, **M/s. Hero Honda Motors Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006 determining an income of Rs. 1019.28 crore. Audit examination revealed that the assessee had debited Rs. 113.23 crore to profit and loss account towards Royalty, Technical guidance fee and Model fee (Know how). As the expenditure was capital in nature (intangible asset), Rs. 84.92 crore (after allowing depreciation[7] @ 25 per cent) should have been disallowed, but Rs. 28.31 crore only was added back to the income of the assessee. The mistake resulted in underassessment of income of Rs. 56.61 crore involving short levy of tax of Rs. 20.31 crore.

3.7.3.4 In Gujarat, CIT Central-II Baroda charge, the assessment of a company, **M/s. Sun Pharmaceuticals Industries Limited,** for assessment year 2001-02 was completed after scrutiny in March 2003 and revised under section 143(3) r.w.s. 147 in March 2005, determining an income of Rs. 43.77 crore. Audit scrutiny of the 3CD report revealed that debit balance of Rs. 15.42 crore of amalgamated company was adjusted in the profit and loss account of assessee's company. It was noticed that the assessee took over all assets and liabilities of amalgamated company and also specifically undertook to discharge such liabilities so such amount should be treated as part of purchase consideration on capital account. The omission to disallow the payment of debit balance on capital account[8] resulted in underassessment of income of Rs. 15.42 crore with consequent short levy of tax of Rs. 7.65 crore including interest.

3.7.3.5 In Tamil Nadu, CIT III Chennai charge, the assessment of a company, **M/s. Mahindra World City Developers Ltd.,** for the assessment year 2004-05 was completed after scrutiny in November 2006 determining a loss of Rs. 21.03 crore. Audit examination revealed that Rs. 16.26 crore on account of interest and finance charges had been debited to the profit and loss account and was allowed as deduction. As the project had not yet commenced, the interest on borrowed capital up to the period of commencement of production or of business operations was required to be capitalised[9]. The omission resulted in overassessment of loss by Rs. 16.26 crore involving potential short levy of tax of Rs. 5.83 crore.

3.7.3.6 In Delhi, CIT IV charge, the assessment of a company, **M/s. GE Money Financial Services Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006 determining an income of Rs. 77.42 crore. Audit examination revealed that the assessee had debited Rs. 11.14 crore to profit and loss account on account of 'Loss on sale of repossessed assets'. This loss, being capital in nature[10], should have been disallowed and added back to the income of the assessee. The mistake resulted in underassessment of income of Rs. 11.14 crore involving short levy of tax of Rs. 5.32 crore including interest.

---

[7] Refer Para 3.8.3
[8] Refer Para 3.7.1 (ii)
[9] Refer Para 3.7.1 (iii)
[10] Refer Para 3.7.1 (iv)

3.8 IRREGULARITIES IN ALLOWANCE OF DEPRECIATION

Irregularities in allowance of depreciation

3.8.1 In computing the business income of an assessee, a deduction on account of depreciation on the cost or written down value of building, plant and machinery, furniture, fixtures etc., is admissible at the rates prescribed in the Income tax Rules, 1962 provided the assets are owned by the assessee and used for the purpose of the business.

3.8.2 The written down value in case of any block of assets in respect of any previous year relevant to the assessment year means the aggregate of the written down value of all the assets falling within that block of assets at the beginning of the previous year as increased by the actual cost of any asset falling within that block, acquired during the previous year and as reduced by the money payable in respect of any asset falling within that block, which is sold or discarded or destroyed during the previous year together with the amount of scrap value, if any. Cost of assets for the purpose of depreciation includes all expenses, which are directly relatable and paid or incurred for acquisition of the assets. Similarly, written down value in respect of an asset is reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority.

3.8.3 Depreciation @ 25 per cent is allowed on intangible assets which include copyrights, patents, technical know-how, franchise charges and any other business or commercial rights of similar nature. Intangible assets, therefore, do not include goodwill, stock exchange membership fees, intellectual property rights or investment in shares. As per the Accounting Standard 26, goodwill is not an intangible asset for the purpose of amortisation. Further, goodwill cannot be considered as any other business or commercial right and depreciation cannot be allowed. It has been judicially held[11] that goodwill is not a capital asset.

3.8.4 Where in any assessment year full effect cannot be given to any depreciation allowance owing to there being no profits or gains or less profits or gains under the head 'profits and gains of business or profession', such unabsorbed depreciation shall be carried forward for the following assessment year(s) and shall be set-off against the income chargeable under the head 'profits and gains of business or profession' or any other head of income for that assessment year(s).

3.8.5 Mistakes in application of the above provisions resulted in short levy of tax aggregating **Rs. 112.59 crore** in 68 cases in Andhra Pradesh, Bihar, Delhi, Goa, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Karnataka, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Nine cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.8.5.1 In Delhi CIT IV charge, the assessment of a company, **M/s. Hindustan Coca Cola Beverages Company Pvt. Ltd.**, for the assessment year 2003-04 was completed after scrutiny in March 2006 determining a loss of Rs. 204.16 crore under normal provision and an income of Rs. 1715.90 crore under special provisions of the Act.

[11] {M/s B. Srinivasa Shetty vs. CIT (128 ITR 294) (SC)}

Audit examination revealed that the assessee claimed and was allowed depreciation @ 25 per cent of Rs. 39.92 crore on goodwill. As goodwill is not covered under intangible assets specified in section 32 of the Act, it should have been disallowed and added back in the income of the assessee. The mistake resulted in incorrect allowance of depreciation of Rs. 39.92 crore involving potential tax effect of Rs. 14.67 crore.

3.8.5.2 In Andhra Pradesh, CIT III Hyderabad charge, the assessment of a company, **M/s. Sri Vishnu Cements Limited,** for the assessment year 2002-03 was completed after best judgement (under section 144) in January 2005 determining 'nil' income under normal provisions. Unabsorbed depreciation of Rs. 28.24 crore (pertaining to the assessment years 1989-90 to 1993-94, 2000-01 and 2002-03) was allowed to be carried forward in the order of assessment year 2002-03. Audit scrutiny however revealed that the unabsorbed depreciation to be carried forward was only Rs. 33.08 lakh (pertaining to assessment year 2000-01). The mistake resulted in excess carry forward of unabsorbed depreciation of Rs. 27.91 crore involving a potential tax effect of Rs. 9.96 crore.

3.8.5.3 In Delhi, CIT III charge, the assessment of a company, **M/s. Steel Authority of India Ltd.,** for the assessment year 2003-04 was completed after scrutiny in March 2006 determining income of Rs. 60.32 crore from long term capital gain and Rs. 2.40 crore from other sources. Audit examination revealed that though there was unabsorbed depreciation of Rs. 10135.68 crore, the same was not set-off from the long term capital gain of Rs. 60.32 crore. The mistake resulted in excess carry forward of unabsorbed depreciation of Rs. 60.32 crore involving potential tax effect of Rs. 9.50 crore.

3.8.5.4 In Maharashtra, City I Mumbai charge, the assessment of a company, **M/s. Videsh Sanchar Nigam Ltd.,** for the assessment year 2001-02 was completed after scrutiny in November 2003 determining an income of Rs. 2283.12 crore. Audit examination revealed that as on 1 April 2000, the opening written down value (WDV) of computers and plant and machinery adopted by assessee was Rs. 49.58 crore and Rs. 751.33 crore respectively as against closing WDV of Rs. 21.96 crore and Rs. 803.11 crore respectively as on 31 March 2000 which was accepted by the assessing officer. Further, it was also noticed that the assessee classified the Gateway Digital System (GDS) under the block of asset of computers and claimed depreciation of Rs. 31.07 crore at the rate of 60 per cent which was allowed even though the GDS was classified by the department under the block of assets of plant and machinery in the assessment year 2000-01 on which depreciation was admissible at the rate of 25 per cent as against 60 per cent allowed by the department during 2001-02. The above omissions resulted in total underassessment of income of Rs. 21.75 crore involving short levy of tax of Rs. 8.60 crore.

3.8.5.5 In Tamil Nadu, CIT Chennai I charge, the assessment of a company, **M/s. Eonour Technologies Ltd.,** for the assessment year 2003-04 was completed after scrutiny in February 2006 determining an income of Rs. 12.73 crore and the income tax return for the assessment year 2004-05 was processed in summary manner in December 2005 at a loss of Rs. 25.12 crore. Audit examination revealed that the assessee had claimed and was allowed depreciation at the rate of 60 per cent on

software rights. As the software rights constituted intangible assets, depreciation on it was allowable at the rate of 25 per cent only. Incorrect adoption of rates of depreciation resulted in excess allowance of depreciation of Rs. 17.33 crore for both the assessment years involving an aggregate tax effect of Rs. 8.12 crore.

3.8.5.6 In Maharashtra, City II Mumbai charge, the assessment of a company, **M/s. H.V. Transmission Ltd.**, for assessment year 2004-05 was completed after scrutiny in October 2006 at 'nil' income after setting off the unabsorbed depreciation of Rs. 14.62 crore pertaining to assessment year 2001-02 and allowing carry forward of unabsorbed depreciation of Rs. 45.93 crore for future set-off. Audit scrutiny of the records for assessment year 2001-02 revised in December 2006 revealed that the depreciation allowed to be carried forward was Rs. 38.76 crore only as against Rs. 60.55 crore considered by department in the assessment of assessment year 2004-05. Omission to rectify the assessment for the assessment year 2004-05 consequent to revision of assessment of assessment year 2001-02 resulted in excess carry forward of unabsorbed depreciation of Rs. 21.79 crore involving potential tax of Rs. 7.82 crore.

3.8.5.7 In Haryana, CIT Panchkula charge, the assessment of a company, **M/s. Uttar Haryana Bijli Vitran Nigam Limited**, for assessment year 2003-04 was completed after scrutiny in December 2005 determining a loss of Rs. 602.64 crore. Audit examination revealed that the assessee claimed and was allowed depreciation of Rs. 111.54 crore on transmission and distribution machinery on written down value of Rs. 485.78 crore, which included assets amounting to Rs. 68.70 crore acquired from consumer contribution & grants and so depreciation of Rs. 14.75 crore allowed on these assets was not admissible. The mistake resulted in excess allowance of depreciation of Rs. 14.75 crore involving potential tax of Rs. 5.42 crore.

3.9 MISTAKES IN ADOPTION OF CORRECT FIGURES/ARITHMETICAL ERRORS ETC

Mistakes in adoption of correct figures/ arithmetical errors etc

3.9.1 The Board[12] has issued instructions from time to time to assessing officers and their supervising officers to ensure that mistakes in scrutiny assessments do not occur.

3.9.2 Audit noticed that the assessing officers had adopted incorrect figures, committed arithmetical errors, allowed claims twice and did not add back inadmissible claims to income, resulting in short levy of tax of **Rs. 109.63 crore** in 47 cases in Bihar, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan and West Bengal. Three cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.9.2.1 In Delhi, CIT I charge, the assessment of a company, **M/s. Bharti Cellular Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006 determining nil income after setting off brought forward losses of Rs. 209.40 crore. Audit examination revealed that while computing the income, the assessing officer arrived at income of Rs. 209.40 crore instead of Rs. 290.40 crore due to totalling mistake. The mistake resulted in underassessment of income and consequential

[12] Central Board of Direct Taxes

incorrect carry forward of loss of Rs. 81.00 crore involving potential tax effect of Rs. 29.06 crore.

3.9.2.2 In Delhi, CIT V charge, the assessment of a company, **M/s. National Thermal Power Corporation Ltd.**, for the assessment year 2002-03 was completed after scrutiny in April 2003 determining an income of Rs. 2098.52 crore which was revised to an income of Rs. 3064.19 crore under section 154/147 in September 2006. Audit examination revealed that as per the order passed under section 154/147, the assessing officer disallowed Rs. 793.15 crore on account of deduction claimed under section 80IA but while computing the taxable income, Rs. 739.15 crore only was added back. The mistake resulted in underassessment of income of Rs. 54 crore involving short levy of Rs. 27.63 crore including interest.

3.9.2.3 In Delhi, CIT I charge, the assessment of a company, **M/s. Airport Authority of India,** for assessment year 2002-03 was completed after scrutiny in August 2004. Audit examination revealed that instead of adding Rs. 16.01 crore on account of provision for gratuity, which was debited to profit and loss account, the assessee deducted it from the taxable income. This was allowed by the assessing officer also. The omission resulted in underassessment of income of Rs. 32.02 crore involving tax effect of Rs. 15.24 crore including interest.

3.9.2.4 In Maharashtra, CIT II Mumbai charge, the assessment of a company, **M/s. Britannia New Zealand Foods Pvt Ltd.**, for the assessment year 2004-05 was completed after scrutiny in November 2006 determining a loss of Rs. 34.77 crore. Audit examination revealed that the assessee in its books of accounts claimed depreciation of Rs. 5.25 crore on account of intangible assets viz. Technical Knowhow, Marketing Infrastructure and Non-compete fees whereas as per Audit Report the corresponding depreciation on the same assets under Income Tax Act was Rs. 19.69 crore. Assessing officer disallowed depreciation on intangible assets on various grounds; however, while computing total income/loss, added back only Rs. 5.25 crore as against the correct amount of Rs. 19.69 crore. The omission resulted in excess allowance of depreciation of Rs. 14.44 crore and consequent excess carry forward of loss to that extent involving potential short levy of tax of Rs. 5.18 crore.

3.10 INCORRECT ALLOWANCE OF PROVISIONS

Incorrect allowance of provisions

3.10.1 A provision made in the accounts for an accrued or known liability is an admissible deduction, while other provisions do not qualify for deduction under the Act. It has been judicially held[13] that in order for a loss to become deductible, it must have actually arisen or be incurred and not merely anticipated as certain to occur.

