

00376



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

for the year ended March 2006

Performance Audit

**UNION GOVERNMENT
(DIRECT TAXES)
NO. 8 OF 2007**

©
Comptroller and Auditor General of India
2007

PRICE : INLAND : Rs. 65
FOREIGN : US \$ 5
(Including Postage/Air Mail)

www.cag.gov.in

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

for the year ended March 2006

Performance Audit

**UNION GOVERNMENT
(DIRECT TAXES)
NO 8 OF 2007**

Laid on the table of Lok Sabha/Rajya Sabha on _____

14 **मई** **2007**
MAY

TABLE OF CONTENTS

CONTENTS		Page
	<i>Preface</i>	<i>iii</i>
	<i>Overview</i>	<i>v</i>
Chapter 1:	Review on the assessment of selected companies in the selected sectors of computer software, automobiles and ancillaries, steel and trading	1-40
Chapter 2:	Review on implementation of TDS/TCS schemes	41-74
Chapter 3	Review on assessment of sports associations/ institutions and sports personalities	75-105
	Appendix	107-138
	Glossary	139-140
	Bibliography	141-141

PREFACE

The Report for the year ended March 2006 has been prepared for submission to the President under Article 151(1) of the Constitution of India.

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

- (i) Chapter 1 is a broad based review on the assessment of selected companies in the selected sectors of computer software, automobiles and ancillaries, steel and trading.
- (ii) Chapter 2 is a review on the implementation of TDS/TCS schemes.
- (iii) Chapter 3 is a review on assessment of sports associations/institutions and sports personalities.

The observations included in this Report have been selected from the findings of test audit conducted during 2005-2006 and in earlier years, which could not be covered in the previous reports.

Overview

Review on assessment of selected companies in the selected sectors of computer software, automobiles and ancillaries, steel and trading

Audit reviewed the assessments of selected companies relating to the assessment years 2002-03, 2003-04 and 2004-05 belonging to selected sectors of computer software, automobiles and ancillaries, steel and trading to examine the application of the provisions of Income Tax Act, 1961 and to quantify the effective rate of tax and tax expenditures as well as voluntary tax compliance by the selected companies of these sectors.

Audit noticed that the effective rate of tax of the selected companies assessed under the normal provisions of the Act for the assessment years 2002-03, 2003-04 and 2004-05 were estimated as 20 percent, 27 percent, 17 percent and tax expenditures in respect of all the benefits allowed under the Act were Rs. 915.3 crore, Rs. 768.7 crore and Rs. 2287.6 crore respectively. Voluntary compliance by the selected companies, which were assessed under the normal provisions of the Act, has improved during the period under consideration. Further, voluntary compliance is higher in respect of companies which have shown profits in all the three years under consideration and were assessed under the normal provisions of the Act as compared to the companies, which have shown profits in only one or two of the three years.

Audit noticed 559 mistakes of various types involving tax effect of Rs. 1508.83 crore in the assessments of all the selected companies in the four selected sectors, whether assessed under the normal provisions or the special provisions of the Act. In computer sector, irregularities amounting to Rs. 266.73 crore were noticed relating to exemptions under section 10A/10B. In automobile including ancillaries and trading sector, irregularities amounting to Rs. 308.43 crore were noticed relating to allowance of depreciation and set off of losses. In steel sector, irregularities amounting to Rs. 91.60 crore were noticed in respect of computation of income under special provisions of the Act.

Audit recommends that

- Variations in profit pattern of companies/assessment under the special provisions of the Act could be given a higher weightage while selecting the cases for scrutiny.
- The claims related to depreciation and set off of losses should be linked with last available assessment records so as to ensure correctness of set off.

- The Government may consider issuing explicit guidelines in respect of deductions under section 10A/10B, deductions under chapter VIA and computation of income under special provisions of Act as to ensure greater clarity while completing assessments. Keeping in mind the quantum of revenue loss to the government, audit recommends that the internal control mechanism of the department be strengthened so as to have better monitoring and linking of records, improved coordination among assessing officers and higher quality assessments.

Review on implementation of TDS/TCS schemes

In this review, audit attempted to verify the extent of identification of potential deductors/activities liable to tax deduction/collection at source and the application of the provisions of the Act relating to TDS/TCS with regard to both non residents and residents. Audit also verified issues relating to accounting and the implementation of e-TDS scheme.

Two hundred forty six TDS units, 174 regular assessment units and 15 international taxation units were audited and 32,630 cases were test-checked. Audit noticed mistakes in 12814 cases involving revenue impact of Rs. 389.20 crore; of this penalty leviable was Rs. 63.23 crore. Mistakes were noticed in 82 cases of non-residents/foreign companies with revenue impact of Rs. 204.19 crore. Audit noticed mistakes relating to omission to collect tax at source in 16 cases involving a revenue impact of Rs. 3.90 crore.

Data collected by audit indicated large potential for TDS and TCS from insurance commission, reinsurance commission, payments to non-residents and sale of liquor.

Evaluation of e-TDS scheme revealed that e-TDS returns filed remained unprocessed for the past three years largely due to software related problems and inadequacy of trained manpower.

Audit recommends that

- Ministry may take necessary steps to bring in all tax deductors into the tax net and enforce recovery of TDS/TCS as required under the Act.
- Adequate enforcement mechanism be evolved to ensure consistency in assessment and prevent loss of revenue, particularly in the important area of international taxation. Coordination between TDS and regular assessment units as also internal audit mechanism should be strengthened.
- Problems relating to software and inadequacy in trained manpower are attended to urgently so that e-TDS returns are processed and revenues due to Government realised.

Review on assessment of sports associations/institutions and sports personalities

Audit reviewed the assessments of sports associations/institutions and sports personalities completed during the period from 1999-2000 to 2005-06 with a view to ascertaining the correctness of exemptions given to sports associations and sports personalities, adequacy of the department's efforts to bring all sports associations and sports personalities into tax net, efficiency and effectiveness of internal audit and internal control mechanism in the department to avoid irregularities and errors in the assessments carried out.

Audit observed a total of 158 cases of irregularities involving tax effect of Rs. 190.92 crore. Of these 130 cases of irregularities involving tax effect of Rs. 179.80 crore were in respect of sports associations/institutions and 28 cases involving tax effect of Rs. 11.12 crore were in respect of sports personalities.

Audit noticed cases of irregular exemptions and deductions granted to sports associations/institutions and sports personalities, non deduction of tax at source from the payments made to sports persons, non filing of returns in case of sports associations/institutions and inconsistency in the decisions taken by the department. Audit also noticed large number of sports associations/institutions and sports clubs which require to be brought into tax net, weak internal audit and internal control mechanism in respect of accumulations made and its utilisation. In respect of sports persons, audit noticed cases where deductions were allowed in respect of income that was not earned in the capacity of sportsman.

Audit recommends that

- Ministry may like to utilize its AST database to focus on potential cases to minimise the misuse of exemptions given to sports associations/institutions/clubs and sports personalities.
- The internal control mechanism in the department may be strengthened to check year wise details of investment, its utilisation for specified purpose within stipulated period, and to check if income/ accumulated income has been applied to specified objectives for which the associations/ institutions were established.
- Ministry may like to strengthen its internal audit to avoid irregularities and errors in assessments done, evasion of tax and misuse of exemptions.

Chapter I

Review on Assessment of selected companies in the selected sectors – Computer Software, Automobiles, and ancillaries, Steel and Trading

- Highlights
- Introduction
- Law and procedure
- Objective of the review
- Audit methodology and audit coverage
- Audit Findings
 - Effective rate of tax and tax expenditure
 - Irregular/excess exemption in respect of section 10A/10B
 - Incorrect deduction of expenditure in chapter VIA
 - Incorrect computation of business income
 - Incorrect allowance of provisions and liabilities
 - Incorrect allowance of capital expenditure and non business expenditure
 - Incorrect computation of income under special provisions of the Act
 - Incorrect computation of capital gains
 - Incorrect allowance of depreciation and set off of losses
 - Under valuation of closing stock
 - Incorrect valuation of sale tax liability
 - Incorrect computation of assets after amalgamation
 - Conclusion and recommendations

Highlights

Audit reviewed the assessments of 909, 1001 and 1050 companies relating to the assessment years 2002-03, 2003-04 and 2004-05 belonging to selected sectors of computer software, automobiles and ancillaries, steel and trading to examine the application of the provisions of Income Tax Act, 1961 and to quantify the effective rate of tax and tax expenditure as well as voluntary tax compliance by the selected companies of these sectors.

(Para 1.5.1)

The effective rate of tax of the selected companies assessed under the normal provisions of the Act were estimated as 20 percent, 27 percent, 17 percent during the assessment years 2002-03, 2003-04 and 2004-05 respectively.

(Para 1.5.4)

Tax expenditures in respect of all the benefits allowed under the Act for the selected companies assessed under the normal provisions for the assessment years 2002-03, 2003-04 and 2004-05 were Rs. 915.3 crore, Rs. 768.7 crore and Rs. 2287.6 crore respectively.

(Para 1.5.5)

Voluntary compliance by the selected companies, which were assessed under the normal provisions of the Act, has improved during the period under consideration. Further, voluntary compliance is higher in respect of companies which have shown profits in all the three years under consideration and were assessed under the normal provisions of the Act as compared to the companies, which have shown profits in only one or two of the three years.

(Para 1.5.11)

Incorrect allowance of depreciation and set off of losses in 65 cases resulted in short levy of tax of Rs. 369.03 crore. In a single case, incorrect allowance of depreciation and set off of losses allowed to **M/s Tata Motors Ltd.** resulted in short levy of tax of Rs. 261.13 crore.

(Para 1.5.32 & 1.5.32.1)

Irregular exemption allowed u/s 10A & 10B in 73 cases resulted in short levy of tax of Rs. 278.75 crore. In a single case, irregular exemption allowed to a software company, **M/s GTL Ltd.** resulted in short levy of tax of Rs. 104.84 crore.

(Para 1.5.19 & 1.5.20.1)

Mistakes in computation of book profit under special provisions of the Act in 35 cases resulted in short levy of tax of Rs. 200.03 crore. In a single case, irregular tax credit under the special provisions of the Act was given to **M/s Tata Steel Ltd.** resulting in tax effect of Rs. 69.64 crore.

(Para 1.5.30 & 1.5.30.2)

Mistakes in computation of business income in 95 cases resulted in short levy of tax of Rs. 148.12 crore. Mistakes in computation of income in case of **M/s Ispat Industries Ltd.** resulted in short levy of tax of Rs. 41.41 crore.

(Para 1.5.27 & 1.5.27.1)

Incorrect deduction of expenditure allowed under Chapter VIA of the Act in 47 cases resulted in short levy of tax of Rs. 167.75 crore. Incorrect allowance of chapter VI A deduction in case of **M/s Jindal Steel and Power Ltd.** resulted in short levy of tax of Rs. 19.90 crore.

(Para 1.5.26 & 1.5.26.3)

Incorrect allowance of provisions and liabilities in 76 cases resulted in short levy of tax of Rs. 165.48 crore. In a single case of **M/s Data Access (India) Ltd.**, incorrect allowance of unascertained liabilities resulted in short levy of tax of Rs. 61.48 crore.

(Para 1.5.28 & 1.5.28.1)

Audit recommends that variations in profit pattern of companies/assessment under the special provisions of the Act could be given a higher weightage while selecting cases for scrutiny.