3.10.2 Irregular allowance of different types of provisions resulted in short levy of tax aggregating **Rs. 97.59 crore** in 20 cases in Andhra Pradesh, Delhi, Gujarat, Madhya Pradesh, Maharashtra, Tamil Nadu and West Bengal. Three cases each involving revenue impact of more than Rs. five crore are illustrated below:

[13] CIT *vs* Indian Overseas Bank , 151 ITR 466 (Madras)

3.10.2.1 In Delhi, CIT II charge, the assessment of a company, **M/s. Mahanagar Telephone Nigam Ltd.,** for the assessment year 2005-06 was completed after scrutiny in March 2006 determining an income of Rs. 834.32 crore. Audit examination revealed that the assessee was allowed to claim Rs. 180.32 crore on account of provision for doubtful debts including disputed bill written back in the assessment order. As the claim included provision of Rs. 168.78 crore for the current assessment year, which was an unascertained liability, it should have been disallowed and added back to the income of the assessee. The mistake resulted in underassessment of income of Rs. 168.78 crore involving tax effect of Rs. 65.34 crore.

3.10.2.2 In Maharashtra, CIT II Mumbai charge, the assessment of a company, **M/s. Tata Finance Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006 at a loss of Rs. 33.98 crore. Audit examination revealed that the assessee claimed and was allowed a deduction of Rs. 20.63 crore towards provisions for non-performing assets. Since provision for non-performing assets is not an allowable expenditure, deduction allowed was required to be disallowed. Omission resulted in underassessment of income of Rs. 20.63 crore involving short levy of potential tax of Rs. 7.40 crore.

3.10.2.3 In Delhi, CIT IV charge, the assessment of a company, **M/s. Hero Honda Finlease Ltd.**, for the assessment year 2000-01 was competed after scrutiny under section 148/143(3) in January 2006 determining an income of Rs. 12.08 crore. Audit examination revealed that the assessee had claimed and was allowed an expenditure of Rs. 10.40 crore on account of "lease equalization charges". As lease equalization is in the nature of provision/reserve, it should have been disallowed and added back to the income of the assessee. The mistake resulted in underassessment of income of Rs. 10.40 crore involving short levy of tax of Rs. 7.22 crore including interest.

3.11 MISTAKES IN APPLICATION OF CORRECT RATE OF TAX/SURCHARGE

Mistakes in application of correct rate of tax/surcharge

3.11.1 Articles 12(4), 12(6) and 13(6) read with Article 7 of Double Taxation Avoidance Agreement between the Government of India and the Governments of Sweden, USA and the France respectively provide that where an assessee is earning income in the nature of royalty or fees for technical services through a permanent establishment situated in the either state, such income is taxable as business income in accordance with the domestic provision of the state of source. In such cases, provisions of section 44D of the Act[14] shall apply.

3.11.2 Under section 44D, no deduction in respect of any expenditure or allowance shall be allowed to an assessee, being a foreign company, under any section in computing the income by way of royalty or fee for technical services received by the foreign company from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or Indian concern after 31 March 1976 but before 1 April 2003. Further as per section 115A (b)(A) of the Act, where the total income of a non-resident includes any income by way of royalty or fee for technical services, tax @ 30 per cent shall be calculated on such income if the

[14] Income Tax Act, 1961

income is received in pursuance of an agreement made before 31 May 1997 and 20 per cent where such royalty is in pursuance of an agreement made after 31 May 1997.

3.11.3 Audit noticed short levy of tax due to incorrect application of rate of tax/surcharge involving revenue impact of **Rs. 92.49 crore** in 19 cases in Delhi, Haryana, Karnataka, Maharashtra, Tamil Nadu and West Bengal. Three cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.11.3.1 In Delhi, DIT International Taxation charge, the assessment of a company, **M/s. Ericsson AB**, for the assessment year 2003-04 was completed after scrutiny in March 2006 determining an income of Rs. 579.26 crore. Audit examination revealed that the above income of the assessee company included royalty and technical fee aggregating Rs. 333.20 crore, which were held by the assessing officer to have been received through its permanent establishment and was taxed @ 10 per cent. As the royalty and technical fee was received by the assessee through the permanent establishment in pursuance with agreement made after 31 March 1997, it should have been taxed @ 20 per cent (instead of 10 per cent) under section 115A read with section 44D of the Act. The mistake resulted in short levy of tax of Rs. 50.23 crore including interest.

3.11.3.2 In Delhi, DIT International Taxation charge, the assessment of a company, **M/s. Oracle Corporation**, for the assessment years 1998-99 and 1999-2000 completed after scrutiny in March 2002 was rectified in March 2006 to incomes of Rs. 55.39 crore and Rs. 84.95 crore respectively. Also assessment for the assessment year 2003-04 was completed after scrutiny in March 2006 determining an income of Rs. 200.02 crore. Audit examination revealed that the assessee was held to have a permanent establishment in India by way of a fixed place of business as well as dependent agent in the form of subsidiary company. The incomes earned by the company included incomes by way of royalty of Rs. 32 crore, Rs. 45.85 crore and Rs. 60.53 crore during the three assessment years and were taxed @ 15 per cent instead of 30 per cent, 20 per cent and 20 per cent respectively as per agreements arrived at between the assessee and an Indian concern between 1993 and 1997 under section 44D read with section 115A(b)(A). The above mistakes resulted in aggregate short levy of tax of Rs. 16.59 crore.

3.11.3.3 In Delhi, DIT International Taxation charge, the assessment of a company, **M/s. Alcatel CIT**, for the assessment year 2003-04 was completed after scrutiny in March 2006 determining an income of Rs. 112.44 crore including income from supply of software of Rs. 76.18 crore. Audit examination revealed that the assessing officer had clearly established in the assessment order that the income from supply of software is taxable as royalty and the assessee was carrying out its business in India through a permanent establishment. Hence as per the section 115A(b)(A) read with section 44D of the Act and in view of the agreement executed after 31 May 1997, the income from royalty of Rs. 76.18 crore should have been taxed @ 20 per cent instead of @ 10 per cent. The mistake resulted in short levy of tax of Rs. 11.35 crore including interest.

3.12 IRREGULAR ALLOWANCE OF DEDUCTION/LIABILITY NOT SUPPORTED BY ACTUAL PAYMENT

Irregular allowance of deduction/ liability not supported by actual payment

3.12.1 Deductions specified under section 43B of the Act are allowable only on actual payment for certain types of expenditure. From 1 April 1989, tax, duty or any sum payable as interest on any loan or borrowing from any public financial institution or a state financial corporation or a state industrial investment corporation actually paid by the assessee on or before the due date of filing the return of income are allowed as deduction.

3.12.2 As per explanations 3C and 3D inserted below section 43B vide Finance Act, 2006 with retrospective effect from 1 April 1989 and 1 April 1997 respectively, any interest which has been converted into a loan or borrowing or advance, but has not been actually paid, shall not be allowed as deduction in the computation of income. It has been judicially held[15] that conversion of interest into loan does not amount to payment of interest for the purpose of section 43B. The Board has also clarified[16] that conversion of interest into loan or borrowing or advance does not amount to actual payment.

3.12.3 Irregular allowance of deductions towards actual payments resulted in short levy of tax aggregating **Rs. 78.98 crore** in 22 cases in Andhra Pradesh, Delhi, Gujarat, Kerala, Maharashtra, Orissa and West Bengal. Four cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.12.3.1 In Delhi, CIT IV charge, the assessment of a company, **M/s. Industrial Finance Corporation of India,** for the assessment year 2003-04 was completed after scrutiny in March 2006 determining a loss of Rs. 1,192.17 crore. Audit examination revealed that the assessee claimed and was allowed a deduction of Rs. 129.65 crore under section 43B on account of interest on PP Bonds-UTI, Borrowing from GIC and Subsidiaries, PP Bonds-FIS. As this amount was not actually paid but reinvested as per a restructuring package, it should have been disallowed and reduced from the loss of the assessee. The mistake resulted in overassessment of loss of Rs. 129.65 crore involving potential tax effect of Rs. 47.65 crore.

3.12.3.2 In Gujarat, CIT Jamnagar charge, the assessment of a company, **M/s. Birla VXL Limited,** for the assessment year 2002-03 was completed after scrutiny in March 2005 determining a loss of Rs. 59.26 crore. Audit scrutiny revealed that the assessee claimed Rs. 21.74 crore under section 43B being amount written back which was disallowed in earlier years. However, no supporting documents were available on record to prove that the expenditure was incurred by the assessee and disallowances of claim in the relevant previous year. Thus, the omission of not disallowing this amount resulted in overassessment of loss of Rs. 21.74 crore involving short levy of potential tax of Rs. 7.76 crore.

3.12.3.3 In Delhi, CIT III charge, the assessment of a company, **M/s. Spice Communication Ltd.,** for the assessment year 2003-04 was completed after scrutiny in

[15] M/s Kalpana Lamps and Components Ltd. *vs* CIT (255 ITR 491), (Madras) (2001)
[16] Circular no. 07/2006 dated 17 July 2006

March 2006 determining 'nil' income after adjusting brought forward business loss of Rs. 21.53 crore. Audit examination revealed that the assessee claimed and was allowed an expenditure of Rs. 17.18 crore towards interest on debentures. As per the notes to accounts, the company had defaulted payment on interest on debentures. It should, therefore, have been disallowed and added back to the income of the assessee. The mistake resulted in underassessment of income and excess carry forward of loss of Rs. 17.18 crore involving potential tax effect of Rs. 6.31 crore.

3.12.3.4 In Delhi, CIT IV charge, the assessment of a company, **M/s. Filatax India Ltd.,** for the assessment year 2003-04 was completed after scrutiny in January 2006 determining a loss of Rs. 18.86 crore. Audit examination revealed that the assessee claimed and was allowed a deduction of Rs. 16.64 crore under section 43B on account of 'interest on term loans' and debentures from UTI' paid by way of conversion into zero coupon non-convertible debentures. As this amount was not actually paid but converted into zero coupon non-convertible debentures, it should have been disallowed and reduced from the loss of the assessee. The mistake resulted in overassessment of loss of Rs. 16.64 crore involving potential tax effect of Rs. 6.11 crore.

3.13 MISTAKES IN COMPUTATION OF INCOME UNDER SPECIAL PROVISIONS

Mistakes in computation of income under special provisions

3.13.1 Where in the case of an assessee, being a company, the income tax payable on the total income as computed under the Act in respect of any previous year relevant to the assessment year commencing on or after 1 April 2001, is less than seven and one-half per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of seven and one-half per cent. For this purpose, book profit means the net profit as per profit and loss account subject to certain additions/deletions. One of such additions relates to amount or amounts set aside as provisions to unascertained liabilities.

3.13.2 Non-compliance with above provisions resulted in short levy of tax aggregating **Rs. 75.20 crore** in 25 cases in Andhra Pradesh, Delhi, Himachal Pradesh, Karnataka, Madhya Pradesh, Rajasthan, Maharashtra, Tamil Nadu and West Bengal. One case involving revenue impact of Rs. 57.25 crore is illustrated below:

3.13.2.1 In Delhi, CIT I charge, the assessment of a company, **M/s. Bharat Sanchar Nigam Ltd.**, for the assessment year 2004-05, was completed after scrutiny in December 2006 determining book profit of Rs. 125.76 crore under special provisions and nil income under normal provisions of the Act. The assessment was rectified in April 2006 and interest of Rs. 2.55 lakh on refund was withdrawn in July 2007. Audit examination revealed that the assessee debited in its profit and loss account, Rs. 560.54 crore for provisions for doubtful debts and disputed bills against which Rs. 56.05 lakh only was added back in the computation of book profit. The mistake resulted in underassessment of book profit by Rs. 559.98 crore involving tax effect of Rs. 57.25 crore including interest.

3.14 INCORRECT COMPUTATION/CARRY FORWARD/ SET-OFF OF LOSSES

Incorrect computation/ carry forward/ set off of losses

3.14.1 Where the net result of computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss cannot be wholly set-off against income under any other head of the relevant year, so much of the loss as has not been set-off shall be carried forward to the following assessment year/years to be set-off against the profits and gains of business or profession of those years. No loss shall be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first determined. Determination of deemed income under the special provisions shall not affect the determination of loss to be carried forward and set-off in future years.

3.14.2 Section 43A of the Act provides that in computing the income of an assessee, any loss on account of variation in the rate of exchange of foreign currency is allowed as admissible expenditure if there is an increase in the liability of the assessee as expressed in Indian currency at the time of making re-payment of the whole or part of the moneys borrowed in any foreign currency by assessee. The Ministry of Law clarified in October 1984 that exchange loss arrived at on the basis of fluctuation in the rate of exchange, not backed by actual remittance cannot be allowed as deduction in computing the total income under the Act. Ministry of Finance also opined in May 1993 that intermediate fluctuations in the rate of exchange would not be relevant.

3.14.3 It has been judicially held[17] that fluctuations in the rate of foreign exchange resulting in gain or loss while repaying the instalments of foreign loan will not alter the cost incurred for purchase of asset for computing the depreciation.

3.14.4 Mistakes in application of the above provisions resulted in short levy of tax aggregating **Rs. 71.46 crore** in 65 cases in Andhra Pradesh, Delhi, Gujarat, Haryana, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Three cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.14.4.1 In Orissa, CIT Bhubaneswar charge, the assessment of a company, **M/s. Orissa Sponge Iron Ltd.**, for the assessment year 2003-04 was completed after scrutiny in January 2006 determining income under special provisions. Audit examination revealed that in the scrutiny assessment for the assessment year 2002-03 completed in December 2006, loss of Rs. 7.76 crore only was allowed to be carried forward as against Rs. 41.44 crore claimed as brought forward in the assessment for the assessment year 2003-04. The mistake resulted in excess carry forward of loss of Rs. 33.68 crore involving potential tax effect of Rs. 12.38 crore.

3.14.4.2 In Delhi, CIT IV charge, the assessment of a company, **M/s. Indian Airlines Ltd.,** for the assessment year 2002-03 was completed after scrutiny in March 2005 determining a loss of Rs. 97.19 crore which was revised to a loss of Rs. 178.66 crore under section 250/143(3) in September 2005. Audit examination revealed that as per the 3CD report, Rs. 44.02 crore had been added to the value of fixed assets on account

[17] CIT vs Tata Iron and Steel Co. Ltd. (1998) (231 ITR 285) (SC)

of change in exchange rate and thus the assessee company claimed excess depreciation of Rs. 17.61 crore @ of 40 per cent. As the amount represented intermediate exchange fluctuation not backed by the actual remittance, the excess depreciation on account of foreign exchange fluctuation was inadmissible and it should have been disallowed. The omission resulted in overassessment of loss by Rs. 17.61 crore involving potential tax effect of Rs. 6.29 crore.