(Para 1.6.7)

Taking all the four selected sectors together maximum tax effect has been noticed in incorrect allowance of depreciation and set off of losses. Audit recommends that the claims related to depreciation and set off of losses should be linked with last available assessment records so as to ensure correctness of set off.

(Para 1.6.12)

Keeping in mind the quantum of revenue loss to the government audit recommends that the internal control mechanism of the department be strengthened so as to have better monitoring and linking of records, improved coordination among assessing officers and higher quality assessments.

(Para 1.6.13)

Review on assessment of selected companies in the selected sectors-Computer Software, Automobiles and ancillaries, Steel and Trading

1.1 Introduction

With a view to focus audit efforts towards examination of important contributions to revenue in the form of direct taxes, corporate tax assessments of companies relating to four sectors (detailed below) which play an important role in the national economy were selected for audit scrutiny:-

- Computer software (large, medium/small)
- Automobiles (LCVs/HCVs, cars, mopeds, scooters, tractors) including ancillaries (sheet metal, axle, breaks, wheels gears and shock absorbers)
- Steel (large, medium/small)
- Trading (large, medium/small)

The above sectors had been identified on the basis of significant growth registered in terms of sales turnover, net profit, dividend declared and tax paid during the year 2004 by utilising the database (Capitaline Plus).

1.2 Law and procedure

Income tax is an annual tax on income of previous year charged in the next following assessment year at the tax rates applicable for the assessment year. The annual Finance Act prescribes the tax rates. No specific provision has been prescribed in the Income Tax Act, 1961 (the Act) or the Wealth Tax Act, 1957 for assessment of companies within the selected sectors and all provisions of the acts *ibid.* are applicable to those entities. Some provisions of the Act, considering their applicability are mentioned below:

1.2.1 Exemption under section 10A and 10B

Exemption under section 10A relates to a deduction of such profits and gains as are derived by an undertaking in free trade zone etc., from the export of articles or things or computer software and exemption under section 10B relates to a deduction of such profits and gains as are derived by a hundred percent export oriented undertaking from the export of articles or things or computer software. These provisions provide for complete tax exemption for a consecutive period of 10 years beginning from the assessment year (AY) during which manufacture/production starts.

1.2.2 The dates from which the exemptions in respect of profits and gains derived by an industrial undertaking, which began or begins to manufacture/produce an article or thing or computer software are given below:

Location	Effective from
Free Trade Zone	AY 1981-82 or subsequent AY
Electronic Hardware/Software Technology Park	AY 1994-95 or subsequent AY
Special Economic Zone	AY 2001-02 or subsequent AY

1.2.3 In respect of profits and gains derived by 100 percent EOU (export oriented unit)- an undertaking has to be approved as 100 percent EOU under section 14 of Industries (Development & Regulation) Act, 1951 and rules made thereunder.

- Exemption u/s 10A & 10B are available from AY 2001-02 only if it is supported by a certificate in form 56F from a chartered accountant along with the audit report certifying correctness of the claim.
- For the assessment year 2003-04 the exemption would be limited to 90 percent of profit.
- No deduction would be available in respect of same profit under any other provision of the Act for the same assessment year or any other assessment year.
- Deductions/exemptions under sections 80IA, 80IB would not be applicable either during period of tax holiday or after tax holiday.
- Unabsorbed depreciation, unabsorbed capital expenditure on scientific research and losses u/s 72(1), 74(1) or 74(3) pertaining to assessment year 2000-01 or earlier assessment years are not allowed to be carried forward and set off.
- In case of transfer of ownership or change of beneficial ownership, no benefit u/s 10A or 10B would be available from the assessment year of such change.
- The benefit u/s 10A or 10B is optional; however, the assessee had to opt out of 10A or 10B during initial assessment year where the assessee intends not to avail the benefit.

1.2.4 Chapter VIA deductions

Deductions under sections 80A to 80U are contained in Chapter VIA of the Act.

1.2.5 Exemption of profit from export of computer software under section 80HHE

These provisions provide for exemption of profit derived from export of computer software or its transmission or providing technical services outside India in connection with development or production of computer software.

- 100 percent of profit upto assessment year 2000-01; 80 percent for assessment year 2001-02; 70 percent for assessment year 2002-03.; 50 percent for assessment year 2003-04.; 30 percent for assessment year 2004-05 and 0 percent from assessment year 2005-06.
- "Export turnover" would be the amount of convertible foreign exchange received in India within the time limit as reduced by the amount of freight, telecommunication charge, or insurance attributable to delivery of computer service outside India and of the expenses incurred in foreign currency in providing the technical service outside India.

- Deduction under 80HHE would be allowed only if supported by a certificate in form 10CCAF from a chartered accountant along with the audit report.
- No deduction would be allowed in respect of such profit under any other provision of the Act for the same or any other assessment year.

1.2.6 Deduction under section 80HHC

Special deduction is available to exporters of specified goods or merchandise according to specific formula.

- Deduction would be: (i) 100 percent of profit up to assessment year 2000-01, (ii) 80 percent for assessment year 2001-02, (iii) 70 percent for assessment year 2002-03, (iv) 50 percent for assessment year 2003-04 and (v) 30 percent for assessment year 2004-05.
- From assessment year 2005-06 there would be no deduction under the section.
- Deduction is not available unless accompanied by the auditor's certificate in form 10CCAC.

1.2.7 Deduction under section 80 IB

Section 80IB provides for 30 percent deduction of profit and gains of the industrial undertaking engaged in manufacture/ production of article or things which are not specified in Eleventh Schedule provided it is a new undertaking and not formed by splitting up or reconstruction of business or by transfer of used plant or machinery and the new undertaking begins to manufacture article or things during the period 1 April 1991 and 31 March 1995. The deduction is for a period of 10 years beginning from the assessment year during which production or manufacture begins.

1.2.8 Depreciation under section 32

Depreciation at prescribed rate on tangible asset / intangible asset, know-how, patents, copyrights, trademark, license, franchises or any other business or commercial rights of similar nature acquired on or after 1 April 1998 is admissible on fulfilment of condition that the asset is owned wholly or partly by the assessee, used for the purpose of business and used during the relevant previous year.

- Depreciation on intangible asset is admissible in lieu of deduction under section 35A/35AB.
- From 1 April 2002 claim and allowance of depreciation is mandatory.

1.2.9 Section 36

The section provides for deduction of various expenses on account of bonus to employee, insurance of stock/stores, contribution to approved gratuity fund,

recognised provident fund, interest on capital borrowed for the purpose of business. Admissibility of the deduction is subject to fulfillment of conditions mentioned in section 43B.

1.2.10 Section 115 JB

With effect from assessment year 2001-02, when income tax payable on total income of a company as computed under normal provisions of the Act in respect of the relevant previous year, is less than 7.5 per cent of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable on such total income shall be the amount of income tax calculated at the rate of 7.5 percent of the book profit or total income. Book profit means the net profit as shown in the profit and loss account, prepared as per the provisions of Part II and III of Schedule VI to the Companies Act, 1956 after making certain adjustments as prescribed in the Act.

1.3 Objective of the review

1.3.1 The review seeks to examine

- The correctness of application of the provisions of the Act.
- The extent of loss of revenue or under assessment due to omissions and mistakes in the assessments of the selected companies in the above sectors.

1.3.2 An attempt has also been made to

- Quantify the effective rate of tax and tax expenditure in respect of the companies selected for the review.
- Indicate the extent of voluntary tax compliance by the selected companies of the above sectors.

1.4 Audit methodology and audit coverage

1.4.1 A database, namely 'Capitaline-Plus' was acquired from the market and was used for the purpose of this review. Out of 313 sectors having about 12,000 companies, 50 sectors were short listed on the basis of high value of gross sales during the year 2004. Out of these 50 sectors, four sectors namely computer software, automobile including ancillaries, steel and trading were short listed based on value of additional fields of rate of growth of sales, dividend annualized, the rate of growth of profit before tax and rate of growth of tax during the year 2004. A list of 529 companies with profit before tax exceeding Rs. 25 lakh during the year 2004 in the above four sectors was prepared, whose assessments were examined by field audit offices during the review. Apart from the above companies, assessments of other companies with sales turnover not less than Rs. 5 crore, including those with loss/nil income in the above four sectors were also selected for the purpose of the review.

1.4.2 Income tax assessments of companies for the assessment years 2002-03 to 2004-05 completed upto March 2006 have been covered under the review. Wherever cases of irregularities have been noticed, the assessment records of preceding years have also been examined, as made available.

1.4.3 Copies of the draft review report containing observations were issued to the respective Chief Commissioners of Income Tax / Director General of Income Tax (Investigation) by the Director General/Pr. Directors of Audit/Pr. Accountants General/Accountants General during the period from July 2006 to August 2006.

1.4.4 The consolidated draft review report was issued to the Ministry in November 2006. An exit conference between the office of the C & A G of India and the Board was held in January 2007.

1.5 Audit findings

1.5.1 Effective rate of tax and tax expenditures: Assessment records of 909 companies, 1001 companies and 1050 companies relating to assessment years 2002-03, 2003-04 and 2004-05 respectively and belonging to selected sectors of computer software, automobile and its ancillaries, steel and trading were examined by audit during the review. Total tax demand as per the department relating to these companies belonging to all the four sectors were Rs. 1671.85 crore, Rs. 3685.06 crore and Rs. 3824.37 crore during assessment years 2002-03, 2003-04 and 2004-05 respectively. Total tax demand of these companies as a percentage of total corporate tax collections in India in the relevant previous years were 4.57, 7.98 and 6.02 for assessment years 2002-03, 2003-04 and 2004-05 respectively. Details are given in **Appendix 1**.

1.5.2 Audit devised a proforma and collected data in respect of the selected companies relating to the above sectors while conducting the review (**Appendix 2**). The gap between the net profit of the companies as per the profit and loss account and their taxable income as determined by audit has been treated as total deductions availed by the selected companies under the Act. This amount multiplied by the corporate tax rate has been treated as 'tax expenditure' or the revenue forgone by the government as a result of granting these concessions to these companies under the Act. The actual tax payable as a percentage of net profit as per the profit and loss account has been treated as effective rate of tax in respect of these companies in the above four sectors. This analysis has been limited to the profit-making companies in these sectors whose incomes have been assessed under the normal provisions of the Act. For this analysis, figures relating to companies with nil income or loss or which were assessed under the special provisions of the Act and the amounts relating to penal interest or penalty etc from the audit's tax calculations were removed from the data.

1.5.3 A total of 664 companies, 775 companies and 852 companies of the selected companies belonging to all the four selected sectors with profits in any or all the years under consideration were assessed under the normal provisions of the

Act. The remaining companies were either nil income or loss-making companies or were assessed under the special provisions of the Act. Details are given in **Appendix 2**.

1.5.4 These companies have reported Rs. 7836.4 crore, Rs. 9489.7 crore and Rs. 17712.5 crore as net profit before tax and the department has assessed their taxable incomes as Rs. 4709.2 crore, Rs. 6856.0 crore and Rs. 8684.6 crore in the assessment years 2002-03, 2003-04 and 2004-05 respectively. The taxable incomes of these companies as determined by audit were Rs. 5221.3 crore, Rs. 7293.3 crore and Rs. 11176.4 crore in these assessment years respectively. Considering tax demand as per department as the numerator, the effective rates of tax* of the above companies of all the four selected sectors were estimated as 20 percent, 27 percent and 17 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively. Taking tax demand due as per audit as the numerator, the effective rate of tax of the above companies of all the four selected sectors were estimated as 23 percent, 28 percent and 21 percent during the same period respectively.

1.5.5 Tax expenditure in respect of all the provisions of the Act for these companies for the assessment years 2002-03, 2003-04 and 2004-05 were Rs. 915.3 crore, Rs. 768.7 crore and Rs. 2287.6 crore respectively. Tax expenditure in respect of deductions relating to chapter VI A of the Act for these companies were Rs. 235.6 crore, Rs. 228.7 crore and Rs. 302.7 crore during the same period respectively. Tax expenditure in respect of deductions other than chapter VI A deductions of the Act for the selected companies during the same period were Rs. 679.7 crore, Rs. 540.0 crore and Rs. 1984.9 crore respectively.

1.5.6 A total of 400 companies had declared profits in all the years under consideration and were assessed under the normal provisions of the Act. Considering tax demand as per department as the numerator, the effective rates of tax of the above companies of all the four selected sectors were estimated as 23 percent, 30 percent and 25 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively. Taking tax demand due as per audit as the numerator, the effective rate of tax of the above companies of all the four selected sectors were estimated as 24 percent, 32 percent and 25 percent during the same period respectively.

1.5.7 A total of 264 companies, 375 companies and 452 companies of the selected companies belonging to all the four selected sectors with profits in any one or two years under consideration were assessed under the normal provisions of the Act. In other year(s), these companies had either shown loss/nil income or had been assessed under the special provisions of the Act. Considering tax demand as per department as the numerator, the effective rates of tax of the above companies of all the four selected sectors were estimated as 16 percent, 23 percent and 11 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively. Taking tax demand due as per audit as the numerator, the effective rate of tax of the above companies of all the four selected sectors were estimated as 22 percent, 23 percent

* Please see notes below appendix 2 (in four pages).

and 18 percent during the same period respectively. For the purpose of this analysis the data of the companies with loss in any of the three years have been removed from those years.

1.5.8 The above analysis, therefore, indicates that in the four selected sectors the companies showing profits and assessed under the normal provisions of the Act in all the three years under consideration have paid a higher effective tax rate than the companies who have shown profits and were assessed under the normal provisions in only one or two of the three years under consideration.

1.5.9 Additions made by the department and voluntary compliance: Figures on total income returned by all the selected companies of four selected sectors with profits and assessed under the normal provisions of the Act for assessment years 2002-03, 2003-04 and 2004-05 are given in Table 1 below along with total income assessed by the department as well as total income as worked out by audit.

(Rs. in crore)

A.Y.	Sector	Number of profit-making companies assessed under the normal provisions of the Act	Total income returned by the companies	Total income assessed by the department	Total income as worked out by audit	Addition by dept (cl 5-cl 4)	Potential additions (cl 6-cl 4)	Potential not realized as a percentage of total income (as per audit) (cl 8- cl 7 / cl 6x100)	Non-compliance by the companies at filing of the return stage (in percentage) (cl 8 as a per cent of cl 4)
1	2	3	4	5	6	7	8	9	10
2002-03	Automobile	118	1881.08	2543.3	2571.1	662.22	690.02	1.08	27
	Software	126	473.99	1129.9	1499.8	655.87	1025.85	24.67	68
	Steel	143	143.58	303.3	362.1	159.75	218.52	16.23	60
	Trading	277	599.29	732.7	788.3	133.37	189.01	7.06	24
	Total	664	3097.9	4709.2	5221.3	1611.21	2123.39	9.81	41
2003-04	Automobile	131	3106.5	3383.2	3416.2	276.65	309.73	0.97	9
	Software	162	2021.44	2066.1	2386.8	44.68	365.39	13.44	15
	Steel	173	186.94	310.5	308.3	123.53	121.38	(-)0.70	39
	Trading	309	973.31	1096.2	1181.9	122.94	208.60	7.25	18
	Total	775	6288.2	6856.0	7293.3	567.81	1005.10	6.00	14
2004-05	Automobile	146	5065.7	5150.9	6373.1	85.15	1307.3	19.18	21
	Software	173	3018.73	1312.6	2476.5	(-)1706.1	(-)542.22	47.00	22
	Steel	199	431.20	492.9	546.8	61.67	115.59	9.86	21
	Trading	334	1666.16	1728.2	1780.0	62.05	113.85	2.91	6
	Total	852	10181.8	8684.6	11176.4	(-)1497.2	994.53	22.29	9

1.5.10 The difference between total income assessed by the department and that as returned by the companies gives us the additions made as a result of assessment efforts made by the department. Additions made by the department in respect of selected companies during assessment years 2002-03 and 2003-04 were Rs. 1611.21 crore and Rs. 567.81 crore respectively. During the assessment year 2004-05 total income as assessed by the department was less than that returned by the companies by Rs. 1497.2 crore. Column 8 of the table showing the difference between total income as worked out by audit and that as returned by the companies can be viewed as a measure of total potential additions that the department could

have made during the assessments. The difference between column 8 and column 7 will give the potential additions not realized by the department during its assessments. The potential-additions gap as a percent of total income (as worked out by audit) is given in column 9 of the table. The figure was 9.81 percent in assessment year 2002-03, which improved to 6.0 percent in assessment year 2003-04 and again deteriorated to 22.29 percent during assessment year 2004-05.

1.5.11 Column 8 of the table above also shows the amounts by which the companies are reporting their taxable incomes short. Column 8 as a percentage of total income returned by the companies (column 4) will give us a measure of non-compliance at the filing of return stage by the companies. This percentage for the assessment years 2002-03, 2003-04 and 2004-05 were 41, 14 and 9 respectively, implying thereby that non-compliance by the above companies at the filing of return stage has decreased during the period. Therefore, the data suggests that voluntary compliance by the above companies in four selected sectors has improved. This analysis in respect of companies showing profits in all the years under consideration and those with profits in only one or two of the three years under consideration and assessed under the normal provisions of the Act is given in **Appendix 3**. The data suggests that voluntary compliance in the selected sectors is more by those companies which have shown profits in all the three years under consideration and were assessed under the normal provisions of the Act as compared to the companies, which have shown profits in only one or two of the three years.

1.5.12 Mistakes in assessments: Audit noticed 559 mistakes of various types involving tax effect of Rs. 1508.83 crore in the assessments of all the selected companies in the four selected sectors, whether assessed under the normal provisions or the special provisions of the Act. Department have replied in 196 cases involving tax effect of Rs 969.05 crore. Of these, department have accepted audit observations in 102 cases involving tax effect of Rs 448.24 crore and not accepted 94 cases involving tax effect of Rs 520.81 crore. Replies are awaited in respect of remaining 363 cases involving tax effect of Rs 539.78 crore. The replies of the department have been suitably incorporated in the report at appropriate places. These audit observations, category wise and sector wise, are depicted in Table 2 below.

(Rs. in crore)

Table 2 : Mistakes in assessments

Nature of mistake	Computer Software (large, medium/small)		Automobiles including ancillaries		Steel (large, medium/small)		Trading (large, medium/small)		Total tax effect	
	No	Tax effect	No	Tax effect	No	Tax effect	No	Tax effect	No	Tax effect
Irregular/excess exemption in respect of section 10A/10B	71	266.73	1	11.18	0	0	1	0.84	73	278.75
Irregular deduction of expenditure in Chapter VI A	17	135.41	13	4.75	10	23.90	7	3.69	47	167.75
Incorrect computation of business income	23	45.51	18	17.46	23	62.16	31	22.99	95	148.12
Incorrect allowance of provisions and liabilities	22	88.83	26	36.97	14	15.87	14	23.81	76	165.48
Incorrect allowance of capital expenditure and non business expenditure	15	16.90	27	22.23	9	21.19	7	0.79	58	61.11
Incorrect computation of income under special provision of the Act	10	5.90	10	102.38	11	91.6	4	0.15	35	200.03
Incorrect computation of capital gains	0	0	3	29.57	0	0	0	0	3	29.57
Incorrect allowance of depreciation and set off of losses	12	30.86	16	266.23	17	29.74	20	42.20	65	369.03
Undervaluation of closing stock	0	0	4	18.57	2	14.81	0	0	6	33.38
Incorrect valuation of sales tax liability	0	0	0	0	1	3.26	0	0	1	3.26
Incorrect computation of assets after amalgamation	3	16.59	0	0	0	0	1	13.28	4	29.87
Suppression of production and sales	0	0	1	5.11	1	1.83	0	0	2	6.94
Irregularities in tax deduction at source	0	0	1	1.69	0	0	4	3.33	5	5.02
Other mistakes such as mistakes in adoption of figures, incorrect rates, default in interest etc.	28	5.96	11	1.21	22	1.99	28	1.36	89	10.52
Total	201	612.69	131	517.35	110	266.35	117	112.44	559	1508.83

1.5.13 Computer software sector: In computer software sector, audit noticed 201 mistakes involving tax effect of Rs. 612.69 crore. Seventy one audit observations with tax effect of Rs. 266.73 crore were noticed in respect of exemptions being granted under section 10 A/10 B. Number of mistakes in respect of deductions under chapter VI A, allowance of provisions and liability and computation of business income were 17, 22 and 23 respectively, with tax effect of Rs. 135.41 crore, Rs. 88.83 crore and Rs. 45.51 crore.

1.5.14 Automobile including ancillaries: In automobile including ancillaries sector, audit noticed 131 mistakes involving tax effect of Rs. 517.35 crore. Sixteen audit observations with tax effect of Rs. 266.23 crore were noticed in respect of incorrect allowance of depreciation and set off of losses. Number of mistakes in respect of computation of income under special provisions of the Act and allowance of provisions and liabilities were 10 and 26 respectively with tax effect of Rs. 102.38 crore and Rs. 36.97 crore.

1.5.15 Steel sector: In steel sector, audit noticed 110 mistakes involving tax effect of Rs. 266.35 crore. Eleven audit observations with tax effect of Rs. 91.60 crore were noticed in respect of computation of income under special provisions of the Act. Number of mistakes in respect of computation of business income and allowance of depreciation and set off of losses were 23 and 17 respectively with tax effect of Rs. 62.16 crore and Rs. 29.74 crore.

1.5.16 Trading sector: In trading sector, audit noticed 117 mistakes involving tax effect of Rs. 112.44 crore. Thirty one audit observations with tax effect of Rs. 22.99 crore were noticed in respect of computation of business income, while 20 and 14 audit observations with tax effect of Rs. 42.20 crore and Rs. 23.81 crore were noticed in respect of allowance of depreciation and set off of losses and allowance of provisions and liabilities respectively.

1.5.17 These audit observations are discussed, category wise, in subsequent paragraphs. The audit observations with tax effect of Rs. 25 crore and above have been discussed individually in the paragraphs, whereas those with tax effect between Rs. two crore and Rs. 25 crore have been shown in the tables in the body of the review. The audit observations with tax effect between Rs. 50 lakh and Rs. two crore have been shown in the **Appendix 4**. The tax effect of other audit observations with money value of less than Rs. 50 lakh have been included in the review, although these have not been individually highlighted. Some audit observations with smaller money value but dealing with interesting issues have also been highlighted in the review.