3.14.4.3 In Maharashtra, CIT III Mumbai charge, the assessment of a company, **M/s. Ricoh India Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006 determining 'nil' income after adjusting the brought forward business loss and unabsorbed depreciation of Rs. 5.53 crore. Audit examination of records revealed that after allowing the set-off of business loss and unabsorbed depreciation of Rs. 10.90 crore from the assessment year 2002-03 to 2004-05, the business loss and unabsorbed depreciation available for future set-off was only Rs. 20.41 crore, as against Rs. 35.89 crore allowed to be carried forward by the department. The mistake resulted in excess carry forward of business loss and unabsorbed depreciation of Rs. 15.48 crore involving potential short levy of tax of Rs. 5.55 crore.

3.15 MISTAKES IN ALLOWANCE OF DEDUCTIONS OTHER THAN DEDUCTIONS UNDER CHAPTER VIA

Mistakes in allowance of deductions other than deductions under Chapter VIA

3.15.1 Where an assessee is engaged in any operation relating to prospecting for any mineral and incurs any expenditure for prospecting for any mineral or on development of a mine or other natural deposit of any such mineral or group of associated minerals, the assessee shall be allowed a deduction equal to its total income or one tenth of the prospecting expenditure incurred by the assessee whichever is less.

3.15.2 Financial corporations engaged in providing long-term finance for industrial or agricultural development or development of infrastructure facility in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes are entitled to a special deduction of an amount transferred by them out of their profits to a special reserve account, not exceeding 40 per cent of their total income as computed before making any deduction under chapter VIA. Where a deduction has been allowed in respect of any special reserve created and maintained as above, any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income-tax as the income of the previous year in which such amount is withdrawn.

3.15.3 Any interest, royalty, fees for technical services or other sum payable outside India shall not be deducted in computing the income under the head 'profits and gains of business or profession' unless tax has been deducted at source and paid into the Government account during the previous year.

3.15.4 Where an assessee incurs any expenditure in any previous year by way of payment of any sum to any employee under voluntary retirement scheme, one fifth of

the amount so paid shall be deducted in computing the profit and gains of that previous year and the balance shall be deducted in equal instalments for each of the four immediately succeeding previous years.

3.15.5 Section 44C provides for deduction to a non-resident assessee towards Head Office expenditure of an amount not exceeding five per cent of the adjusted total income.

3.15.6 Mistakes in application of above provisions resulted in short levy of tax aggregating **Rs. 69.75 crore** in 15 cases in Delhi, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, Orissa, Tamil Nadu, Uttar Pradesh and West Bengal. Five cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.15.6.1 In West Bengal, CIT II Asansol charge, the assessment of a company, **M/s. Eastern Coalfields Ltd.**, for the assessment year 2004-05 was completed after scrutiny in December 2006 determining a loss of Rs. 218.74 crore. Audit examination revealed that the assessee had claimed deduction of Rs. 61.52 crore towards development expenditure on coal mine, and the same was allowed in the assessment even though the assessee had no income during the previous year relevant to the assessment year 2004-05. Therefore, no deduction was admissible[18]. The mistake thus resulted in over assessment of loss by identical amount involving potential tax effect of Rs. 22.07 crore.

3.15.6.2 In Maharashtra, City-II Mumbai charge, the assessment of a company, **M/s. LIC Housing Finance Ltd.**, for the assessment years 2003-04 and 2004-05 was completed after scrutiny in December 2005 and March 2006 determining taxable incomes of Rs. 153.32 crore and Rs. 171.20 crore respectively. Audit examination revealed that during the relevant previous years, assessee had withdrawn Rs. 10 crore and Rs. 25 crore from special reserves and credited the same to profit and loss account but reduced the entire amount withdrawn from the special reserve in the computation of income. As such the amounts withdrawn from the special reserve escaped assessment and, therefore, were required to be brought to tax. The omission resulted in underassessment of income aggregating Rs. 35 crore for two assessment years involving short levy of tax of Rs. 16.95 crore.

3.15.6.3 In Tamil Nadu, CIT III Chennai charge, the assessment of a company, **M/s. Sify Ltd.**, for the assessment year 2002-03 was completed after scrutiny in December 2006 determining a loss of Rs. 106.84 crore. Audit examination revealed that deduction of Rs. 27.44 crore was claimed and allowed on account of payment made to non-residents for providing bandwidth connectivity services to the assessee and for installation of related equipment in the assessee's premises. As the payment had been made without deducting tax at source, the deduction claimed by the assessee was required to be disallowed and brought to tax. It was observed that similar disallowance had been made in respect of the same assessee for the assessment years 2003-04 and 2004-05. The incorrect allowance of deduction for the assessment year 2002-03 had resulted in a potential short levy of tax of Rs. 9.80 crore.

---

[18] Refer para 3.15.1

3.15.6.4 In Maharashtra, CIT I Mumbai charge, the assessment of a company **M/s. Alstom Projects (I) Ltd.**, for the assessment year 2002-03 was completed after scrutiny in March 2005 determining book profit at Rs. 75.53 crore under special provisions and loss of Rs. 263.81 crore under normal provisions of the Act. Audit examination revealed that while computing the income under normal provisions, the assessee claimed and was allowed a deduction of Rs. 11.03 crore being one fifth of the total expenditure aggregating Rs. 55.17 crore towards voluntary retirement scheme. Besides, the assessee debited another Rs. 23.04 crore to its books of account on account of voluntary retirement scheme which was required to be disallowed. The omission resulted in underassessment of income of Rs. 23.04 crore involving short levy of tax of Rs. 8.22 crore.

3.15.6.5 In Delhi, DIT International Taxation charge, the assessment of a company, **M/s. Mitsubishi Corporation,** for the assessment years 1998-99 to 2003-04 was completed after scrutiny in March 2006 during which the income from trading activities was determined @ 2.75 per cent of the turnover in India after allowing expenses of the liaison office and head office expenditure. Audit examination revealed that while calculating the deduction under section 44C, it was irregularly allowed on the total incomes instead of allowing on the incomes which were held to be taxable in India. The mistake resulted in underassessment of income of Rs. 9.96 crore involving short levy of tax of Rs. 5.84 crore including interest.

3.16 MISTAKES IN ASSESSMENT WHILE GIVING EFFECT TO APPELLATE ORDER

Mistakes in assessment while giving effect to appellate order

3.16.1 An aggrieved assessee can appeal to the Commissioner of Income Tax (Appeals) against the order of an assessing officer who shall comply with the directions given in the appellate order. Further appeal is also permitted to be made on questions of fact and law to Income Tax Appellate Tribunal and on the questions of law alone to the High Court and the Supreme Court thereafter. Any mistake committed while giving effect to an appellate order will result in underassessment/overassessment of income.

3.16.2 It has been judicially held[19] that broken period interest paid on purchase of securities is a revenue expenditure and hence an allowable expenditure. It has also been judicially held[20] that deduction on account of broken period interest was not to be allowed at the time of purchase of securities.

3.16.3 Mistakes in implementation of appellate orders resulted in short levy of tax aggregating **Rs. 22.61 crore** in nine cases in Gujarat, Maharashtra, Orissa, Rajasthan and Tamil Nadu. Two cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.16.3.1 In Maharashtra, DIT (International Taxation), the assessment of a foreign banking company, **M/s. Deutsche Bank A.G.,** for the assessment year 2001-02 was completed after scrutiny in March 2004 determining the income at Rs. 360.84 crore

[19] American Express Bank (258 ITR 601) Mumbai HC
[20] Vijaya Bank Ltd. (187 ITR 541SC)

followed by a rectification in January 2006 for giving effect to CIT (Appeal)'s order dated 18.2.2005. Audit examination revealed that the assessing officer disallowed a deduction on account of broken period interest of Rs. 33.23 crore paid in respect of securities purchased in the relevant previous year in view of Supreme Court's decision in the case of Vijaya Bank Ltd.. However, the corresponding deduction in respect of interest of Rs. 30.60 crore on securities sold during the relevant previous year but purchased in earlier previous year was allowed on the condition that the same being disallowed in the past was subject to withdrawal if the addition of Rs. 33.30 crore was deleted in appeal. CIT(Appeal) vide order dated 18.2.05 deleted the disallowance of Rs. 33.23 crore in view of decision in the case of American Express Bank. While giving effect to appellate order in January 2006, the assessing officer however did not consider withdrawal of deduction of Rs. 30.60 crore already allowed in the scrutiny assessment. Omission to disallow the deduction resulted in underassessment of income of Rs. 30.60 crore involving short levy of tax of Rs. 14.69 crore.

3.17 IRREGULAR ALLOWANCE OF EXEMPTIONS AND EXCESS RELIEF

Irregular allowance of exemptions and excess relief

3.17.1 Section 91(1) of the Act provides that if any person, who is resident in India, paid tax outside India on the income accrued to him, he is entitled for deduction from the Indian income tax payable of a sum calculated on such doubly taxed income at the Indian rate of tax or rate of tax of such other country which ever is less, or at the Indian rate of tax if both the rates are equal. However, no such deduction shall be allowed in respect of expenditure incurred in relation to income not includible in total income under the provisions of section 14A.

3.17.2 Sections 10A/10B of the Act provide that with effect from 1 April 2001, a deduction of such profits and gains as are derived by an undertaking/by an hundred per cent export oriented undertaking is allowed from the total income of the assessee. This deduction has to be, however, restricted to the extent of income available.

3.17.3 Mistakes in application of the above provisions resulted in irregular allowance of exemptions and excess relief involving short levy of tax aggregating **Rs. 30.97 crore** in 11 cases in Karnataka, Madhya Pradesh, Maharashtra and Tamil Nadu. Two cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.17.3.1 In Maharashtra, CIT II Mumbai charge, the assessment of a company, **M/s. Tata Sons Ltd.,** for the assessment years 1992-93, 1993-94 and 1995-96, was completed after scrutiny in March 1995, March 1999 and March 1998 at the taxable incomes of Rs. 40.44 crore, Rs. 53.98 crore and Rs. 56.10 crore which were revised to Rs. 37.53 crore, Rs. 36.40 crore and Rs. 40.92 crore in March 1996, October 2003 and June 2004 respectively while giving effect to CIT(Appeal)'s order. The incomes were again revised in February 2007 (Assessment years 1992-93 and 1993-94) and June 2006 (1995-96) to give effect to ITAT's orders allowing DIT relief of Rs. 1.97 crore, Rs. 1.87 crore and Rs. 5.88 crore respectively for income generated outside India in the three assessments. Audit examination of the ITAT's orders passed in February 2007 and June 2006 revealed that the entire overseas profit of the assessee was claimed as exempt from tax and as such the assessee was not entitled for the DIT relief as claimed and allowed by the department. Omission to withhold/disallow the DIT relief

aggregating Rs. 9.72 crore resulted in short levy of tax of Rs. 18.63 crore including withdrawal of interest on refund.

3.17.3.2 In Karnataka, CIT I Bangalore charge, the scrutiny assessment of a company, **M/s. GE Power Controls India Pvt Ltd.,** for the assessment year 2003-04 was completed in March 2006 at a loss of Rs. 18.64 crore. Audit scrutiny revealed that the assessee had filed the return at a loss of Rs. 20.11 crore which was arrived at after taking into effect deduction under section 10A/10B of Rs. 26.78 crore. The returned loss was accepted and the loss was assessed at Rs. 18.64 crore after making certain additions and allowing deduction to the extent of Rs. 26.75 crore under section 10A/10B instead of restricting it to the extent of income of Rs. 8.11 crore available (after giving effect to the additions made) and assessing nil income. The mistake resulted in incorrect computation of income and excess allowance of deduction of Rs. 18.64 crore (Rs. 26.75 crore-Rs. 8.11 crore) involving a potential tax effect of Rs. 6.85 crore.

3.18 NON/SHORT LEVY OF INTEREST

Non/short levy of interest

3.18.1 Assessee is liable to pay interest at the rates prescribed by Government from time to time under different provisions of the Act:

- Section 220 provides for levy of interest for default in payment of tax demand
- Section 234A/234B provide for levy of interest for default in furnishing return of income / payment of advance tax whereas section 234C provides for levy of interest for deferment of advance tax.
- Interest is also charged from the assessee on excess refund under section 234D in case any refund is granted to the assessee at summary assessment stage and no refund is due on regular assessment or the amount refunded at summary assessment stage exceeds the amount refundable on regular assessment.

3.18.2 Mistakes in compliance with the above provisions resulted in short levy of interest aggregating **Rs. 30.50 crore** in 48 cases in Andhra Pradesh, Delhi, Gujarat, Karnataka, Kerala, Haryana, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. The revenue impact in individual cases under this category ranged from Rs. 5.02 lakh to Rs. 4.82 crore.

3.18.2.1 In Delhi, DIT International Taxation charge, the assessment of a company, **M/s. Rolls Royce Industrial Power (I) Ltd.**, for the assessment year 1999-2000 was completed after scrutiny, in August 2003 determining a loss of Rs. 8.71 crore and re-assessed under section 147 r.w.s. 143(3) on 19.09.2005 determining an income of Rs. 28.90 crore. Another rectification order under section 154 was issued on 09.11.2005 wherein the assessing officer accepted the contention of the assessee that interest under section 234B was wrongly charged from 01.04.1999 to 19.09.2005 instead of from 01.08.2003 to 19.09.2005 in rectification order. Audit scrutiny revealed that (in the ITNS 150) interest of Rs. 6.55 crore under section 234B was incorrectly charged for the period 01.04.1999 to 31.07.2003 instead of Rs. 1.73 crore for the period 01.08.2003 to 30.09.2005. The mistake resulted in excess charge of interest of Rs. 4.82 crore.

3.19 INCORRECT ALLOWANCE OF DEDUCTIONS UNDER CHAPTER VIA

Incorrect allowance of deductions under Chapter VIA

3.19.1 Where any deduction is allowed under Chapter VIA (80C to 80U)[21] in respect of an income of the nature specified in that section which is included in the gross total income of the assessee, then, for the purpose of computing deduction under that section, the amount of income of that nature as computed in accordance with the provisions of this Act (before making any deduction under chapter VIA) shall alone be deemed to be the amount of income of that nature which is derived or received by the assessee and included in his gross total income.