1.5.18 The cases relating to tax deducted at source as mentioned in para numbers 1.5.28 (serial number 3 of table 10) and 1.5.37 with tax implication of Rs. 3.47 crore are also featured in the review "Implementation of TDS/TCS schemes".

1.5.19 Irregular /excess exemption in respect of section 10A/10B

Audit noticed 73 mistakes involving tax effect of Rs. 278.75 crore where exemption under section 10A/10B have been allowed by the assessing officer though the assesseees did not comply with the necessary conditions to be eligible to get the exemption as shown in paragraph 1.5.20 to 1.5.25.

1.5.20 Irregular/excess exemption u/s 10A & 10B during transfer of ownership/beneficial interest

Sub section (9) of section 10A / 10B provides that where in any previous year the ownership or the beneficial interest in the undertaking is transferred by any means, the deduction during the period from 1 April 2001 to 31 March 2004 shall not be allowed to the assessee. Further, where on the last day of any previous year, the shares of the company carrying not less than fifty one percent of the voting power are not beneficially held by persons who held the shares of the company carrying not less than fifty one percent of the voting power on the last day of the previous year in which the undertaking was set up, the company shall be presumed to have transferred its ownership or the beneficial interest in the undertaking. In other words the persons who held 51 percent of shares at the time of setting up of the undertaking shall have to be continued to hold not less than 51 percent of shares in order to get the benefit under this section.

Audit noticed that exemption has been allowed ignoring the transfer or ownership of beneficial interest of the assessee in following cases:

1.5.20.1 In City 2 Mumbai charge, the assessments of a company **M/s. GTL Ltd.** for assessment years 2002-03, 2003-04 and 2004-05 were completed in summary manner in March 2003, March 2004 and February 2005 respectively and the assessment for only assessment year 2004-05 was selected for scrutiny. Audit scrutiny revealed that the assessee company previously known as M/s Global Tele Systems Ltd (GTSL) changed its name to **M/s GTL Ltd** with effect from 14 September 2001 consequent to merger of M/s. Global Electronic Commerce Services Ltd (GECS) from 01 January 2000. M/s GTL Ltd formerly known as M/s GTSL had set up an export-oriented unit (EOU) on 07 July 1999 in assessment year 2000-01 and the paid up share capital of the company as on the last day of the assessment year in which EOU was set up, was Rs. 43.41 crore. In the above share capital, the percent of shares of promoters (20.99 percent) together with FIIS (20.50 percent) and NRI's/ foreign corporation/ OCBs (14.79 percent) was 56.28 percent which came down to 39.49 percent as on the last day of the assessment year 2002-03 (promoters : 25.70 percent, FII'S : 5.63 percent and NRI's/foreign corporation/ OCBs : 8.16 percent). As such, in accordance with the above quoted provision the beneficial ownership would be deemed to have been transferred in assessment year 2002-03 and the exemption under section 10B was not allowable to the assessee for assessment year 2002-03 and subsequent assessment years. Omission to disallow the same resulted in underassessment of income of Rs. 215.89 crore for the assessment year 2002-03 to 2004-05 leading to short levy of tax of Rs.104.84 crore including interest.

Department raised demand of Rs.50.66 crore in respect of assessment years 2002-03 and 2004-05. The assessment for the assessment year 2003-04 was also being reopened.

1.5.20.2 Other two similar cases are shown in Table 3 below:

(Rs. in crore)

Sl No / Name of assessee and charge	Assessment year & type of assessment	Nature of mistake	Tax effect
Software sector			
1. M/s. W.N.S. Global, City 10 Mumbai	2003-04 143(3)	The company, a wholly owned subsidiary of M/s British Airways Pvt. Ltd, UK, was claiming deduction of resultant profits u/s 10A. In May 2002, M/s WNS (Mauritius) Ltd acquired the entire share capital of the company from M/s British Airways and still the company claimed deduction of Rs. 30.75 crore u/s 10A which was allowed by the department irregularly.	16.41
Automobile including ancillaries sector			
2. M/s Igarishi Motors India Ltd, Chennai I	2001-02 2002-03 2003-04 143(3)	The assessee company was incorporated in 1992 with seven shareholders who held more than 51% of the shares. It was seen from the ninth annual report for the year 2000-01 that out of the seven original shareholders, only four were still with the company and their shareholding was less than 51% of the voting power. Thus the ownership was changed due to the issue of shares on private placement basis. Therefore deduction of Rs. 6.62 crore, Rs. 10.36 crore and Rs. 5.58 crore allowed u/s 10 A during these years was irregular.	11.18

1.5.21 Incorrect exemption u/s 10A & 10B due to incorrect computation of total income

Sub sections 6(ii) of 10A and 10B provide that no loss pertaining to the newly established undertakings in free trade zones or to the newly established hundred percent export oriented undertakings shall be carried forward or set off where such loss relates to any of the relevant assessment years ending before the 1 April 2001. It implies that, losses if pertaining to assessment year commencing on or after 1 April 2001 of the undertaking covered under section 10 A/10 B shall be set off or carried forward for set off. However, such losses may be carried forward or set off against those profits of the undertaking, which are covered under section 10 A/10 B only and not against those which are not covered under section 10 A/10 B, as according to provision of section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to the income which does not form part of the total income under the Act.

Sub section (5) of 80 HHE provides that where a deduction is allowed for any assessment year, the deduction shall not be granted in relation to such profit under any other provisions of the Act, for the same year and any other assessment year. Further, sub section 8 of 10A & 10B also provide that where the assessee, before the due date for furnishing the return of income under sub-section (1) of section 139, furnishes to the assessing officer a declaration in writing that the provisions of this section may not be made applicable to him, the provisions of the section shall not apply to him for any of the relevant assessment years.

Audit noticed mistakes in 12 cases involving tax effect of Rs. 23.01 crore where above provisions were not adhered to correctly while allowing exemption of income u/s 10A & 10B. Four such cases are illustrated below:

(Rs. in crore)

Sl No./ Name of assessee and charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Computer Science Corporation India (P) Ltd, Indore, MP	2002-03 143(1) 2003-04 143(3)	The assessee was allowed exemption of Rs. 17.66 crore incorrectly u/s 10A in respect of Indore unit as the exemption was allowed u/s 80HHE in earlier years and change in option to claim exemption from section 80HHE to section 10A was not allowable. It was also noticed that the loss sustained in Noida unit was not set off against the profit of Indore unit. The omission to allow incorrect exemption as well as carry forward & set off of loss of Rs. 46.71 lakh resulted in under assessment of income of Rs. 18.13 crore.	8.23
2. M/s. Cognizant Technology Solutions India Ltd. Chennai I	2003-04 143(3)	The assessee had losses in three STP units and profits in five other STP* units for which exemption was claimed u/s 10B. The assessee claimed set off of losses of three units against the taxable profits of the year which was rejected by the assessing officer, in the assessment order, but the same was allowed at computation stage thereby resulting in underassessment of income of Rs. 9.39 crore.	3.45
3. M/s. Penta Media Graphics Ltd, Chennai-III	2002-03 143(3)	The interest income of Rs. 10.39 crore was not reduced from the business income for the purpose of exemption u/s 10B. The non-exclusion of interest income has resulted in excess allowance of exemption u/s 10B to the extent of Rs. 5.08 crore.	2.52
4. M/s Computech International Limited, Kolkata -I	2001-02 143(3)	Deduction u/s 10A was computed on the basis of total export turnover of Rs. 62.09 crore instead of Rs. 25.55 crore being sale proceeds brought into India in convertible foreign exchange within the stipulated period.	2.07

Seven similar cases are given at serial number 1 to 7 of Appendix 4.

1.5.22 Excess exemption u/s 10A & 10B due to incorrect computation of turnover

The profits derived from export of articles or things or computer software shall be the amount which bears to the profits of the business of the undertaking, the same proportion as the export turnover in respect of such articles or things or computer software bears to the total turnover of the business carried on by the undertaking.

The export turnover has been defined as consideration in respect of export received in convertible foreign exchange, but does not include the expenses incurred towards insurance, freight communication if any, and expenses incurred in foreign exchange in providing the technical services outside India.

* Software technology park

Audit noticed mistakes in 48 cases involving tax effect of Rs. 106.75 crore where exemption under section 10A & 10B was allowed without making adjustment of the expenses incurred in foreign exchange or incorrect computation of turnover adopted thereby resulting in excess deduction. One case is illustrated below:

1.5.22.1 In City 2 Mumbai charge, the assessments of a software company **M/s Mahindra British Telecom Ltd**, for the assessment years 2002-03 and 2003-04 were completed after scrutiny in November 2004, December 2005 respectively and for assessment year 2004-05 in summary manner in February 2005. Audit scrutiny revealed that while working out the amount of exemption u/s10A, expenditure incurred in foreign currency for providing technical services was reduced from export turnover as well as from total turnover. However, the Act provides for reducing this amount only from the export turnover. Reducing the same from total turnover was not in order, which resulted in excess exemption of Rs. 144.62 crore with consequent short levy of tax of Rs. 52.27 crore.

1.5.22.2 Eight similar audit observations are shown in Table 5 below:

(Rs. in crore)

Table 5 : Excess exemption u/s 10A & 10B due to incorrect computation of turnover			
Sl No./Name of assessee and charge	Assess-ment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s. Afteck Infosys Ltd., City 6 Mumbai	2003-04 2004-05 143(3)	The assessee had incurred the expenses in foreign currency towards installation service, testing etc. of Rs. 26.38 lakh and Rs. 41.51 crore. This was not reduced from the export turnover while computing exemption u/s 10B. Department has accepted the audit observation.	9.91
2. M/s Mphasis BFL Ltd, Bangalore III	2002-03 143(3)	In allowing the deduction u/s 10B, telecommunication charges attributable to export software outside India at Rs. 3.74 crore and the expenditure incurred in foreign currency for providing technical services outside India at Rs. 69.97 crore were incorrectly reduced from the total turnover. Department has accepted the audit observation.	9.84
3. M/s. Micro Technologies India Ltd., City 8 Mumbai	2002-03 143(3) 2003-04 2004-05 143(1)	The assessee had not received export sale proceeds in India but utilized them in purchase of equities in foreign companies with necessary permission of the RBI. This can not be taken as permission to consider the said proceeds as deemed to have been received in India for the purpose of exemption u/s 10A. This resulted in under assessment of income of Rs. 10.45 core.	5.27
4. M/s Micro Technologies India, City 8 Mumbai	2002-03 143(1)	The assessee had total profit of Rs. 5.73 crore from both STP and non STP units against which profit of Rs. 5.60 crore (98 percent) of total profit (was claimed as exempt u/s 10A). However, the assessee had debited 85 percent of total expenditure towards non STP units which was not in proportion of profit attributable to non STP units.	4.65
5. M/s Axes Technology India P Ltd., Bangalore -I	2002-03 143(1)	The assessee adopted Rs. 79.13 crore as export turnover whereas it had received only Rs. 58.84 crore in convertible foreign exchange within the prescribed time limit. Further, the data communication expenses at Rs. 39.02 lakh debited in the accounts was not reduced from export turnover. The above omissions resulted in excess deduction u/s 10A to the extent of Rs. 9.69 crore. Department has accepted the audit observation.	3.98

6. M/s Cognizant Technology Solutions India (P) Ltd, Chennai -I	2002-03 143(3)	The assessee in computing deduction u/s 10A had excluded the expenditure in foreign currency from the export turnover as well as from the total turnover though exclusion was to be done from export turnover only. Further, a sum of Rs. 12.70 crore was debited towards telecommunication charges but only a portion amounting to Rs. 5.45 crore was excluded from the export turnover. In the scrutiny assessment for the year 2003-04, the assessing officer has excluded 75 percent of the remaining sum, apart from the amount excluded from the export turnover as expenditure incurred in India attributable to delivery of software outside India. However, similar disallowance of Rs. 5.44 (75 percent of remaining Rs. 7.25 crore) was not considered for assessment year 2002-03.	3.94
7. M/s. Covansys (India) Pvt Ltd, Chennai I	2002-03 143(3)	While computing the exemption u/s 10B, telecommunication charges and expenditure incurred in foreign currency of Rs. 11.59 crore were reduced from the total turnover. These items were to be excluded from export turnover only. Incorrect computation of total turnover resulted in an excess allowance of exemption of Rs. 4.73 crore.	2.29
8. M/s Oracle Solutions services (I) Ltd., Bangalore -III	2002-03 143(3)	In allowing the deduction u/s.10A, the total turnover was adopted at Rs. 41.80 crore as against Rs. 51.29 crore as shown in the profit and loss account. The above omission resulted in excess deduction u/s.10A at Rs. 4.12 crore. Department has accepted the audit observation.	2.02

Seven similar cases are featured at serial number 8 to 14 of Appendix 4.

1.5.23 Incorrect exemption u/s 10A & 10B in respect of reconstitution/ splitting up of undertakings

No exemption is admissible to the assessee if company/undertaking is formed by splitting up or the reconstruction of business already in existence or by the transfer to a new business of machinery or plant previously used for any purpose.

Audit noticed mistakes in two cases involving tax effect of Rs. 7.88 crore where exemption u/s 10A & 10B was allowed irregularly ignoring the splitting up or the reconstruction of business of the undertakings. One such case is shown in Table 6 below:

(Rs. in crore)

Sl No./ Name of assessee and charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Computech International Limited Kolkata -I	2001-02 2002-03 2003-04 143(3)	The assessee was allowed irregular exemption of Rs. 12.99 crore u/s 10A in respect of an STP/software unit in these assessment years which had been reconstructed in March 2000 with used plant and machinery of existing IT division in respect of which deduction u/s 80IB had been availed by the assessee up to assessment year 2000-01.	7.32

One similar case is featured at serial number 15 of Appendix 4.

1.5.24 Excess exemption u/s 10A & 10B allowed due to non adjustment of arm length price

Under section 92C of the Act, no exemption u/s 10A & 10B or under chapter VI-A shall be allowed in respect of the amount of income by which the total income of the assessee is enhanced after computation of income under the section. Where any person has entered into an international transaction in previous year, the assessing officer may refer the computation of arm length price to the transfer pricing officer.

Audit noticed mistakes in 2 cases involving tax effect of Rs. 0.72 crore where above provisions were not followed. One of these cases is given at **serial number 16 of Appendix 4.**

1.5.25 Irregular exemption u/s 10A & 10B without furnishing certificate/accountant's report

Sub section (5) of sections 10A /10B provides that exemption shall not be allowed for any assessment year beginning on or after 1 April 2001, unless the assessee furnishes a certificate in the prescribed form, along with the return of income, the report of an accountant in accordance with the provisions of the sections.

Audit noticed mistakes in 3 cases involving tax effect of Rs. 7.96 crore where exemption u/s 10A & 10B was allowed without furnishing the report of accountant by the assessee. One such case is shown in Table 7 below:

(Rs. in crore)

SI No./ Name of assessee and charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
M/s Gavs Information Services Ltd, Chennai I	2002-03 & 2004-05 143(1) 2003-04 143(3)	The assessee was allowed exemption u/s 10B of Rs. 7.46 crore, Rs. 5.48 crore & Rs. 2.47 crore in these years though he had not filed report of the accountant along with the return of income.	6.90

One similar case is featured at **serial number 17 of Appendix 4.**

1.5.26 Incorrect deduction under Chapter VI-A

A deduction under section 80HHE of the Act, on account of the profits derived from export of computer software shall be the amount which bears to the profits of the business, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee.

As per section 10A of the Act, income includes amount received from rendering technical services outside India but excludes expenditure in foreign currency in providing technical services from export turnover. However, the profits from technical service rendered outside India is specifically provided for under section 80HHE of the Act and therefore said profit is eligible for deduction under 80HHE instead of 10A of the Act.

Audit noticed mistakes in 47 cases involving tax effect of Rs. 167.75 crore while allowing deduction under sections 80HHE, 80HHC, 80IA, 80IB, 80JJAA etc under Chapter VI A. Two such cases are discussed below:

1.5.26.1 In City 2 Mumbai charge, the assessment of a company **M/s. Tata Sons Ltd.** for the assessment year 2002-03 was completed after scrutiny in March 2005. Audit scrutiny revealed that the assessee was allowed exemption of Rs.362.94 crore under section 10A and deduction of Rs.539.13 crore under section 80HHE. While computing the deduction u/s 80HHE, the assessing officer had taken the total turnover at Rs.2881.67 crore as against Rs.4120.40 crore. As per provision contained u/s 80HHE, total turnover of the business as against total turnover of the undertaking is required to be considered. Adoption of the incorrect total turnover resulted in under assessment of income of Rs. 162.08 crore involving tax effect of Rs.57.86 crore.

The department in its reply stated that the turnover referred to in section 80HHE implies turnover of the business of the assessee and hence the turnover of units availing exemption under section 10A can not be included while computing the total turnover of the assessee. The department's reply is not tenable as total turnover should include turnover of all the activities whether under section 10A or under section 80HHE. Further, the department, in the assessment for the assessment year 2003-04, had allowed deduction under section 80HHE on total turnover including turnover of units availing exemption under section 10A.

1.5.26.2 The assessment of a company **M/s. Tata Sons Ltd.** for the assessment year 2001-02 was completed u/s 250 in October 2005. Audit scrutiny revealed that the department has allowed exemption u/s 10A amounting to Rs. 664.29 crore and deduction u/s 80HHE of Rs.115.19 crore. The deduction u/s 80HHE was calculated on business income of Rs. 856.14 crore, which included the profit from 10A units amounting to Rs. 664.29 crore. The non-exclusion of the amount of exemption u/s 10A from the business income while calculating deduction under section 80HHE resulted in excess allowance of deduction u/s 80HHE amounting to Rs. 89.37 crore there by leading to short levy of tax of Rs. 35.34 crore.

1.5.26.3 Seven similar cases are shown in Table 8 below:

(Rs. in crore)

Table 8 : Incorrect deduction under Chapter VI-A			
Sl No./ Name of assessee and charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s. Tata Sons Ltd City 2 Mumbai	2002-03 143(3) rws 263	While working out the qualifying business profit for arriving at deduction u/s 80HHE, an amount of Rs. 365.94 crore was reduced as deduction under section 10A instead of Rs. 435.29 crore actually allowed in giving affect to CIT order u/s 263 of the Act. This has resulted in excess allowance of deduction u/s 80HHE amounting to Rs. 43.08 crore.	23.48

2. M/s IGate Global Solutions Ltd, Bangalore-I	2002-03 2003-04 143(3)	While determining the export turnover for calculating deduction under section 10 A, expenditure incurred in foreign exchange inter-alia including travel expenditure incurred in foreign currency at Rs.3.42 crore & Rs.128.89 crore respectively in these assessment years were treated as expenditure incurred in rendering technical services abroad and reduced from export turnover. The deduction relating to profits from rendering technical services abroad should have been allowed under section 80HHE and the said profit should be reduced to arrive at the deduction under section 10A. However the profits relating to rendering technical services abroad have not been reduced from the profits eligible for deduction u/s 10A. This resulted in excess allowance of deduction aggregating Rs. 5.18 crore.	3.66
3. M/s Mahindra British Telecom Ltd City 2 Mumbai	2002-03 2003-04 143(3)	Non-reduction of exempted income u/s 10A from the profit for working out deduction u/s 80HHE resulted in excess allowance of deduction to the extent of Rs. 7.96 crore.	2.86
4. M/s NIIT GIS Ltd, Delhi V	2002-03 143(1)	The assessee was engaged in manufacture of software which was not an article or thing and did not form an industrial undertaking. Secondly, the assessee had not furnished mandatory audit report in prescribed form along with the return for claiming deduction under section 80IB. So, deduction of Rs. 5.86 crore allowed u/s 80IB was irregular.	2.38
5. DSL Software Ltd, Bangalore-I	2003-04 143(3)	Similar excess allowance under section 10A, as in case of sl no. 2 above.	2.01
Steel sector			
6. M/s Jindal Steel and Power Limited, Hissar	2002-03 143(3)	Deduction of Rs. 52.0 crore and Rs. 3.74 crore was allowed on power generation units under sections 80IA and 80IB respectively under normal provisions and by charging tax of Rs. 9.38 crore on book profits under section 115JB. Audit scrutiny revealed that deductions under sections 80IA and 80IB were allowed without obtaining the unit-wise accounts of all the units as required under the Income Tax Rule 18 BBB (2). In the absence of this, allocation of head office expenses, financial expenses and other miscellaneous expenses to all units could not be ascertained and therefore, correctness of the deductions allowed is not verifiable.	19.90
Trading sector			
7. M/s Hyderabad Chemical Supplies Ltd, CIT II Hyderabad	2005-06 143(1)	Under section 80IA (5) the loss can be carried forward and set off against the profits earned by the same unit only in subsequent years. However, loss of Rs. 5.87 crore from the unit was set off against the profits of non eligible unit incorrectly.	2.42

Ten similar cases are featured at serial number 18 to 27 of Appendix 4.

1.5.27 Incorrect computation of business income

Under the Act, the total income of any person for any previous year includes income from whatever source derived which is received or deemed to have been received or which accrues or arises during such previous year unless it is specifically exempted from tax by other provisions of the Act.

Fees paid for acquiring industrial information and technique likely to assist the assessee in manufacture and processing of goods form part of technical know how which qualify for depreciation under the block of intangible assets.

Any sum, whether received or receivable, in cash or kind, under an agreement for not carrying out any activity in relation to any business (non-compete fee) shall be chargeable to income tax under the head 'profits and gains of business or profession'.

Any sum received by the assessee from employees to which the provisions of sub-clause (x) of clause (24) of section 2 apply, are allowable as deduction only if such sum is credited to the employees' account on the relevant fund or funds on or before the 'due date'.

It has been judicially held* that, if any subsidy has been paid to the assessee for assisting him in carrying out the business operations after start of production/business, such subsidy should be treated as assistance for the purpose of the trade and classified as a revenue receipt.