3.19.2 An assessee being an Indian company or other assessee resident in India, engaged in the business of export is entitled a deduction subject to conditions, on profits derived from the export of goods or merchandise, if the sale proceeds are received in convertible foreign exchange. Also, where the export out of India is of goods or merchandise manufactured or processed by the assessee and of trading goods, the profits derived from such export shall, in respect of trading goods, be the export turnover in respect of such trading goods as reduced by the direct and indirect costs attributable to export of such trading goods. Sub section 4 of section 92 C of the Act provides that no deduction under Chapter VIA shall be allowed in respect of income by which the total income of the assessee is enhanced after computation of arm length price.

3.19.3 Incorrect application of the provisions of chapter VIA resulted in short levy of tax aggregating **Rs. 16.27 crore** in 30 cases in Andhra Pradesh, Delhi, Gujarat, Karnataka, Kerala, Maharashtra Punjab, Tamil Nadu, Uttar Pradesh and West Bengal. One case involving revenue impact of Rs. 4.92 crore is illustrated below:

3.19.3.1 In Maharashtra, CIT III Mumbai Charge, the assessment of a company, **M/s. Reliance Industries Ltd.**, for the assessment year 2004-05 was completed after scrutiny in November 2006 determining income of Rs. 1,646.57 crore after allowing the deductions under Chapter VIA of the Act. Audit scrutiny revealed that while computing taxable income the assessing officer made an addition of Rs. 5.13 crore on account of transfer pricing. However, while computing the deduction towards export profits, the addition made on account of transfer pricing was not excluded from the business profits as provided in the aforesaid provisions of the Act. The admissible deduction towards export profits thus worked out to Rs. 67.58 crore as against Rs. 81.29 crore allowed by the Department. The omission resulted in excess deduction of Rs. 13.71 crore towards export profits involving short levy of tax of Rs. 4.92 crore.

3.20 EXCESS ALLOWANCE OF REFUND/INTEREST ON REFUND

Excess allowance of refund / interest on refund

3.20.1 Where as a result of any order passed in assessment, appeal, revision or any other proceedings, refund of any amount becomes due to an assessee, this may be granted in cash or adjusted or set-off against outstanding dues to the assessee for any assessment year.

[21] Except section 80M

3.20.2 Interest on excess payment of advance tax, tax deducted or collected at source and any other tax or penalty becoming refundable will be paid at the rate of one per cent (since reduced to two third per cent with effect from 1 June 2002 and one-half per cent from 8 September 2003) for every month or part of month for the period from 1 April of the relevant assessment year to the date on which refund is granted. No interest will be payable, if the amount of refund is less than ten per cent of the tax determined under summary or on regular assessment.

3.20.3 Non-compliance with the above provisions by assessing officers resulted in excess allowance of refund or interest on refund totalling **Rs. 25.14 crore** in 12 cases in Delhi, Karnataka, Madhya Pradesh, Maharashtra, Rajasthan and West Bengal. Two cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.20.3.1 In Madhya Pradesh, CIT II Jabalpur charge, the assessment of a company, **M/s. Northern Coalfields Ltd. Singrauli Sidhi**, for assessment years 2002-03 to 2004-05 was completed after scrutiny between November 2005 and August 2007 and refund aggregating Rs. 49.03 crore in three assessment years was authorised between November 2005 and December 2007. Audit examination revealed that the assessee was paid interest aggregating Rs. 9.61 crore pertaining to three assessment years though the interest was not payable, as the principal amount of refund aggregating Rs. 39.43 crore was less than ten per cent of the assessed tax aggregating Rs. 1,614.11 crore. The mistake resulted in incorrect payment of interest of Rs. 9.61 crore on refund during three assessment years.

3.20.3.2 In Karnataka, CIT I Bangalore charge, the assessment of a company, **M/s. Infosys Technologies Ltd.**, for the assessment year 2003-04 was completed after scrutiny in January 2006 determining an income of Rs. 505.63 crore which was revised to Rs. 245.99 crore in February 2007 while giving appeal effect. Audit examination revealed that the assessing officer allowed an interest of Rs. 10.68 crore (which included Rs. 0.38 crore allowed twice for March 2007) as against the allowable interest of Rs. 5.23 crore on refund of Rs. 80.47 crore. The mistake in calculation of interest on refund resulted in excess payment of interest of Rs. 5.45 crore.

3.21 MISTAKES IN COMPUTATION OF CAPITAL GAINS

Mistakes in computation of capital gains

3.21.1 Any profit and gains arising from the transfer of a capital asset shall be chargeable to income tax under the head 'capital gains' and is taxable in the year in which the transfer took place unless the same is exempt under the specific provisions of the Act.

3.21.2 The "net worth" of the undertaking or the division, as the case may be, shall be deemed to be the cost of acquisition and the cost of improvement and is the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in its books of account.

3.21.3 Mistakes in application of the above provisions resulted in short levy of tax aggregating **Rs. 16.69 crore** in nine cases in Andhra Pradesh, Kerala, Madhya Pradesh,

Maharashtra and West Bengal. Two cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.21.3.1 In Maharashtra, Central I Mumbai charge, the assessment of a company, **M/s. Carol Info Services Ltd.**, for the assessment year 2001-02 was completed after scrutiny in March 2004 allowing carry forward of business loss of Rs. 17.98 crore and long-term capital loss of Rs. 11.08 crore for future set-off. Audit examination revealed that the assessee had sold part of its undivided interest in land and building to M/s. Enron Ltd. for Rs. 125.75 crore during the relevant previous year which included Rs. 28.60 crore on account of 'land' and Rs. 97.15 crore on account of 'Building'. The sold portion constituted 54 per cent of its undivided interest in land and building as against 58.7 per cent claimed. The incorrect claim on the part of the assessee led to inflation of the index cost price resulting in excess computation and carry forward of long term capital loss of Rs. 3.18 crore. Further, the assessee had adjusted the sale proceeds of the building from the block of assets treating the same as a depreciable asset which was also not in order. The part of the building sold was not used for the purpose of business and hence was not a depreciable asset. The said asset being a short term capital asset, the sale proceeds thereof as such were required to be taxed as short term gain but the same were not taxed at all. The omission resulted in underassessment of short term capital gain of Rs. 14.44 crore involving potential short levy of tax of Rs. 6.43 crore.

3.21.3.2 In Maharashtra, CIT VIII Mumbai charge, the assessment of company **M/s. Hotel Corporation of India Ltd.**, for assessment year 2003-04 was completed after scrutiny in March 2006 determining an income of Rs. 70.92 crore. During the relevant previous year, the assessee had transferred two of its undertakings viz. Centaur Hotel, Mumbai Airport (CHMA) and Centaur Hotel, Juhu Beach(CHJB) at prices of Rs. 83 crore and Rs. 153 crore respectively. Audit examination revealed that while computing the net worth of the two undertaking transferred, the assessee added the value of liabilities to the aggregate value of total assets of the undertaking instead of reducing the same from the total assets. Thus the assessee worked out net worth of the undertakings at Rs. 28.21 crore as against Rs. 5.05 crore and the same was accepted by the department. Omission to compute the net worth correctly[22], resulted in under statement of capital gain by Rs. 23.16 crore involving short levy of tax of Rs. 5.89 crore including interest.

3.22 INCOME NOT ASSESSED

Income not assessed

3.22.1 Section 5 of the Act provides that the total income of any previous year of a person, who is a resident includes all income from whatever source derived which is received or which accrues or arises or is deemed to accrue or arise during such previous year unless specifically exempted from tax by the provisions of Act.

3.22.2 Non-inclusion of income chargeable to tax in total income resulted in short levy of tax aggregating **Rs. 16.14 crore** in 25 cases in Andhra Pradesh, Delhi, Karnataka,

[22] Refer Para 3.21.1

Maharashtra, Uttar Pradesh and West Bengal. The revenue impact in individual cases under this category ranged from Rs. 10.42 lakh to 2.48 crore.

3.22.2.1 In Maharashtra, CIT I Mumbai charge, the assessment of a company, **M/s. Videsh Sanchar Nigam Ltd.**, for the assessment year 1999-2000 was completed after scrutiny in February 2002 determining an income of Rs. 1871.97 crore. Audit examination revealed that assessee in its return of income offered income aggregating Rs. 138.62 crore towards 'Interest on GDR proceeds' and 'Interest income on Export Earners Foreign Currency Account' as against the correct amount of Rs. 145.71 crore shown in the statement of earnings in foreign exchange. The omission to consider the correct interest income resulted in underassessment of income of Rs. 7.09 crore involving short levy of tax of Rs. 2.48 crore.

3.22.2.2 In Delhi, CIT IV charge, the assessment of a company, **M/s. Delhi Metro Rail Corporation Ltd.**, for the assessment year 2003-04 was completed after scrutiny in March 2006 determining a loss of Rs. 14.65 crore. Audit examination revealed that the miscellaneous income and the interest earned on income tax refund of Rs. 6.04 crore had not been added back to the income of the assessee. The mistake resulted in over assessment of loss of Rs. 6.04 crore involving potential tax effect of Rs. 2.22 crore.

3.23 MISTAKES IN SUMMARY ASSESSMENTS

Mistakes in summary assessments

3.23.1 Section 143(1) of the Act provides that the assessment may be completed in a summary manner after, *inter alia,* rectifying any arithmetical error in the return, accounts and accompanying documents.

3.23.2 Audit issued 93 paragraphs involving revenue impact of **Rs. 102.18 crore** related to summary assessments in the states of Andhra Pradesh, Assam, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. Ministry has accepted two cases involving revenue impact of Rs. 25.83 lakh. In 10 cases, the Ministry has not accepted the observations, being summary assessment cases, but remedial action have been initiated/taken under section 148 of the Act. Six cases each involving revenue impact of more than Rs. five crore are illustrated below:

3.23.2.1 In Karnataka, Bangalore CIT III charge, the return of a company, **M/s. Mysore Petro Chemical Ltd.,** for the assessment year 2004-05 was processed in summary manner in September 2006 at a loss of Rs. 72.02 crore. Audit examination revealed that instead of setting off brought forward loss of Rs. 79.92 crore to the extent of available profit of Rs. 7.90 crore for the assessment year 2004-05 and arriving at 'Nil' income, the entire loss was set-off. The mistake resulted in computation of excess loss of Rs. 72.02 crore involving a potential tax effect of Rs. 25.84 crore.

3.23.2.2 In Tamil Nadu, CIT III Chennai charge, the income tax returns of a company, **M/s. Madras Fertilizers Ltd.**, for the assessment years 2000-01 and 2001-02 were processed in summary manner accepting nil incomes. Audit examination revealed that the assessee claimed and was allowed expenditure of Rs. 19.45 crore, being 10 per

cent of the cost of "revamp hookup expenses", as deferred revenue expenditure for the assessment years 2000-01 and 2001-02. As deferred revenue expenditure is not an allowable expenditure under the Act and the revamp expenditure is not specified in section 35D that allows amortization of certain preliminary expenses, it should have been added back to income. Omission resulted in overassessment of loss by Rs. 19.45 crore involving potential short levy of tax of Rs. 7.59 crore.

3.23.2.3 In Tamil Nadu, CIT II Coimbatore charge, the return of a company, **M/s. SKM Egg Products Exports (India) Ltd.,** for the assessment year 2002-03 was processed in summary manner in February 2003 accepting 'nil' income and the assessment for the assessment year 2003-04 was completed after scrutiny in February 2006 determining an income of Rs. 64.99 lakh under special provisions of the Act. Audit examination revealed that the assessee, being a 100 per cent Export Oriented Undertaking (EOU), claimed and was allowed exemption under section 10B in the assessment year 2002-03 for the first time although it commenced manufacture of egg powder from the assessment year 1998-99 as it was a loss making unit up to the assessment year 2001-02. Further, carry forward of unabsorbed depreciation of Rs. 18.00 crore and business losses of Rs. 1.27 crore relating to the assessment years 1998-99 to 2000-01 was claimed and allowed in contravention of the provisions of section 10B. This mistake resulted in incorrect allowance of carry forward of losses of Rs. 19.27 crore involving potential tax effect of Rs. 6.91 crores.

3.23.2.4 In Delhi, CIT V charge, the assessment of a company, **M/s. RPG Communications Holding Ltd.**, for the assessment year 2005-06 was processed in a summary manner in April 2006 at a loss of Rs. 18.57 crore. Audit examination revealed that during the relevant previous year, the assessee had business income of Rs. 11.13 lakh and brought forward losses of Rs. 18.68 crore. After adjusting the previous year's brought forward losses to the extent of income available during the relevant previous year, the income should have been assessed at 'nil' instead of at a loss of Rs. 18.57 crore. This omission resulted in overassessment of loss of Rs. 18.57 crore, which can be set-off in subsequent years and therefore can result in underassessment of income, involving potential tax effect of Rs. 6.79 crore.

3.23.2.5 In Tamil Nadu, CIT I Chennai charge, the income tax return of a company, **M/s. Tamil Nadu Industries Captive Power Company Ltd.**, for the assessment year 2005-06 was processed in summary manner in November 2005 at a loss of Rs. 16.68 crore Audit examination revealed that the assessee had allotted shares valued at Rs. 16.00 crore by a resolution passed in an extraordinary meeting held in March 1996 to the then promoters and shareholders for consideration other than cash. The share capital was classified as 'intangible assets' upto March 2004. However, the intangible assets were written off and claimed as revenue expenditure during the previous year relevant to the assessment year 2005-06. As the allotment of equity shares to the promoters was a capital expenditure it was not allowable as revenue expenditure. Further, no depreciation was allowable on above as no intangible asset was acquired by the assessee after 1 April 1998 in terms of the provisions of section 32 of the Act. The incorrect allowance of written off amount resulted in overassessment of loss by Rs. 16.00 crore involving potential short levy of tax of Rs. 5.85 crore.

3.23.2.6 In Tamil Nadu, CIT Coimbatore I charge, the return of a company, **M/s. Sakthi Sugars Ltd.**, for the assessment year 2003-04 was processed in summary manner in February 2004 at a loss of Rs. 14.36 crore. Audit examination revealed that the assessee had deducted "Interest savings on export sales" of Rs. 14.04 crore from his business income stating that it would be considered separately. However, it was not considered while computing the total income for the relevant assessment year. Omission to disallow the same resulted in excess computation of loss by Rs. 14.04 crore involving potential tax effect of Rs. 5.16 crore.