Audit noticed mistakes in 95 cases involving tax effect of Rs. 148.12 crore due to failure to adhere to the above provisions. Mistakes noticed in respect of one assessee are given below:

1.5.27.1 In Kolkata I charge, assessments of a company **M/s Ispat Industries Limited**, for the assessment years 2001-02, 2002-03 and 2004-05 were completed after scrutiny and for assessment year 2003-04 was completed in summary manner at loss of Rs. 548.31 crore, Rs. 649.85 crore, Rs. 322.25 crore and Rs. 413.47 crore respectively. Audit scrutiny revealed the following inaccuracies in computation of income resulting in under assessment of income involving aggregate tax effect of Rs. 41.41 crore as shown below:

- As per the fixed assets schedule of the assessee for the year ending 31 March 2004, deferred revenue expenditure (DRE) available for set off was Rs. 122.23 crore, whereas DRE allowed was Rs. 143.02 crore. Further, depreciation allowed on fixed assets was in excess by Rs. 2.74 crore. Thus the over assessment of loss worked out to Rs. 23.53 crore having potential tax effect of Rs. 8.62 crore. In reply the assessing officer stated that the amount had not been claimed by the assessee. The contention is not tenable as an amount of Rs. 122.23 crore of DRE after adjustment and transfer was allowable as against an amount of Rs. 143.02 crore actually allowed.
- In the assessment year 2003-04, the assessee was allowed a separate deduction of Rs. 14.24 crore on account of difference in interest liability arising out of restructuring package. It was irregular as there was no credit of such amount in the profit and loss account during the previous years.

* 228 ITR 253, Sahney Steel and Press Works Ltd v/s CIT -- 1997

This resulted in potential tax effect of Rs. 5.08 crore. In reply, the assessing officer stated that the amount had been duly credited to the profit and loss account on the basis of the notes on accounts. The contention is not acceptable as it was reversal of previous year's accounting of restructuring package of loan.

- The assessee had written off Rs. 35.78 crore on account of "bills discounted being bills receivable" and claimed the amount as bad debt. It was noticed that it was neither a bad debt nor represented a loan/advance or banking business. The assessing officer has admitted that the amount was an investment and also the fact that the amount had not been taken into account in computing the income of the previous years. Thus, allowance of written off amount as bad debt resulted in over assessment of loss. This resulted in potential tax effect of Rs. 13.15 crore. In reply, the assessing officer has admitted that the amount in question was an investment towards earning discounting charges and has stated that the assessee can claim the same as a bad debt in the event of it being rendered irrecoverable. The contention is not acceptable as the same is to be treated as a capital loss and not a business loss.
- The assessee during the previous year converted a piece of freehold land into "stock- in- trade" for the purpose of commercial development. A sum of Rs. 174.35 crore was debited in the profit and loss account on account of such conversion but the land was valued at Rs. 105 crore as a part of closing stock, thus showing a loss of Rs. 69.35 crore. The loss was claimed as capital loss which was irregular as land is not subject to depreciation excepting in the event of natural calamity and capital expenditure in commercial development of land could not have any fall in value. This resulted in potential tax effect of Rs. 14.56 crore. The assessing officer in reply has stated that the claim for capital loss has not been allowed in the assessment. The same is not tenable as the assessee has computed the loss in the year of conversion and deferred the claim to the year of transfer and the irregular computation of capital loss was not rejected in the scrutiny assessment.

1.5.27.2 Twelve similar cases are given in Table 9 below:

(Rs. in crore)

Table 9 : Incorrect computation of business income			
Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Penta Media Graphics Ltd, Chennai III	2003-04 143(3)	Number of additions were made in the scrutiny assessment and income from business was increased from Rs. 4.60 crore to Rs. 73.14 crore but corresponding exemption u/s 10-B was not allowed on the additions. This resulted in over assessment of income of Rs. 29.74 crore.	15.01 Over charge

2. M/s National Informatics Centre Services Incorporation Delhi V	2002-03 2003-04 143(3) 2004-05 143(1)	In the assessment year 2003-04, as per 'Notes to Accounts', the amount of fees derived from services provided or rendered was Rs. 19.34 crore whereas the profit and loss account showed Rs. 8.99 crore as service and support receipts. Thus an amount of Rs. 10.35 crore has escaped assessment. Similar issues were also noticed in the assessment year 2002-03 and 2004-05 resulting in underassessment of income of Rs. 6.12 crore and Rs. 7.73 crore respectively. The above mistakes resulted in underassessment of income of Rs. 24.20 crore.	8.77
3. M/s Penta Media Graphics Ltd, Chennai III	2004-05 143(1)	The assessee had debited a sum of Rs. 37.31 crore in the profit and loss account towards "Depreciation as per Companies Act". From Form 3 CD filed along with return of income, it was noticed that the assessee company was not eligible for claiming depreciation as per the Act as per the Auditor's certificate. While computing taxable income depreciation as per Company's Act was not added back. The department has initiated remedial action.	8.11
4. M/s Satyam Computer Services Limited, Hyderabad Central	2004-05 143(1)	While calculating total tax payable, interest of Rs. 7.21 crore leviable for default in payment of advance tax was not levied. Non-levy of interest was due to the fact that taxes paid outside India amounting to Rs. 59.90 crore were considered as advance tax in arriving at total tax payable. As there is no specific provision in the Act to treat taxes paid outside India as advance tax, interest under section 234B is to be calculated without taking into account the taxes paid outside India as advance tax.	7.22
Automobile including ancillaries sector			
5. M/s Tata Motors Ltd, City 2 Mumbai	2001-02 2004-05 143(3)	In the assessment year 2001-02, unutilized central excise value added credit of Rs. 13.66 crore was not added back while computing the taxable income. In the assessment year 2004-05, the assessee had received interest u/s 244-A of Rs. 21.69 crore out of which the assessee had offered only Rs. 15.84 crore for taxation and the balance amount of Rs. 5.85 crore was not offered contending that the department had filed an appeal to ITAT. The assessee was however liable to pay tax on the entire amount of Rs. 21.69 crore and not on Rs. 15.84 crore.	5.79 (P) 1.70
6. Honda Motor Cycle and Scooter India (P) Ltd, Haryana, Gurgaon	2002-03 2003-04 143(3)	<p>In the assessment year 2002-03, expenditure of Rs. 4.59 crore on account of technical assistance; royalty and depreciation on technical know-how paid to foreign company was allowed as deduction though tax at source was not deducted. Such expenditure ought to have been disallowed. Besides, land development expenses of Rs. 41.11 lakh were included in the cost of building on which depreciation of Rs. 4.11 lakh was incorrectly allowed. The omissions resulted in over computation of loss of Rs. 4.63 crore.</p> <p>In the assessment year 2003-04, the assessee claimed deduction of Rs. 3.72 crore on account of royalty and of Rs. 2.90 crore on account of technical assistance fee treating the same as revenue expenditure. The assessing officer disallowed Rs. 2.49 crore for non deduction of tax at source and Rs. 4.14 crore was allowed as deduction. Since the technical assistance and royalty is paid for industrial information and technique likely to assist in manufacture or processing of goods, it forms part of intangible assets qualifying for depreciation of Rs. 62.53 lakh. Moreover, these payments were made to the holding company. Thus, deduction of Rs. 3.51 crore was allowed in excess. Besides, depreciation of Rs. 45.79 lakh on technical know how was</p>	3.04(P)

		allowed as deduction. Audit scrutiny revealed that it was accounted for in books in March 2003 and therefore, half of the normal depreciation was admissible being asset used for less than 180 days. Thus, depreciation on technical know-how was excess allowed by Rs. 22.89 lakh. Further, excess depreciation of Rs. 3.70 lakh on land development expenses needed to be withdrawn. The omissions resulted in over computation of loss by Rs. 3.78 crore.	
7. M/s Eicher Motor Ltd, Indore	1992-93 143(3) 147/154 February 2006	Provisions provided u/s 34A relating to quantum of set off of unabsorbed depreciation/investment allowances equal to 2/3 rd of positive income of assessment year was not observed and unabsorbed depreciation was taken at Rs. 2.96 crore instead of Rs. 1.40 crore as per appellate order of a subsequent date of 2002. Department has accepted the audit observation.	2.81
Steel sector			
8. M/s Steel Authority of India Ltd, Delhi III	2004-05 143(1)	The assessee had deposited Rs. 29.36 crore on account of employees' contribution to provident fund after the stipulated due date in respect of Bokaro Steel Ltd. This should have been added back to the income of the assessee. The omission to do so resulted in underassessment of income of Rs. 29.36 crore involving potential tax effect of Rs. 10.53 crore.	10.53
9. M/s Shobhagya Steels Ltd., Chennai – III	2004-05 143(1)	The assessee had filed its return of income for the assessment year 2004-05 admitting a loss of Rs. 5.59 lakh. While processing the return in summary manner, the returned loss was taken as Rs. 20.85 crore (including carry forward loss) erroneously.	7.46 (P)
Trading sector			
10. M/s. Indian Potash Ltd, Chennai I	2004-05 143(1)	The assessee had incorrectly claimed expenditure towards discount amounting to Rs. 9.04 crore included under "Schedule-17- other expenses", relating to previous year. The foreign currency balances of creditors, debtors and loans from banks as on 31 March 2004, were restated at the average exchange rate instead of the closing exchange rate prevailing as on 31 March 2004 which resulted in under statement of profit to the extent of Rs. 8.80 crore.	7.80
11. M/s Mahendra Inter Trade Ltd City 2 Mumbai	2002-03 143(1)	The assessee had debited Rs. 7.31 crore on account of "bad debts & advances written off" to the profit and loss account and the entire amount was allowed as business loss though the conditions such as the assessee should satisfy that writing off of the loan in the books of account and proving genuineness of irrecoverability, were not fulfilled.	2.61
12. M/s. Sembcorp Logistics India(P) Ltd., Chennai-III	2002-03 143(1)	The assessee company had claimed a sum of Rs. 6.90 crore relating to adjustments pertaining to earlier period. As these items have been incurred in earlier years, the same cannot be allowed as a deduction in subsequent years and required to be disallowed.	2.46 (P)

Fourteen similar cases are featured at **serial number 28 to 41 of Appendix 4.**

1.5.28 Incorrect allowance of provisions and liabilities

Under the Act, a provision made in the accounts for an accrued or known liability is an admissible deduction while other provisions made do not qualify for the deduction. It has been judicially held[†] that for a loss to be deductible, it must have

[†] CIT vs Indian Overseas Bank {151 ITR 446} (Madras)

actually arisen and incurred and not merely anticipated as certain to occur in future. It has also been judicially held[†] that only such expenditure that accrues in a year under mercantile system of accounting is allowable from the profits of the same year.

Audit noticed mistakes in giving effect to the above provisions in 76 cases involving tax effect of Rs. 165.48 crore. One such case is discussed below:

1.5.28.1 In Delhi IV charge, the assessment of **M/s Data Access (India) Ltd.** for the assessment year 2004-05 was processed in summary manner in April 2005 determining a loss of Rs. 107.62 crore. Audit scrutiny revealed that the assessee had made a provision for expenses amounting to Rs. 183.77 crore and showed it in the balance sheet under the head "current liabilities and provisions". As per the note given below the details of the above head, the assessee had declared that provisions for expenses included liability of Rs. 171.36 crore which was not based on actual bills. Thus, it was an unascertained liability and should have been added back to the taxable income, which was not done in the instant case. The mistake resulted in underassessment of income of Rs. 171.36 crore involving tax effect of Rs. 61.48 crore. Reply is awaited.