3.24 ASSESSMENTS INVOLVING OVERCHARGE OF TAX

Assessments involving overcharge of tax

3.24.1 During test check in audit during 2006-07, overassessment of income was noticed in 25 cases involving overcharge of tax totalling **Rs. 166.21 crore** in, Delhi, Haryana, Maharashtra, Orissa, Tamil Nadu, Uttar Pradesh and West Bengal. Three cases each involving revenue impact of Rs. five crore or more are illustrated below:

3.24.1.1 In Delhi, CIT VI charge, the assessment of a company, **M/s. The Fertilizer Corporation of India Ltd.,** for the assessment year 2003-04 was completed after scrutiny in January 2006 determining 'nil' income. Audit examination revealed that the assessee added back Rs. 164.38 crore on account of 'profit chargeable to tax' in his computation sheet which was already considered in the schedule 18, 27 and 28 of the profit and loss account. The amount added by the assessee was again added by the Assessing Officer. It was further noticed that the assessee had debited Rs. 66.81 crore on account of prior period adjustments in the profit and loss account which was inclusive of 'depreciation' of Rs. 54.93 crore. Subsequently, the assessee added back the depreciation in the computation sheet while computing total income, which at the time of scrutiny was again added back by the assessing officer. Thus, the depreciation was added back twice. The mistakes resulted in overassessment of income aggregating Rs. 219.31 crore involving tax effect of Rs. 80.60 crore.

3.24.1.2 In Maharashtra, DIT I (International Taxation) Mumbai charge, the assessment of a company, **M/s. Cartier Shipping Co. Ltd.**, for the assessment year 1998-99, originally completed after scrutiny in February 2001 determining an income of Rs. 1.53 crore was revised in January 2006 to an income of Rs. 103.48 crore. Audit examination revealed that the assessing officer levied interest of Rs. 62.25 crore for default in payment of advance tax on the revised demand from April 1998 to January 2006 as against Rs. 33.28 crore worked out for the period from the date following the date of regular assessment from February 2001 to January 2006. The mistake resulted in excess levy of interest by Rs. 28.97 crore.

3.24.1.3 In Gujarat, CIT I Ahmedabad charge, the assessment of a company, **M/s. Core Health Care Limited**, for the assessment year 1996-1997 was completed after scrutiny in February 1999 determining a loss of Rs. 18.82 crore which was revised to Rs. 64.02 crore while giving effect to appellate order in February 2004. The assessment was again revised under section 143(3) read with section 147 in March 2004 determining total loss of Rs. 37.42 lakh. Audit scrutiny revealed that while passing the assessment order in March 2004, loss of Rs. 18.82 crore determined as per assessment order of February 1999 was adopted instead of loss of Rs. 64.02 crore

determined in the assessment order of February 2004. The omission resulted in under assessment of loss of Rs. 45.20 crore involving potential tax of Rs. 20.79 crore.

3.24.1.4 In Delhi, DIT International Taxation charge, the assessment of a company, **M/s. Oracle Corporation,** for the assessment years 1998-99 and 1999-2000 was completed after scrutiny in March 2002 determining incomes of Rs. 21.16 crore and Rs. 35.00 crore respectively. The case was reassessed under section 148/143(3) in March 2006 determining incomes of Rs. 55.39 crore and Rs. 84.95 crore respectively. Thus, an additional tax demand of Rs. 12.85 crore and Rs. 20.39 crore was created on reassessment of income in March 2006 for the assessment year 1998-99 and 1999-2000 respectively. Audit examination revealed that the interest of Rs. 16.59 crore and Rs. 21.41 crore under section 234B(3) was charged for the period from 1 April 1998 to 31 March 2006 instead of for the period from 1 March 2002 to 31 March 2006. The mistake resulted in excess charge of interest aggregating Rs. 20.19 crore for the two assessment years.

CHAPTER IV

Contents	Page

PART A – INCOME TAX

PART B – WEALTH TAX

Chapter Summary

This chapter consists of two parts, part A and part B, containing audit observations on assessments in respect of income tax and wealth tax respectively.

Audit issued 229 (182 in income tax and 47 in wealth tax) observations with a revenue impact of Rs. 62.47 crore (Rs. 61.68 crore in income tax and Rs. 79 lakh in wealth tax) involving various irregularities, omissions and mistakes to the Ministry of Finance for comments. The Ministry had accepted 16 observations (10 in income tax and six in wealth tax) involving revenue impact of Rs. 90.06 lakh (Rs. 84.01 lakh in income tax and Rs. 6.05 lakh in wealth tax) **till December 2008**.

(Paragraphs 4.4, 4.5, 4.21 and 4.22)

Audit noticed mistakes in:

- carry forward and set-off of losses in 15 cases involving revenue impact of Rs. 19.10 crore

  (Paragraph 4.6.2)

- computation of business income in 22 cases involving revenue impact of Rs. 8.54 crore.

  (Paragraph 4.7.2)

- adoption of correct figure in eight cases involving revenue impact of Rs. 8.61 crore.

  (Paragraph 4.8.2)

- levy of interest in 26 cases involving revenue impact of Rs. 3.05 crore.

  (Paragraph 4.9.2)

- allowing depreciation and deduction in respect of export profit in 19 cases involving revenue impact of Rs. 4.03 crore.

  (Paragraphs 4.10.2 and 4.11.2)

- computation of tax and allowance of liability in 11 cases involving revenue impact of Rs. 3 crore.

  (Paragraphs 4.12.2 and 4.13.2)

- computation of capital gains/loss and income not assessed in 13 cases involving revenue impact of Rs. 2.11 crore.

  (Paragraphs 4.14.2 and 4.15.2)

- assessment of salary income and levy of surcharge in five cases involving revenue impact of Rs. 93.14 lakh.

  (Paragraphs 4.16.2 and 4.17.2)

- overcharge of tax in 15 cases involving revenue impact of Rs. 1.97 crore.

  (Paragraph 4.19.1)

- wealth not assessed in 32 cases due to non-correlation of income tax assessment records involving revenue impact of Rs. 66.64 lakh.

  (Paragraph 4.23.3)

Assessees had availed un-entitled benefits in summary assessments in 40 cases involving revenue impact of Rs. 7.43 crore.

(Paragraph 4.18.2)

CHAPTER IV

A – INCOME TAX

Number of assessees

4.1 The number of assessees (other than companies) as per records of the Income-tax Department as on 31 March of 2007 and 2008 were 3.09 crore and 3.32 crore respectively as given in Table no. 2.6 of chapter II of this report.

Receipts from income tax

4.2 During 2007-08, income tax receipts were Rs. 1,02,655.08 crore compared to Rs. 75,079 crore in 2006-07 and constituted 32.88 per cent of the total direct taxes collection. Table no. 2.3 of chapter II of this report shows the details.

Status of assessments

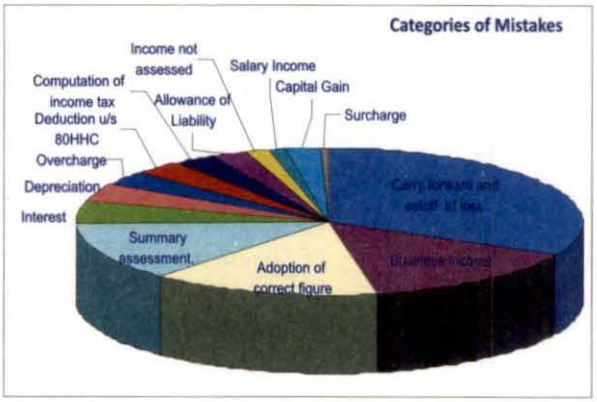
4.3 Chart 5 of paragraph 2.9 of chapter II of this report contains the particulars of assessments due for disposal, assessments completed and those pending. Details of demands remaining uncollected during the last five years are given in Chart 6 of chapter II of this report.

4.4 RESULTS OF AUDIT

Results of Audit

4.4.1 Audit issued 182 draft paragraphs, of which 167 draft paragraphs involved undercharge of tax of Rs. 59.71 crore and 15 involved overcharge of tax of Rs. 1.97 crore, to the Ministry of Finance between May 2008 and October 2008 for comments. The internal audit of the department had seen nine of these cases and had not noticed the mistakes pointed out in this report.

4.4.2 Out of the 182 draft paragraphs issued to the Ministry, 174 cases have been included in this chapter. Of these, 159 cases involve undercharge of Rs. 56.80 crore and remaining 15 cases involve overcharge of Rs. 1.97 crore. Each category of mistake starts with a suitable preamble followed by the combined/ consolidated revenue impact of all observations of similar nature. Mistakes in carry forward and set-off of losses, calculation of business income, adoption of figures and in summary assessment comprised 75 per cent (Rs. 44.34 crore by value) of the draft paragraphs included in the chapter.



4.5 STATUS OF REPLIES RECEIVED FROM THE MINISTRY OF FINANCE

Status of replies received from the ministry of finance

4.5.1 Out of 174 cases included in this chapter, the Ministry of Finance has accepted audit observations in 10 cases involving aggregate revenue impact of Rs. 84.01 lakh. In five cases, the Ministry has not accepted the audit observation. In the remaining

cases, replies have not been received (till December 2008). Replies of the Ministry, wherever received, have been examined and suitably incorporated in the report.

4.6 INCORRECT CARRY FORWARD AND SET-OFF OF LOSS

Incorrect carry forward and set-off of loss

4.6.1 The Income Tax Act, 1961 provides that where for any assessment year, the net result of computation under the head 'profits and gains of business or profession' is a loss to the assessee and such loss can not be or is not wholly set off against income under any other head, so much of the loss as has not been set off shall be carried forward to the following assessment year and shall be set off against the profits and gains, if any, of that assessment year. If the loss cannot be wholly so set off, the balance shall be carried forward to the following assessment years. No loss shall, however, be carried forward for more than eight assessment years immediately succeeding the assessment year for which the loss was first computed.

Further, section 80P provides that a deduction equal to whole of the amount of profits and gains of business attributable to the specified activities is allowable to a consumer's cooperative society. However, such deduction shall be restricted to one lakh rupees in respect of the 'profits and gains of business or profession' attributable to the activities other than the specified activities.

4.6.2 Audit noticed short levy of tax aggregating **Rs. 19.10 crore** in 15 cases in Delhi, Gujarat, Karnataka, Maharashtra, Orissa, Punjab, Rajasthan and Tamil Nadu as the assessing officers did not apply the above provisions correctly.. In one case the Ministry has accepted the observation.

4.6.3 Four cases each above Rs. 50 lakh are illustrated below:

4.6.3.1 In Orissa, CIT. Sambalpur charge, the assessment of a co-operative society, **Bolangir Anchalick Gramya Bank**, for assessment year 2004-05 was completed after scrutiny in December 2005 and rectified under section 154 in March 2007 determining a loss of Rs. 139.37 crore including brought forward loss of Rs. 129.65 crore. Audit examination revealed that the brought forward loss of Rs. 129.65 crore included Rs. 34.70 crore which was more than eight years old. This resulted in excess allowance of business loss of Rs. 34.70 crore involving potential tax effect of Rs. 12.45 crore.

4.6.3.2 In Rajasthan, CIT Kota charge, the assessment of an association of persons/body of individuals, **Hadoti Kshetriya Gramin Bank Ltd**, for the assessment years 2004-05 and 2005-06 was completed after scrutiny determining 'nil' income (for both assessment years) after setting off brought forward business losses of Rs. 3.82 crore and Rs. 7.08 crore respectively. Audit examination revealed that the assessed incomes included 'income from other sources' of Rs. 2.13 crore and Rs. 4.21 crore for the assessment years 2004-05 and 2005-06 respectively. It was, therefore, irregular to set off the brought forward business losses to the extent of income from other sources. The mistakes resulted in under assessment of total income by Rs. 6.34 crore with short levy of aggregate tax by Rs. 2.47 crore including interest.

4.6.3.3 In Rajasthan, CIT II Jaipur charge, the assessment of a co-operative society, **M/s. Rajasthan Co-operative Dairy Federation Ltd.,** for the assessment year 2004-05 was completed after scrutiny in December 2006 determining 'nil' income after setting off brought forward business losses of Rs. 8.34 crore and unabsorbed depreciation of Rs. 2.42 crore to the extent of income. Brought forward business losses of Rs. 2.28 crore and unabsorbed depreciation of Rs. 19.01 crore (total Rs. 21.29 crore) were allowed to be carried forward. Audit examination revealed that only Rs. 14.68 crore (unabsorbed depreciation) was available for set-off. The mistake resulted in excess carry forward of losses by Rs. 6.61 crore with potential short levy of tax of Rs. 2.03 crore.

4.6.3.4 In Karnataka, CIT Davangere charge, the assessment of a co-operative society, **M/s. Primary Co-operative Agricultural and Rural Development Bank Ltd**, for the assessment year 2005-06 was completed after scrutiny in September 2006 determining a loss of Rs. 82.75 lakh. Audit examination revealed that the assessee was allowed to carry forward a total loss of Rs. 5.48 crore as against the actual brought forward loss of Rs. 3.31 crore. The mistake resulted in excess carry forward of business loss of Rs. 2.17 crore involving a potential tax effect of Rs. 68.13 lakh.

4.7 MISTAKES IN COMPUTATION OF BUSINESS INCOME

Mistakes in computation of business income

4.7.1 The Income tax Act, 1961 provides that in a scrutiny assessment, the assessing officer will make a correct assessment of the total income or loss of the assessee and determine the correct sum payable by him or refundable to him on the basis of such assessment. Income under the head 'profits and gains of business or profession' is computed in accordance with the method of accounting regularly employed by the assessee.

Further, where in any financial year, the assessee has paid any interest, royalty fees for technical services or other sum chargeable under this Act which is payable within India to a contractor or out side India on which tax has not been paid or deducted, such amount is not allowable as deduction while computing taxable income.

4.7.2 Non-compliance with the above provision while computing business income was noticed in 22 cases, resulting in short levy of tax aggregating **Rs. 8.54 crore** in Delhi, Gujarat, Jharkhand, Karnataka, Maharashtra, Orissa, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal.