1.5.28.2 Thirteen similar cases are shown in Table 10 below:

(Rs. in crore)

Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Penta Media Graphics P Ltd, Chennai III	2002-03 143(3)/263	The assessee had made advance of Rs.126.33 crore to its subsidiary companies for which no interest was charged. Assessee had paid interest on loans but made advances to its subsidiaries without charging interest. Hence, a proportionate interest and finance charge was required to be disallowed which was not done.	5.56
2. M/s Data Access (India) Ltd, Delhi IV	2003-04 144	The assessee had received interest income of Rs. 9.07 crore which should have been taxed under the head 'income from other sources'. As income from other sources cannot be set off against brought forward business losses, it should have been taxed.	4.57
3. M/s Polaris Software Lab Ltd Chennai III	2002-03 2003-04 143(3)	A sum of Rs. 4.79 crore and Rs. 2.71 crore in respect of 10A units and 80 HHE units towards 'provision for performance award' disallowed in the previous years were now claimed on payment basis in the current year and 'provision for estimated loss on incomplete contracts written back'. However no such disallowance of above payment were found in the records of earlier years and no details were found in the record regarding the above claims preferred during the current year. Further, no TDS was deducted on payment of Rs. 1.12 crore and Rs. 2.93 crore made towards expenditure on professional charges in foreign currency.	4.09

[†] 82 ITR 364 Kedarnath Jute Manufacturing Co Ltd versus CIT. (Supreme Court)

4. M/s Moser Baer India Ltd, Delhi II	2003-04 143(3)	The assessee was not eligible for deduction u/s 35AB as from the assessment year 1999-2000, only depreciation @ 25 percent was allowable on such intangible assets viz. technical know how, patents, copyrights etc. Hence, the assessee was eligible for deduction of Rs. 2.05 crore only as depreciation (on intangible asset of Rs. 8.21 crore) instead of the deduction of Rs. 9.58 crore allowed.	3.13
Automobile including ancillaries sector			
5. M/s Ford India Ltd, Chennai I	2002-03 143(3)	The assessee had incurred expenditure of Rs. 26.59 crore in foreign currency towards interest on Foreign Currency Non Resident loans. As the assessee had not deducted tax at source, the expenditure was not allowable. This resulted in over assessment of loss involving a potential demand of Rs. 9.49 crore. Further, omission to deduct tax at source u/s 195 resulted in non levy of tax of Rs. 5.32 crore besides penalty leviable u/s 271C for failure to deduct tax @ 100% of the tax omitted to be deducted. The assessee was also liable for TDS interest of Rs. 2.88 crore u/s 201 (1A) and penalty of the amount of tax was required to be deducted.	9.49 (P) 8.19
6. M/s Yamaha Motors India Ltd, Delhi VI	2003-04 143(3)	The assessee had made provisions towards gratuity, superannuation, pension, after-sale services and warranties amounting to Rs.14.97 crore. As the amount was merely a provision and not an ascertained liability, it was not an allowable expenditure and should have been added back.	5.50
7. M/s Tata Motors Ltd, City 2 Mumbai	2001-02 143(3)	Provisions for staff welfare scheme amounting to Rs.13.16 crore debited in the profit and loss account was not added back while computing the taxable income resulting in under assessment.	5.20 (P)
Steel sector			
8. M/s Haryana Roadways Engineering Corporation Ltd, Gurgaon	2002-03 143(3) 2003-04 143(1)	The assessee company, following mercantile system of accounting, had not credited Rs. 2.80 crore on account of interest receivable stating that it was payable to scheduled banks and public financial institutions on borrowings. The Act provides that income accrued is chargeable to tax and deduction of interest payable on actual payment. In the assessment year 2003-04, interest of Rs. 2.34 crore payable to scheduled banks and public financial institutions was not disallowed although the same was not paid before the due date of filing of return.	2.46
9. M/s Usha Martin Ltd, Jharkhand Ranchi	2003-04 143(3) 2004-05 143(1)	While computing total income under section 115JB, the assessing officer omitted to add provisions of taxes amounting to Rs. 5.13 crore. Further, in the computation of income for the assessment year 2004-05, provision of taxes amounting to Rs. 7.75 crore was also omitted to be added back.	3.28
10. M/s Sandesh Springs P Ltd, Ludhiana Central	2002-03 153A /144	The assessing officer incorrectly raised the demand of Rs. 2.94 crore instead of Rs. 7.65 crore, resulting in short demand of Rs. 4.71 crore. Rectification action has been initiated after being pointing out by the audit.	4.71
Trading sector			
11. M/s State Trading Corporation of India Ltd, Delhi VI	2004-05 143(1)	Prior period expenses of Rs. 12.06 crore were charged to the 'Profit and Loss Account' but not added back. The mistake resulted in underassessment of income.	5.06

12. MMTC Ltd, Delhi II	2002-03 2003-04 2004-05 143(3)	Incorrect allowance of provision for advances of Rs. 13.07 crore being an ascertained liability and prior period expenditure of Rs. 7.15 crore resulted in underassessment of income. Further, short levy of interest of Rs. 21.0 lakh was also noticed.	9.88
13. M/s Global Infrastructure & Technologies Ltd City 1 Pune	2003-04 143(3)	The assessee claimed deduction of Rs. 8.30 crore on account of interest payable but not provided in the books of accounts and same was allowed by the department. Further note 12 to the accounts clarifies that these were provisions with reference to interest on secured loans/bonds. Since the above provisions were not booked in the accounts, the same were not admissible expenditure in view of the provisions contained in section 43-B. Department has accepted the audit observation.	3.05

Twenty four similar cases are featured at serial number 42 to 65 of Appendix 4.

1.5.29 Incorrect allowance of capital and non business expenditure

Any expenditure not being in the nature of capital expenditure, laid down and expended wholly and exclusively for the purpose of business or profession is allowable as deduction. It has been judicially held[@] that expenditure incurred by the assessee by way of technical know-how to its foreign collaborator under an agreement is to be treated as capital.

Audit noticed mistakes in giving effect to the above provisions in 58 cases involving tax effect of Rs. 61.11 crore. Ten such cases are given in Table 11 below:

(Rs. in crore)

Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Aftack Infosys Ltd City 6 Mumbai	2003-04 143(3) 2004-05 143(1)	A deduction of Rs. 3.90 crore and Rs. 16.61 crore in assessment years 2003-04 & 2004-05 respectively was allowed towards software development expenses. The benefit to be derived from the said expenses was of enduring nature and same was required to be treated as capital in nature and depreciation @ 60 percent was allowable. The mistake resulted in under assessment of income of Rs. 8.20 crore. Department has accepted the observation.	2.96
2. M/s Orbitech Solutions Ltd City 8 Mumbai	2003-04 143(3)	A deduction of Rs. 6.14 crore on account of product development expenses during the year was allowed. As this was in nature of capital, the same was not allowable as business expenses. Department has accepted the observation.	2.25
3. M/s Siemens Information Systems Ltd City 7 Mumbai	2002-03 143(3)	A deduction of Rs. 14.99 crore on account of cost of software and cost of hardware was allowed as revenue expenditure. As these items would be giving the benefit of enduring nature to the assessee, the said expenses should have been treated as capital expenditure. This has resulted in under assessment of income of Rs. 5.99 crore after allowing depreciation at the rate of 60 percent.	2.14

[@] 23 Taxmann 66 (SC) – Scientific Engineering Home (P) Ltd. Vs CIT

4. M/s Oracle India (P) Ltd, Delhi V	2003-04 143(3)	An expenditure of Rs. 4.85 crore on account of fixed assets written off in the profit and loss account was allowed incorrectly as the same is of capital nature.	2.44
Automobile including ancillaries sector			
5. M/s Tata Motors Ltd, City 2 Mumbai	2000-01 143(3)	The assessee had claimed and was allowed a deduction of Rs. 23.02 crore on account of expenditure incurred towards development of software called SAP [§] programme. Since the benefit from this programme was of enduring nature and the asset was of depreciable nature, the expenditure was required to be treated as capital expenditure and depreciation at the rate of forty percent was to be allowed. Incorrect treatment of the same as revenue expenditure and allowance of deduction resulted in under assessment of income of Rs. 13.81 crore. Department replied that the expenditure was revenue in nature. Department's reply is not tenable in view of the fact that similar expenditure in the case of two other assesseees during the assessment year 2001-02, had been considered as capital.	5.32 (P)
6. M/s Hyundai Motor India Ltd, Chennai - I	2003-04 143(3)	The assessee had debited Rs. 126.55 crore towards a technical transfer fee under "Royalty" which included a sum of Rs. 9.63 crore towards "technical know-how" paid to M/s. Hyundai Motor Company, Korea, the holding company, in pursuance of the Technology and Royalty agreement entered into in September 2002. It is observed that though royalty payment made from time to time at specified percentage on the net selling price of the products sold by the assessee was an allowable expenditure, the lump sum payment on account of technical know-how, however was required to be capitalized duly allowing appropriate depreciation in view of the judicial decision cited above. The irregular allowance of payment on technical know how resulted in under assessment of income to an extent of Rs. 7.07 crore.	2.91
7. M/s Jamna Auto Industries Ltd, Haryana Yamunanagar	2003-04 143(3)	Interest of Rs. 5.71 crore converted into loan by banks and public financial institutions was incorrectly allowed as deduction treating it as deemed to have actually been paid. The omission resulted in over computation of loss by Rs. 5.71 crore.	2.09
Steel sector			
8. M/s Steel Authority of India Ltd, Delhi III	2003-04 143(3)	As per the 'Notes on Accounts' the assessee had paid Rs.44.37 crore on account of surcharge for delayed payment for electricity and fuel bills to M/s Damodar Valley Corporation. The assessing officer had added back Rs.14.09 crore only out of Rs.44.37 crore as an adjustment relating to earlier years. The balance amount of Rs.30.28 crore was also to be added back as the nature of expenditure was penalty. Department did not accept the audit observation stating that late payment of surcharge was in the nature of compensation and not a penalty. The reply is not tenable as any payment over and above the actual charges on account of failure to pay the actual charges within stipulated time is deemed to be penalty in nature. Department, however, did not explain as to why only Rs.14.09 crore was disallowed.	11.11
9. M/s Southern Iron & Steel Co. Ltd, Coimbatore I	2002-03 143(1)	The assessee had claimed a sum of Rs.11.46 crore as deduction u/s 43-B towards interest on term loan, which was disallowed in the assessment year 2001-02. The assessee claimed the same on the ground that when interest payable to the banks was converted into loan, the interest due is deemed to have been paid. Conversion of	4.09 (P)

[§] M/s SAP Asia Systems

		the interest due into loan by funding the interest does not tantamount to payment made by the assessee. Once it is converted into a loan, it ceases to be revenue expenditure and is not deductible u/s 36 or 37 of the Act. Department has accepted the audit observation.	
10. M/s Steel Authority of India Ltd, Delhi-III	2004-05 143(1)	The assessee had debited Rs. 34.67 crore to the profit and loss account as prior period expenditure (after netting out prior period expenditure of Rs. 59.90 crore and prior period income of Rs. 25.23 crore). Out of the prior period expenditure of Rs. 59.90 crore, only Rs. 51.79 crore was added back in the computation of income. Failure to add back the remaining amount of Rs. 8.11 crore resulted in underassessment of income.	2.91

Fifteen similar cases are featured at serial number 66 to 80 of Appendix 4.

1.5.30 Incorrect computation of income under special provisions of the Act

As per provisions of section 115-JB of the Act, where the income tax payable on the total income as computed under the normal provisions of the Act in respect of any previous year relevant to the assessment year commencing on or after 1 April 2001, is less than 7.5 percent of the book profit, such book profit shall be deemed to be the total income of the assessee and the assessee is liable to pay income tax @ 7.5 percent on such total income.