4.7.3 Two cases each above Rs. 50 lakh are illustrated below:

4.7.3.1 In Orissa, CIT Cuttack charge, the assessment of an individual, **Shri Bighnaraj Naik**, for the assessment year 2005-06 was completed after scrutiny in March 2007. Audit examination revealed that the assessee, a transport contractor, had association with various truck owners for supply of trucks on demand and payments were being made to drivers of the trucks on the spot after obtaining proof of delivery. In the previous year relating to the assessment year 2005-06, the assessee had paid Rs. 13.07 crore to the drivers. The assessee was therefore liable to deduct two per cent of the payments, made towards tax deducted at source which was not done.

Hence the payment of Rs. 13.07 crore was not allowable while computing taxable income from business or profession. However the amount was not added back while completing the assessment. The omission resulted in underassessment of income of Rs. 13.07 crore involving short levy of tax of Rs. 5.45 crore.

4.7.3.2 In Delhi, CIT VIII charge, the income tax assessment of an individual, **Shri Rajeev Khanna**, for the assessment year 2003-04 was completed after scrutiny in February 2006 determining an income of Rs. 2.73 crore. Audit examination revealed that assessee claimed and was allowed an expenditure of Rs. 1.46 crore on account of market development fee in the profit and loss accounts. Since, this expenditure gave an enduring benefit to the assessee, it was required to be treated as capital expenditure and added back to the income of the assessee. The mistake resulted in underassessment of income of Rs. 1.46 crore involving short levy of tax of Rs. 62.48 lakh including interest.

4.8 MISTAKES IN ADOPTION OF CORRECT FIGURE

Mistake in adoption of correct figures

4.8.1 The Board has issued instructions from time to time to the assessing officers and their supervising officers to ensure that mistakes in scrutiny assessments do not occur.

4.8.2 Audit noticed that assessing officers had adopted incorrect figures, committed arithmetical errors, allowed claims twice and did not add back inadmissible claims to income, resulting in short levy of tax of **Rs. 8.61 crore** in eight cases in Andhra Pradesh, Maharashtra, Punjab, Rajasthan and Tamil Nadu.

4.8.3 Three cases, each above Rs. 50 lakh are illustrated below:

4.8.3.1 In Punjab, CIT II Amritsar charge, the assessment of a cooperative society **M/s. Amritsar District Cooperative Milk Producers Union Ltd.,** for the assessment year 2004-05 was completed after scrutiny in November 2006 determining a loss of Rs. 21.79 crore. Audit examination revealed that the assessee had actually incurred a loss of Rs. 3.21 crore in respect of assessment year 2004-05 and not Rs. 21.79 crore as allowed by the assessing officer. The mistake resulted in excess computation of loss of Rs. 18.58 crore involving potential tax effect of Rs. 6.50 crore.

4.8.3.2 In Punjab, CIT II Amritsar charge, the assessment of a cooperative society, **M/s. Ajnala Co-operative Sugar Mills** for the assessment year 2004-05 was completed after scrutiny in November 2006 determining a loss of Rs. 46.82 crore. Audit examination revealed that the assessing officer adopted Rs. 46.82 crore instead of Rs. 43.82 crore as carry forward business loss and unabsorbed depreciation. The mistake resulted in excess carry forward of loss of Rs. 3 crore involving potential tax effect of Rs. 1.05 crore.

4.8.3.3 In Tamil Nadu, CIT II Coimbatore charge, the assessment of a firm, **M/s. KKS Khader Mohideen Sahib & Sons**, for the assessment year 2003-04 was completed after scrutiny in January 2006 determining a loss of Rs. 1.47 crore. Audit examination revealed that the assessee had filed a return with' nil' income. However, while

completing the scrutiny assessment, the assessing officer erroneously adopted the loss at Rs. 1.47 crore instead of 'nil' income returned by the assessee. The mistake resulted in over assessment of loss by Rs. 1.47 crore involving potential short levy of tax of Rs. 54.07 lakh.

4.9 INCORRECT/NON-LEVY OF INTEREST

Incorrect/ non-levy of interest

4.9.1 The Income Tax Act provides for levy of interest for delays in filing the return of income, payment of advance tax and default in payment of demand.

4.9.2 Audit noticed short levy of interest for delays in filing return of income, payment of advance tax and default in payment of demand aggregating **Rs. 3.05 crore** in 26 cases in Delhi, Gujarat, Haryana, Jharkhand, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Uttar Pradesh and West Bengal. In two cases the Ministry has accepted the observations.

4.9.3 One case above Rs. 50 lakh is illustrated below:

4.9.3.1 In Haryana, CIT Panchkula charge, the assessment of a local authority, **M/s. Haryana Urban Development Authority**, for the assessment year 2003-04 was completed after scrutiny in November 2005 determining an income of Rs. 69.39 crore. Audit examination revealed that the assessee had filed the return on 12 April 2004 as against the due date of 31 October 2003. The assessee was liable to pay interest of Rs. 96.25 lakh on payable tax of Rs. 16.04 crore for late filing of return, which was not levied.

4.10 MISTAKES IN ALLOWANCE OF DEPRECIATION

Mistakes in allowance of depreciation

4.10.1 The Income Tax Act, 1961 provides that in computing the business income of an assessee, a deduction on account of depreciation on the fixed assets used for the purpose of the business is admissible at the prescribed rates and on the written down value.

4.10.2 Assessing officers committed mistakes in allowing depreciation in 11 cases, which resulted in short levy of tax aggregating **Rs. 2.19 crore** in Andhra Pradesh, Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh and Orissa.

4.10.3 Two cases, each above Rs. 50 lakh are illustrated below:

4.10.3.1 In Andhra Pradesh, CIT Central Hyderabad charge, the assessment of an association of persons/trust, **M/s. Kamineni Education Society,** for the assessment year 2003-04 was completed after scrutiny in March 2006 determining an income of Rs. 1.30 crore after allowing a deduction of Rs. 1.60 crore towards depreciation in respect of capital assets. Audit examination revealed that the assessee had charged depreciation Rs 1.60 crore on the assets acquired whose entire cost of acquisition had been treated as application of income and hence was not admissible. The mistake resulted in under assessment of income of Rs. 1.60 crore with tax effect of Rs. 68.60 lakh including interest.

4.10.3.2 In Maharashtra, Pune City I charge, the assessment of a co-operative society, **M/s. Bhima Shankar Sahakari Sakhar Karkhana Ltd.,** for the assessment year 2004-05 was completed after scrutiny in September 2006 at a loss of Rs. 4.03 crore. Audit examination revealed that while computing the income the assessing officer reduced Rs. 5.91 crore as depreciation (as per Income Tax Act) but did not add back Rs. 2.04 crore as depreciation as per Companies Act debited in the profit and loss account. The mistake resulted in underassessment of income of Rs. 2.04 crore involving potential tax impact of Rs. 62.78 lakh.

4.11 INCORRECT ALLOWANCE OF DEDUCTION IN RESPECT OF EXPORT PROFITS

Incorrect allowance of deduction in respect of export profit

4.11.1 The Income Tax Act, 1961 provides that an assessee being Indian company or other assessee resident in India, engaged in export business, is entitled to a deduction equal to the profit derived from the export of goods or merchandise other than the exempted items if the sale proceeds thereof are received in convertible foreign exchange.

4.11.2 Audit noticed mistakes in computation of export profits resulting in short levy of tax aggregating **Rs. 1.84 crore** in eight cases in Gujarat and Punjab.

4.11.3 One case above Rs. 50 lakh is illustrated below:

4.11.3.1 In Punjab, CIT III Ludhiana charge, the assessment of a firm, **M/s. Jawand Sons,** for the assessment years 2002-03 and 2004-05 was completed after scrutiny in December 2006 determining incomes of Rs. 65.34 lakh and Rs. 2.86 crore respectively. Audit examination revealed that profit of the business was adopted as Rs. 1.97 crore and Rs. 4.22 crore instead of Rs. 54.16 lakh and Rs. 1.34 crore for the assessment years 2002-03 and 2004-05 respectively. The mistake resulted in excess allowance of deduction of Rs. 1.44 crore with short levy of tax of Rs. 75.28 lakh.

4.12 MISTAKES IN COMPUTATION OF TAX

Mistakes in computation of tax

4.12.1 The Income tax Act, 1961 provides that income tax is chargeable for every assessment year in respect of the total income of the previous year of an assessee according to the rates prescribed under the relevant Finance Act.

4.12.2 Audit noticed that the assessing officer did not apply the correct rate of tax in eight cases in Gujarat, Jharkhand, Maharashtra, Madhya Pradesh and Uttar Pradesh which resulted in short levy of tax of **Rs. 1.51 crore.**

4.12.3 Two cases, each above Rs. 50 lakh are illustrated below:

4.12.3.1 In Gujarat, CIT Central II Ahmedabad charge, the assessment of an individual, **Shri Harshad M Shukla**, for the assessment year 2003-04 was completed after best judgment assessment in December 2006 at an income of Rs. 3.91 crore on which tax demand worked out to Rs. 1.95 crore. Audit examination revealed that as per demand notice dated 29.12.2006 the total tax demand was raised for Rs. 1.35 crore only. The mistake resulted in short demand of Rs. 59.79 lakh.

4.12.3.2 In Maharashtra, CIT XVI Mumbai charge, the assessment of an individual, **Shri Dilipkumar V Lakhi,** for the assessment year 2003-04 was completed after scrutiny in March 2006 determining an income of Rs. 26.65 crore and revised to Rs. 25.70 crore in December 2006 while giving effect to order of CIT (Appeal). Audit examination revealed that income from capital gain of Rs. 4.95 crore included a short term capital gain of Rs. 2.83 crore on which department computed tax at the rate of 10.5 per cent (including surcharge) instead of computing tax at the rate of 31.50 per cent (including surcharge). This mistake resulted in short levy of tax of Rs. 59.71 lakh.

4.13 INCORRECT ALLOWANCE OF LIABILITY

Incorrect allowance of liability

4.13.1 Certain deductions being cess, fee or any sum payable by an assessee as employer by way of contribution to any provident fund, superannuation fund or gratuity fund etc. are deductible on actual payment basis. It is further provided that such expenditure would be allowable only if the payment is made before the due date of filing of the return.

4.13.2 Assessing officers allowed liabilities without actual payment by the due date or payments being made after the due date of filing of the return, resulting in short levy of tax **of Rs. 1.49 crore** in three cases in Gujarat and West Bengal.

4.13.3 One case above Rs. 50 lakh is illustrated below:

4.13.3.1 In Gujarat, CIT III Baroda charge, the assessment of an association of persons, **M/s. Shree Sardar Co-op Sugar Ind Limited,** for the assessment year 2004-05 was completed after scrutiny in December 2006 determining a loss of Rs. 16.27 crore. Audit examination revealed that the assessee was allowed an expenditure of Rs. 2.96 crore as interest on term loan to Gujarat State Co-operative Bank even though the assessee had not paid the interest within the prescribed time limit specified under section 43B. The mistake resulted in over assessment of loss of Rs. 2.96 crore with potential tax effect of Rs. 91.01 lakh.

4.14 MISTAKES IN COMPUTATION OF CAPITAL GAIN/LOSS

Mistakes in computation of capital gain/loss

4.14.1 The Income Tax Act, 1961 provides any expenditure, not being in the nature of capital expenditure, of the assessee laid out or expended wholly or exclusively for the purpose of business, is allowable as deduction in computation of the income chargeable under the head 'profits and gains of business or profession'.

4.14.2 Audit noticed mistakes in the computation of capital gain resulting in short levy of tax of **Rs. 1.34 crore** in four cases in Haryana, Maharashtra and West Bengal.

4.14.3 One case above Rs. 50 lakh is illustrated below:

4.14.3.1 In Maharashtra, CIT Mumbai city XXIII charge, the assessment of an individual, **Shri Kanaiya D. Kataria,** for the assessment year 2003-04 was completed after scrutiny in January 2006 at a loss of Rs. 2.36 crore. Audit examination revealed that the assessee was not in the business of film production but had lent Rs. 2.60 crore

to a film producer for making a film. The borrower suffered a loss of Rs. 2.55 crore in the film production. The same was claimed as business loss by the assessee and was allowed by the department. Since a sum advanced by way of loan is capital loss, the same should have been disallowed. The mistake resulted in under assessment of income to the extent of Rs. 2.51 crore [Rs. 2.55 crore – Rs. 3.75 lakh (Capital gain)] involving potential tax effect of Rs. 75.74 lakh and positive tax of Rs. 3.33 lakh.

4.15 INCOME NOT ASSESSED

Income not assessed

4.15.1 The Income tax Act, 1961 provides that income tax shall be charged for every assessment year in respect of total income of the previous year of every person. The term "income" has an inclusive definition under the Act and includes capital gains, unexplained investment etc.

4.15.2 Audit noticed short levy of tax aggregating **Rs. 77.15 lakh** in nine cases in Gujarat, Haryana, Jharkhand, Kerala, Maharashtra, Tamil Nadu and West Bengal as the assessing officers had not assessed all income to tax. In two cases the Ministry has accepted the observations. One case above Rs. 20 lakh is illustrated below:

4.15.2.1 In Maharashtra, CIT Central I Mumbai charge, the assessment of a firm, **M/s. F.A. Constructions**, for the assessment year 2003-04 was completed after scrutiny in March 2005 determining an income of Rs. 59.35 lakh. Audit examination revealed that Rs. 50 lakh credited in profit and loss account as goodwill was excluded while computing the taxable income. Omission resulted in underassessment of income to that extent with short levy of tax of Rs. 21.17 lakh including interest.

4.16 MISTAKES IN ASSESSMENT OF SALARY INCOME

Mistake in assessment of salary income

4.16.1 The Income tax Act, 1961 provides that any salary due from an employer or a former employer to an assessee in a previous year, whether paid or not, shall be chargeable to tax. Salary includes any fees, commissions, perquisites or profit in lieu of or in addition to salary.

4.16.2 Audit noticed short levy of tax aggregating **Rs. 60.82 lakh** in two cases in West Bengal as the assessing officers had not assessed all salary income to tax. One case above Rs. 30 lakh is illustrated below:

4.16.2.1 In West Bengal, CIT central I Kolkata charge, the assessment of an individual, **Shri Rajendra Kumar Somany,** for the assessment year 2004-05 was completed after scrutiny in October 2006 determining an income of Rs. 54.99 lakh including salary of Rs. 34.77 lakh. Audit examination revealed that the remuneration (salary, P.F. and commission) taxable in the hands of the assessee was Rs. 1.08 crore as against Rs. 34.77 lakh assessed. The omission resulted in underassessment of salary income of Rs. 73.19 lakh involving tax effect of Rs. 31.64 lakh including interest.

4.17 NON-LEVY OF SURCHARGE

Non-levy of surcharge

4.17.1 Income tax including surcharge is to be charged at the rates prescribed in the relevant Finance Act.

4.17.2 Assessing officers did not levy surcharge at the rate(s) prescribed in the Finance Act resulting in short demand of **Rs. 32.32 lakh** in three cases in Rajasthan and Punjab. One case above Rs. 10 lakh is illustrated below.

4.17.2.1 In Rajasthan, CIT II Jaipur charge, the assessment of an Association of Person/Body of Individuals, **M/s. Rajasthan State Agriculture Marketing Board,** for assessment year 2004-05 was completed after scrutiny in February 2006 determining an income of Rs. 3.46 crore. Audit examination revealed that tax on income of Rs. 3.46 crore was charged at Rs. 1.06 crore (due to non-levy of surcharge and undue levy of education cess) as against Rs. 1.14 crore. The mistake resulted in undercharge of tax of Rs. 11.52 lakh including interest.

4.18 MISTAKES IN SUMMARY ASSESSMENT

Mistakes in summary assessments

4.18.1 Section 143(1) of the Income Tax Act 1961, provides that the assessment may be completed in a summary manner after *inter alia*, rectifying any arithmetical error in the return, accounts and accompanying documents.

4.18.2 During test check of income tax assessments, audit noticed mistakes in 40 cases of summary assessments involving revenue impact of **Rs. 7.43 crore** in Andhra Pradesh, Bihar, Delhi, Gujarat, Himachal Pradesh, Jharkhand, Maharashtra, Madhya Pradesh, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand, and West Bengal. In two cases the Ministry has not accepted the observations being summary assessment cases, but remedial action has been initiated.

4.18.3 Three cases, each above Rs. 50 lakh are illustrated below:

4.18.3.1 In Uttar Pradesh, CIT I Kanpur charge, the income tax return of an individual, **Shri Raj Kumar Rastogi**, for the assessment year 2005-06 was processed in summary manner in March 2006 determining an income of Rs. 2.93 lakh. Audit examination revealed that the assessee had paid freight charges of Rs. 4.28 crore without deducting tax at source. Therefore, Rs. 4.28 crore was required to be disallowed and added back to the income of the assessee. The mistake resulted in short computation of income of Rs. 4.28 crore with short levy of tax of Rs. 1.79 crore including interest.

4.18.3.2 In Delhi, CIT 10 charge, the income tax return of an individual, **Mohd. Rais,** for the assessment year 2004-05 was processed in a summary manner in December 2004 at a loss of Rs. 4.15 crore. Audit examination revealed that the assessee had losses of Rs. 1.20 crore for the assessment year 2004-05. However, the assessee filed return of income at a loss of Rs. 4.15 crore (including brought forward losses) which was also processed by the department. The omission resulted in over assessment of loss by Rs. 2.95 crore involving potential tax effect of Rs. 97.12 lakh.

4.18.3.3 In Orissa, CIT Sambalpur charge, the income tax return of an individual, **Shri Arwinder Singh Chawla**, for the assessment year 2006-07 was processed in summary manner in February 2007. Audit examination revealed that the assessee was allowed tax credit of Rs. 33.93 lakh on contract receipts of Rs. 15.51 crore where as only an amount of Rs. 13.20 crore was offered to tax. The short disclosure of contract receipts

of Rs. 2.31 crore resulted in understatement of income to that extent with short levy of tax of Rs. 85.24 lakh.

4.19 CASES OF OVERASSESSMENT/OVERCHARGE

Cases of overassessment /overcharge

4.19.1 Audit noticed avoidable mistakes resulting in overcharge of tax aggregating **Rs. 1.97** crore in 15 cases in Bihar, Gujarat, Haryana, Jharkhand, Maharashtra, Rajasthan, Uttar Pradesh and West Bengal. In four cases the Ministry has accepted the observations.

B-WEALTH TAX

4.20 During 2007-08, wealth tax receipts constituted 0.1 per cent of the direct tax collection. Collection of wealth tax in 2007-08 was Rs. 340.32 crore as compared to Rs. 240.33 crore in 2006-07.

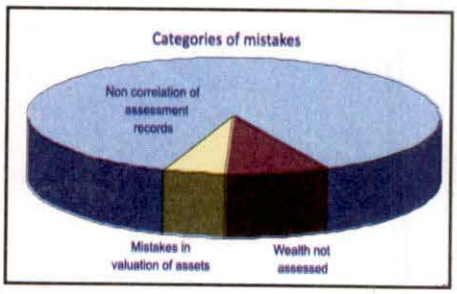
Results of audit

4.21 Audit issued 47 draft paragraphs to the Ministry involving undercharge of wealth tax of Rs. 79.06 lakh between May 2008 and October 2008 to the Ministry of Finance for their comments. Internal audit of the department had seen only four of these cases and the mistakes pointed out were not noticed by it.

4.21.1 Out of the 47 draft paragraphs issued to the Ministry, 42 draft paragraphs involving revenue impact of Rs. 77.25 lakh have been included in this chapter. Each paragraph indicates a particular category of mistake and starts with a suitable preamble followed by combined/consolidated revenue impact of all observations of similar nature.

Status of the Ministry's replies

4.22 Out of the 42 cases included in this chapter, the Ministry of Finance has accepted audit observations in six cases involving aggregate revenue impact of Rs.6.05 lakh. In four cases, the Ministry has not accepted the audit observation. In the remaining cases, replies have not been received up to December 2008. Replies of the Ministry wherever received, have been examined and suitably incorporated.



4.23 NON-CORRELATION OF ASSESSMENT RECORDS

Wealth not assessed due to non-correlation of records of different direct taxes

4.23.1 The Board has issued instructions (November 1973, April 1979 and September 1984) to assessing officers for ensuring proper coordination amongst assessment records pertaining to different direct taxes and for simultaneous disposal of income tax and wealth tax assessment cases so that there is no evasion of tax.

4.23.2 The net wealth chargeable to tax comprises certain assets specified[1] under section 2(ea) of the Wealth Tax Act 1957 subject to adjustment of any debt owed by the assessee in relation to any of the specified assets on the valuation date.

---

[1] Specified assets include following items :

- Any building or land appurtenant thereto whether used for residential purposes or for the purpose of maintaining a guest house or otherwise including a farm house situated within twenty-five kilometers from local limits of any Municipality or a Cantonment Board,
- Motor cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade), (continued. on next page)
- Jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals,
- Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes),
- Urban land and
- Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.
- Any residential property that has been let-out for less than 300 days in the previous year.

4.23.3 Non-correlation of assessment records of income tax with other direct taxes resulted in non levy of wealth tax aggregating **Rs. 66.64 lakh** in 32 cases in Andhra Pradesh, Delhi, Gujarat, Jharkhand, Kerala, Maharashtra, Punjab and West Bengal charges. In five cases the Ministry has accepted the observations.

4.23.4 Four cases each above Rs. four lakh are illustrated below:

4.23.4.1 In West Bengal, CIT III Kolkata charge, the income tax assessment of a company, **M/s. Howrah Flour Mills Ltd.**, for assessment years 2001-02 and 2003-04 was completed after scrutiny and subsequently revised after giving effect to ITAT's order in March 2006. Audit examination revealed that the assessee had rental incomes of Rs. 32.89 lakh and Rs. 47.72 lakh from Godown during the assessment years 2001-02 and 2003-04 respectively, which were assessed as income from house property. The assessee was, therefore, liable to pay wealth tax. But neither did the assessee file the return(s) of wealth nor did the Assessing Officer initiate any wealth tax proceedings. Omission resulted in wealth of Rs. 8.14 crore escaping assessment involving non-levy of wealth tax of Rs. 12.55 lakh including interest.

4.23.4.2 In Delhi, CIT II charge, the income tax assessment of a company, **M/s. Jay Pee Ventures Ltd.,** for the assessment year 2004-05 was completed after scrutiny in March 2006 determining an income of Rs. 10.22 crore. Audit scrutiny revealed that, during the previous year relevant to the assessment year 2004-05, the assessee was in possession of aircraft of Rs. 10.41 crore falling within the purview of section 2(ea) of the Wealth Tax Act. However, neither did the assessee file return of net wealth nor did the department initiate any wealth tax proceedings despite instructions of the Board. Omission resulted in wealth of Rs. 10.26 crore escaping assessment involving non-levy of wealth tax of Rs. 12.01 lakh including interest.

4.23.4.3 In Maharashtra, CIT V Pune charge, the income tax assessment of a company, **M/s. Swastik Rubber Products Ltd.,** for the assessment year 2001-02 was completed after scrutiny in March 2004 at a loss of Rs. 1.96 crore. Audit scrutiny revealed that the assessee was in possession of land valued at Rs. 4.30 crore which was to be treated as chargeable wealth. The assessee was, therefore, liable to pay wealth tax. However, neither did the assessee file its return of wealth nor did the department initiate any wealth tax proceedings despite instructions of the Board. Omission resulted in wealth of Rs. 4.15 crore escaping assessment involving non-levy of wealth tax of Rs. 6.58 lakh including interest.

4.23.4.4 In Maharashtra, CIT II Mumbai charge, the income tax assessment of a company, **M/s. Eveready Investment (P**). Ltd., for the assessment year 2002-03 was completed after scrutiny in December 2004 determining an income of Rs. 49.14 lakh. Audit scrutiny revealed that during the previous year relevant to the assessment year 2002-03, the assessee had received rental income of Rs. 33.69 lakh from house property (having capitalised value of Rs. 3.10 crore) let out to a bank for commercial purpose. However, neither the assessee filed its return nor did the department initiate any wealth tax proceedings. Omission resulted in wealth of Rs. 2.95 crore escaping assessment involving non levy of wealth tax of Rs. 4.33 lakh including interest.

4.24 WEALTH NOT ASSESSED

Non-inclusion of taxable assets in the net wealth

4.24.1 The Wealth Tax Act, 1957, provides that from assessment year 1993-94, 'assets' will, inter alia, include guest house and all residential buildings, urban land, motor cars other than those used in the business of running them on hire or as stock in trade.

4.24.2 Assessing officers did not include such taxable assets during wealth tax assessment in eight cases in Andhra Pradesh, Delhi, Tamil Nadu and West Bengal charges resulting in short levy of tax aggregating **Rs. 6.37 lakh.**

4.25 MISTAKES IN VALUATION OF ASSETS

Mistakes in valuation of assets

4.25.1 The Wealth Tax Act, 1957, provides that the value of any asset other than cash is determined on the valuation date in the manner laid down in schedule III to the Act.

4.25.2 Assessing officers did not adopt the correct value of assets chargeable to wealth resulting in under valuation of Rs. 1.95 crore involving short levy of wealth tax of **Rs. 3.75 lakh** in two cases of Kerala and Tamil Nadu.

New Delhi
Dated: 20 MAY 2009

(MAHUA PAL)
Principal Director (Direct Taxes)

Countersigned

New Delhi
Dated: 20 MAY 2009

(VINOD RAI)
Comptroller and Auditor General of India

Appendices

Appendix 1

Chapter I

Introduction

(Referred to in Paragraph 1.6.1)

Recoveries made in respect of DPs issued during 2007-08

(Rs. in lakh)

Sl. no.	Name of assessee	CIT charge	Assessment year(s)	Category of mistake	Tax effect
1	M/s RMK Viswanathan & Sons	CIT-II Madurai	2003-04	Incorrect computation of business income	106.00
2	Turquoise Investment & Finance Pvt.Ltd.	CIT Ujjain	2003-04	Incorrect set off of business loss	94.76
3	Punjab School Education Board, Mohali	CIT-II Chandigarh	1999-00	Short levy of interest for late filing of return	70.43
4	M.N.Dastur & Co Ltd	CIT-III B'lore	2000-01	Incorrect allowance of Y2K expenditure	36.56
5	M/s Elgi Equipments Ltd.	CIT-I Coimbatore	2003-04	Incorrect computation of business income	16.78
6	M/s SKM Animal feed & Food India Ltd	CIT-II Coimbatore	1998-99	Incorrect allowance of deduction U/s 80-IA	15.49
7	M/s Asia Timber Products (P) Ltd.	CIT Madurai II	1998-99	Incorrect allowance of deduction under Section 80-IA	14.55
8	M/s RMK Viswanatha pillai & Sons	CIT Madurai II	2002-03	Incorrect allowance of capital expenditure	11.85
9	Tulip Labels Pvt Ltd.	CIT-III B'lore	2004-05	Incorrect computation of tax	6.82
10	United Telecom Ltd.	CIT-B'lore	2002-03	Incorrect set off of loss	6.24
11	Sh. Rajinder Thakur	CIT-Shimla	2001-02	Irregular set off of losses	2.94
12	M/s Ransal Rubber Industries Pvt Ltd.	CIT-III Kolkata	2005-06	Wealth not assessed	0.54
13	Sh.Kailash Charan	CIT-IV Hyderabad	2004-05	Wealth not assessed	0.47
14	Dr. Usha Rani	CIT-Ranchi	2004-05 &2005-06	Wealth not assessed	0.36
					383.79

Appendix-2
(Referred to in Paragraph 1.15.1)

STATEWISE DETAILS OF RECORDS NOT PRODUCED TO AUDIT IN EARLIER YEARS AND REQUISITIONED AGAIN IN 2007-08

Sl. no.	State	Records requisitioned again	Records not produced	Percent
1	Andhra Pradesh	4,241	2,241	52.84
2	Assam	16	6	37.5
3	Chhattisgarh	150	74	49
4	Jharkhand	88	20	22.72
5	Gujarat	7,796	4,667	59.86
6	Haryana	1,040	599	57.59
7	Himachal Pradesh	285	67	23.50
8	Jammu & Kashmir	43	43	100
9	Karnataka	8,649	7,335	84.80
10	Kerala	1,710	561	32.80
11	Madhya Pradesh	3,368	3,227	95.81
12	Orissa	3,977	3,249	81.69
13	Punjab	4,852	3,413	70.34
14	UT Chandigarh	1,400	1,118	79.85
15	Rajasthan	3,418	3,094	90.52
16	Tamil Nadu	2,489	1,262	50.70
17	Uttar Pradesh	27	11	40.74
18	Delhi	13,137	8,198	62.40
19	Maharashtra	5,607	3,622	64.59
20	West Bengal	5,721	116	2.02
Total		**68,014**	**42,923**	**63.10**

Chapter II

Tax Administration

Appendix 3

(Reference: Paragraph 2.4/Table no. 2.2)

Minor head wise details of Budget estimates and Actuals for 2007-08

Sl. no.	Head of revenue	Budget estimates (Rs. in crore)	Actuals (Rs. in crore)	Surplus(+)/ Shortfall(-)	Percentage of surplus/ shortfall
0020 - Corporation tax					
(i)	Income tax on companies	1,43,574	1,71,196.20	(+) 27,622.20	(+) 19.24
(ii)	Surcharge	12,157	6,519.00	(-) 5,638.00	(-) 46.38
(iii)	Other receipts	12,670	15,195.68	(+) 2,525.68	(+) 19.93
(iv)	**Net collection**	**1,68,401**	**1,92,910.88**	**(+) 24,509.88**	**(+) 14.55**
0021 - Taxes on income other than corporation tax					
(i)	Income tax	90,198	97,225.31	(+) 7,027.31	(+) 7.79
(ii)	Surcharge	4,727	1,691.77	(-) 3035.23	(-) 64.21
(iii)	Other receipts	3,849	3,738.00	(-) 111.00	(-) 2.88
(iv)	**Net collection**	**98,774**	**1,02,655.08**	**(+) 3,881.08**	**(+) 3.93**

Appendix 4
[Reference: Paragraph 2.5/Table no. 2.3]

(Rs. in crore)

All India collection figures of Corporation tax and Income tax

Sate	Corporation tax				Income tax				Total of two heads			
	2005-06	2006-07	2007-08	Percent change over pre. Year	2005-06	2006-07	2007-08	Percent change over pre. Year	2005-06	2006-07	2007-08	Percent change over pre. year
Andhra Pradesh	4,059.58	5,298.93	6,711.88	26.66	2,477.86	4,607.63	6,736.57	46.20	6,537.44	9,906.56	13,448.45	35.75
Assam	520.16	306.13	1,018.84	232.81	1,175.63	1,512.58	935.76	(-) 38.13	1,695.79	1,818.71	1,954.60	7.47
Bihar	140.41	100.94	112.22	11.17	448.87	445.81	673.47	51.06	589.28	546.75	785.69	43.70
Chattisgarh	416.57	857.07	1,365.03	59.26	745.18	659.38	507.74	(-) 22.99	1161.75	1,516.45	1,872.77	23.49
Delhi	18,512.26	29,039.11	34,254.21	17.96	6,769.71	8,180.46	10,211.09	24.82	25,281.97	37,219. 57	44,465.30	19.47
Goa	810.15	1,229.40	1,728.42	40.59	258.91	390.80	403.81	3.32	1,069.06	1,620.20	2,132.23	31.60
Gujarat	3,080.89	4,968.43	6,177.42	24.33	2,971.72	3,941.97	5,459.79	38.50	6,052.61	8,910.40	11,637.21	30.60
Haryana	866.62	1,356.98	2,465.45	81.68	1,218.87	1,716.00	2,599.48	51.48	2,085.49	3,072.98	5,064.93	64.82
HP	60.97	241.21	237.56	(-) 1.51	169.82	168.52	217.63	29.14	230.79	409.73	455.19	11.09
J&K	128.48	170.31	289.75	70.13	109.81	204.72	233.88	14.24	238.29	375.03	523.63	39.62
Jharkhand	431.79	672.84	1,088.70	61.80	534.99	763.96	843.49	10.41	966.78	1,436.80	1,932.19	34.47
Karnataka	7,386.03	9,931.98	17,950.05	80.72	6,224.82	8,430.36	11,804.58	40.02	13,610.85	18,362.34	29,754.63	62.04
Kerala	576.15	784.86	1,174.92	49.69	1,069.56	1,295.75	1,514.89	16.91	1,645.71	2,080.61	2,689.81	29.27
MP	1295.56	1,765.28	2,033.61	15.20	915.64	758.81	1,454.41	91.66	2211.20	2,524.09	3,488.02	38.18
Maharashtra	38,011.81	54,691.89	81,127.49	48.33	17,642.76	24,999.17	36,507.60	46.03	55,654.57	79,691.06	1,17,635.09	47.61
Orissa	1,766.00	1,862.20	2,015.42	8.22	634.81	1,425.17	2,239.25	57.12	2,400.81	3,287.37	4,254.67	29.42
Punjab	248.42	817.83	656.68	(-) 19.70	1,407.72	1,322.10	1,864.58	41.03	1,656.14	2,139. 93	2,521.26	17.81
Rajasthan	1,177.09	2,884.26	3,111.69	7.88	912.48	1,446.25	2,064.75	42.76	2,089.57	4,330. 51	5,176.44	19.53
Tamil Nadu	6,505.11	9,226.64	10,992.72	19.14	3,929.50	5,060.27	6,385.57	26.19	10,434.61	14,286.91	17,378.29	21.64
UP	1,068.97	1,454.42	3,972.12	173.10	2,073.27	2,712.46	2,950.51	8.77	3,142.24	4,166.88	6,922.63	66.13
Uttaranchal	8,584.45	9,132.35	5,377.16	(-) 41.11	489.26	504.11	1,214.32	140.88	9,073.71	9,636.46	6,591.48	(-) 31.59
West Bengal	5,042.43	6,907.18	8,299.21	20.15	2,192.85	2,587.47	3,364.88	30.04	7,235.28	9,494.65	11,664.09	22.84
Union Territories	318.17	487.57	606.01	24.29	420.58	553.51	574.48	3.78	738.75	1,041.08	1,180.49	13.39
CTDS	269.09	130.14	144.32	10.89	1190.00	1,392.05	1,892.55	35.95	1,459.09	1,522.19	2,036.87	33.81
Total	**1,01,277.16**	**1,44,317.95**	**1,92,910.88**	**33.67**	**55,984.62**	**75,079.31**	**1,02,655.08**	**36.73**	**1,57,261.78**	**2,19,397.26**	**2,95,565.96**	**34.71**

Appendix 5

[Reference: Paragraph 2.5/Table no. 2.3]

(Rs. in crore)

State/UT wise break up of Direct taxes

States	0020 Corpn tax	0021 Income Tax	0023 Hotel Rect Tax	0024 Interest Tax	0026 Fringe Ben. Tax	0028 Expdr Tax	0031 Estate Duty	0032 Wealth Tax	0033 Gift Tax	0034 Sec. Trans Tax	0036 Ban. Cash Tran. Tax	Total
Andhra Pradesh	6,711.88	6,736.57	3.86	0.51	336.74	3.15	0	15.79	0.30	4.22	22.64	**13,835.66**
Arunachal Pradesh	0	8.56	0	0	0	0	0	0	0	0	0	**8.56**
Assam	902.52	739.67	0	0.09	6.25	- 26.08	0	0.81	0	0	0.12	**1,623.38**
Bihar	112.22	673.47	0	0.43	5.01	0.09	0	0.14	0	0	0.06	**791.42**
Chhatisgarh	1,365.03	507.74	0	0.02	18.11	0.02	0	0.48	0.02	0	0.25	**1,891.67**
Delhi	34,254.21	10,211.09	0	2.11	1,329.91	1.34	0.10	91.98	1.15	0.90	62.19	**45,954.98**
Goa	1,728.42	403.81	0	0	19.84	0.86	0	3.26	0	0	0.07	**2,156.26**
Gujarat	6,177.42	5,459.79	0.07	0.79	247.86	3.18	0.06	10.60	0	0.28	9.09	**11,909.14**
Haryana	2,465.45	2,599.48	0	0.06	176.64	0.77	0	3.66	0	0	0.20	**5,246.26**
Himachal Pradesh	237.56	217.63	0	0	9.60	0.52	0	0.01	0	0	0.22	**465.54**
Jammu & Kashmir	289.75	233.88	0	0	7.21	-0.04	0	0.12	0	0	2.42	**533.34**
Jharkhand	1,088.70	843.49	0	0.06	25.51	0.11	0	0.38	0	0	0.32	**1,958.57**
Karnataka	17,950.05	11,804.58	0.21	-3.70	854.59	1.99	0.07	18.97	0.05	9.14	70.99	**30,706.94**
Kerala	1,174.92	1,514.89	0.02	0.33	65.07	1.73	0	2.27	-0.18	0	16.74	**2,775.79**
Madhya Pradesh	2,033.61	1,454.41	0.02	0.02	59.38	0.03	0.02	-0.97	0	0.01	9.69	**3,556.22**

States	0020 Corpn tax	0021 Income Tax	0023 Hotel Rect Tax	0024 Interest Tax	0026 Fringe Ben. Tax	0028 Expdr Tax	0031 Estate Duty	0032 Wealth Tax	0033 Gift Tax	0034 Sec. Trns. Tax	0036 BCTT	Total
Maharashtra	81,127.49	36,507.60	0.14	0.37	2,718.03	11.46	0	118.53	0.09	8,545.41	324.77	**1,29,353.89**
Manipur	10.02	0.97	0	0	0	0	0	0.07	0	0	0	**11.06**
Meghalaya	75.40	129.10	0	0	1.95	0	0	0.16	0	0	0.05	**206.66**
Mizoram	0	0.18	0	0	0	0	0	0	0	0	0	**0.18**
Nagaland	1.00	10.20	0	0	0	0	0	0	0	0	0.01	**11.21**
Orissa	2,015.42	2,239.25	0	0.01	23.65	0.05	0	0.47	0.02	0.02	0.26	**4,279.15**
Punjab	656.68	1,864.58	0	0.05	53.79	3.96	0.01	6.30	0	0	-0.89	**2,584.48**
Rajasthan	3,111.69	2,064.75	0	0.04	50.04	7.27	0	3.91	0	0	3.01	**5,240.71**
Sikkim	1.21	14.70	0	0	0	0	0	0	0	0	0	**15.91**
Tamil Nadu	10,992.72	6,385.57	0.26	0.83	533.83	17.21	0.02	26.57	0.12	14.81	38.35	**18,010.29**
Tripura	28.69	32.38	0	0	3.05	0	0	0.07	0	0	0.06	**64.25**
Uttar Pradesh	3,972.12	2,950.51	0	0.39	105.83	6.46	0.02	7.48	0.02	0.10	1.69	**7,044.62**
Uttaranchal	5,377.16	1,214.32	0	0.04	94.60	0.33	0	2.39	0	0	0.29	**6,689.13**
West Bengal	8,299.21	3,364.88	0	0.06	313.64	2.10	0	25.40	-0.01	1.18	22.11	**12,028.57.**
Total (i)	**1,92,160.55**	**1,00,188.05**	**4.58**	**2.51**	**7,060.13**	**36.51**	**0.30**	**338.85**	**1.58**	**8,576.07**	**584.71**	**3,08,953.84**

States	0020	0021	0023	0024	0026	0028	0031	0032	0033	0034	0036	
	Corpn tax	Income Tax	Hotel Rect Tax	Interest Tax	Fringe Ben. Tax	Expdr Tax	Estate Duty	Wealth Tax	Gift Tax	Sec. Trns. Tax	BCTT	Total
Union Terretories												
Andaman and Nicobar Islands	9.32	7.20	0	0	4.74	0	0	0	0	0	0	21.26
Chandigarh	535.92	485.00	0	0.09	29.18	1.17	0	1.39	0	0	1.17	1,053.92
Daman	0.77	1.30	0	0	0	0	0	0	0	0	0	2.07
Diu	0	0.30	0	0	0	0	0	0	0	0	0	0.30
Dadra and N.Haveli	0	0	0	0	0	0	0	0	0	0	0	0
Pondicherry	59.98	79.62	0	0	4.27	0	0	0.08	0	0	0	143.95
Lakshadweep	0	0.15	0	0	0	0	0	0	0	0	0	0.15
Silvassa	0.02	0.91	0	0	0	0	0	0	0	0	0	0.93
Total (ii)	606.01	574.48	0	0.09	38.19	1.17	0	1.47	0	0	1.17	1,222.58
Total (i) &(ii)	1,92,766.56	1,00,762.53	4.58	2.60	7,098.32	37.68	0.30	340.32	1.58	8,576.07	585.88	3,10,176.42
CTDS (Prov)	144.32	1,892.55	0	0	0	0	0	0	00	0	0	2036.87
Grand Total	1,92,910.88	1,02,655.08	4.58	2.60	7,098.32	37.68	0.30	340.32	1.58	8,576.07	585.88	3,12,213.29

Appendix 6
[Reference: Paragraph 2.9]

(Number in lakh)

(i) Status-wise break-up of Income tax (including Corporation tax) assessments completed during the years 2005-06 to 2007-08

		2003-04	2004-05	2005-06	2006-07	2007-08
(a)	Individuals	196.55	186.95	210.65	196.19	206.75
(b)	Hindu undivided families	4.83	4.56	4.97	4.43	4.84
(c)	Firms	10.13	8.56	9.32	8.60	8.47
(d)	Companies	3.42	2.99	2.87	2.06	3.39
(e)	Others (including trusts)	0.85	3.98	0.99	1.13	5.52
Total		**215.78**	**207.04**	**228.80**	**212.41**	**228.97**

Appendix-7
[Reference: Paragraph 2.11]

(Rs. in crore)

Year wise break up of tax recovery certificates pending as on 31 March 2008 and amount of demand

Year	No. of certificates	Amount
2002-03 and earlier years	53,700	12,850.08
2003-04	14,246	2,628.57
2004-05	22,607	1,740.97
2005-06	13,144	1,446.56
2006-07	21,479	1,553.36
2007-08	1,19,404	7,225.40
Total	**2,44,580**	**27,444.94**