Audit noticed mistakes in 35 cases involving tax effect of Rs. 200.03 crore due to incorrect computation of book profits and non-adherence of the above provisions of the Act. Two such cases are discussed below:

1.5.30.1 In City 2 Mumbai charge, the assessments of an automobile company, **M/s. Tata Motors Ltd**, for the assessment years 2003-04 and 2004-05 were completed after scrutiny in January 2006 and in summary manner in July 2005 respectively. The tax was paid u/s.115-JB of the Act. Audit scrutiny revealed the following inaccuracies:

While working out the book profit, deferred tax amounting to Rs.576.55 crore, provisions for staff welfare schemes amounting to Rs.10.58 crore, provision for diminution in the value of investments of Rs.74.30 crore, provision for pension of Rs.14.87 crore, provision for bad and doubtful debts of Rs.97.94 crore and provision for loss on quantities of Rs.69 lakh were not considered for addition. As these amounts debited to the profit and loss account were merely provisions and not ascertained liabilities, these were required to be added to the book profit. The book profit was also reduced on account of profits eligible for deduction u/s.80-HHC amounting to Rs.14.22 crore and brought forward losses of Rs.152.97 crore, though deduction u/s.80-HHC was not allowed in computation under normal provisions of the Act as there was no profit available. There was also no loss in the books of account of the current year. These omissions resulted in under assessment of book profit of Rs.972.12 crore with consequent short levy of tax of Rs.86.18 crore including withdrawal of interest of Rs.7.38 crore u/s 244-A.

Department stated that the assessee is required to provide for all the liabilities which are legally and contractually due. However, the assessment has been reopened under section 148. The reply is not acceptable as the provisions are not ascertained liabilities but contingent in nature and therefore not allowable in view of the Supreme Court decision**.

1.5.30.2 In City 2 Mumbai charge, the assessments of M/s. Tata Steel Ltd for the assessment years 2002-03 and 2003-04 were completed after scrutiny in February 2005 and in March 2006 respectively. The rectification order was passed in January 2006 in respect of assessment year 2002-03. Audit scrutiny revealed that the department while determining tax demand allowed credit of Rs. 53.83 crore and Rs. 126.92 crore u/s 115JAA respectively before charging interest u/s.234-B. In accordance with the provisions of section 234B, interest for default in payment of advance tax should be calculated after giving credit of advance tax/TDS only. There is no provision in the Act to treat MAT credit in the nature of an advance tax or prepaid tax. The omission resulted in short levy of interest of Rs. 69.64 crore.

Five similar cases are given in Table 12 below:

(Rs. in crore)

Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Dusk Valley Technologies Ltd, Delhi IV	2002-03 143(3)	The income was computed at Rs. 4.81 crore and Rs. 1.69 crore under normal and special provisions of the Act with tax liability of Rs. 2.41 crore and Rs. 12.93 lakh respectively. Thus, the assessee was to pay tax under normal provision as it was on the higher side, but instead the assessee paid tax under special provision.	2.28
Steel sector			
2. M/s. Tata Iron & Steel Co. Ltd, City 2 Mumbai	2002-03 143(3)	The assessee had returned income of Rs. 132.12 crore u/s 115-JB but the return was processed u/s 143(1) and income was adopted as 'Nil' and the entire prepaid taxes along with interest amounting to Rs. 17.18 crore was granted and paid to the assessee in March, 2004. This mistake was rectified by raising a demand of Rs. 10.44 crore in March 2005. However the assessing officer did not consider the refund of Rs. 17.18 crore paid to the assessee which resulted in short levy of interest including interest u/s 234D.	18.21
3. M/s. Tata Steel Ltd City 2 Mumbai	2003-04 143 (3)	The assessing officer allowed MAT credit of Rs. 126.92 crore u/s 115JAA for the assessment year 1998-99, 1999-00 and 2000-01 instead of Rs. 123.89 crore allowable. This resulted in excess credit of Rs. 3.02 crore.	3.31
Automobile including ancillaries sector			
4.M/s Tata Motors Ltd, city 2 Mumbai	2000-01 143(3)	The assessee had filed revised return in February 2002 due to increase in capital gains to Rs.253.24 crore from Rs.150.14 crore on account of sale of its assets at Jamshedpur and Pune division as slump sale. The transaction was not routed through profit and loss account as a result of which the net profit was worked out to a smaller figure. This further resulted in under computation of book profit.	11.90

** Bharat Earth Movers Ltd Vs. CIT (245 ITR 428)

5. M/s. Premier Automobiles Ltd, City 10, Mumbai	2001-02 143(3)	While working out the book profit u/s 115-JB, provision for diminution in the value of investment amounting to Rs. 40.86 crore and provision for bad and doubtful debts amounting to Rs. 37.97 lakh were not considered for addition. Omission to do so resulted in under assessment of book profit of Rs. 41.24 crore. Department stated that in accordance with the Supreme Court judgment in the case of M/s Apollo Tyres, no adjustment can be made to the computation under section 115JB as provided by the assessee. Reply is not tenable as the Supreme Court judgment does not prohibit making adjustments provided in the Act. The above liabilities are contingent in nature and covered under section 115JB (2), which are required to be added while computing book profit.	3.49
--	-------------------	--	------

Two similar cases are featured at **serial number 81 to 82 of Appendix 4.**

1.5.31 Incorrect computation of capital gains

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. The mode of computation of capital gains in respect of long-term asset provides for deduction of cost of acquisition and expenditure incurred wholly and exclusively in connection with such transfer.

The assessing officer did not apply the above provisions correctly in the three cases, resulting in tax effect of Rs. 29.57 crore. One case is illustrated below:

In City II, Mumbai charge, the assessment of a company **M/s. Tata Motors Ltd** for the assessment year 2000-01 was completed after scrutiny in March 2003. Audit scrutiny revealed that the assessee had an income of Rs. 55.53 crore under the head 'long term capital gains'. However, in computation of income from long-term capital gains, an amount of Rs. 5.53 crore only was considered. Thus income to the extent of Rs. 50.00 crore was underassessed. Further, the assessee had entered into a share sales agreement with M/s. Lucent Technologies International Inc. USA in March, 2000. The assessing officer, while computing the capital gains on sale of such shares, considered only initial payment received by the assessee. The subsequent consideration received was not taken into account despite the fact that a letter was submitted by the assessee to this effect in November 2004. This resulted in under assessment of income of Rs. 21.84 crore. The above omissions resulted in short levy of tax of Rs. 27.65 crore (potential). On this being pointed out by audit the department has rectified the assessment in January 2006.

Two similar cases are featured at **serial number 83 to 84 of Appendix 4.**

1.5.32 Incorrect allowance of depreciation and set off of losses

Depreciation is allowable on know how, patents, copyrights, trade marks, licenses, franchises or any other business or commercial rights of similar nature, being intangible assets acquired on or after 1 April 1998, owned wholly or partly by the assessee and used for the purpose of the business or profession, at the applicable

rates prescribed. If there is no positive income in the current year, losses can be carried forward to the subsequent year for set off. Loss under the capital gains can be set off only against income from capital gains in the same year and in subsequent years. For availing the benefit of section 10A/10B, loss relating to the business of the undertaking shall not be carried forward or set off, where such loss relates to any of assessment years prior to assessment year 2000-01.

Audit noticed mistakes relating to non adherence of above provisions in 65 cases involving tax effect of Rs. 369.03 crore. Four such cases are given below:

1.5.32.1 In City 2 Mumbai charge, the assessments of a company **M/s. Tata Motors Ltd** for the assessment years 2003-04 and 2004-05 were completed after scrutiny in January 2006 and in summary manner in July 2005 respectively. Audit scrutiny revealed that the assessee had paid tax U/s.115-JB. The income under normal provisions of the Act was computed at Rs. 118.73 crore after setting-off the brought forward business loss and depreciation of Rs. 1149.62 crore whereas the available brought forward business loss and depreciation was Rs. 472.35 crore only. Had the correct amount of brought forward loss and depreciation been set off, the tax payable under the normal provisions of the Act would have been higher than that under the special provisions, and hence should have been taxed as such. The omission resulted in under assessment of income of Rs. 677.27 crore with consequent short levy of tax of Rs. 261.13 crore. Department has accepted the audit observation and taken remedial action.

1.5.32.2 In City 7 Mumbai charge, the assessments of a trading company, **M/s. Procter and Gamble House Products Ltd**, for the assessment years 2002-03, 2003-04 and 2004-05 were completed after scrutiny and in summary manner in March 2005, March 2006 and January 2005 respectively. Audit scrutiny revealed that the assessing officer allowed set off of brought forward losses of Rs. 75.83 crore pertaining to the years 1998-99 and 1999-2000 during the years 2002-03, 2003-04 and 2004-05 whereas brought forward losses available for the said assessment years to be set off were Rs. 6.93 crore only. It was noticed that the figures of losses had been adopted from the assessee's statement furnished along with the return for the assessment year 2002-03. Thus, the brought forward sets off of losses have been exceeded by Rs. 68.90 crore. Further, the assessee was also allowed to set off long term capital loss of Rs. 91.65 lakh from the business income incorrectly during the assessment year 2002-03. The above omissions resulted in under assessment of income totalling Rs. 69.82 crore and consequent short levy of tax of Rs. 33.64 crore.

1.5.32.3 In City 2 Mumbai charge, the assessments of a company, **M/s. Tata Motors Ltd**, for the assessment year 2003-04 were completed after scrutiny in March 2006. Audit scrutiny revealed that the assessee had business income of Rs. 518.65 crore. The brought forward depreciation including that of assessment year 2002-03 worked out to Rs. 820.65 crore. After allowing the above business income to set-off against the brought forward depreciation, the balance amount of depreciation allowed to be carried forward works out to Rs. 302.00 crore

whereas the department allowed the amount of depreciation to be carried forward at Rs. 378.67 crore resulting in excess allowance of depreciation of Rs. 76.67 crore with consequent short levy of tax of Rs. 28.17 crore. Department accepted the observation and stated that necessary remedial action would be taken.

1.5.32.4 In City 7 Mumbai charge, the assessment of a software company **M/s. Siemens Information Systems Ltd** for the assessment year 2002-03 was completed after scrutiny in February 2005. Audit scrutiny revealed that the assessing officer allowed exemption u/s.10A of Rs. 72.76 crore as against the business income of Rs. 45.22 crore resulting in net loss of Rs. 27.54 crore. The resultant loss was allowed to be carried forward. Audit noticed that business loss of Rs. 20.02 crore and unabsorbed depreciation of Rs. 33.06 crore pertaining to the period from assessment year 1994-95 to 2001-02 was also allowed to be carried forward. This resulted in incorrect allowance of carry forward of losses of Rs. 80.62 crore with consequent short levy of tax of Rs. 28.78 crore (Potential).

One similar case is shown in Table 13 below:

(Rs. in crore)

Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Trading sector			
1. M/s National Mineral Development Corporation Ltd, Hyderabad IV	2002-03 to 2004-05 143(3) 2005-06 143(1)	The assessee was allowed depreciation debited to profit and loss account as per Company's Act. However, instead of depreciation of Rs. 39.91 crore, Rs. 42.27 crore, Rs. 53.98 crore and Rs. 63.84 crore which stood debited to the profit and loss account, amounts of Rs. 35.60 crore, Rs. 37.35 crore, Rs. 52.92 crore and Rs. 63.33 crore were added back towards depreciation as per Company's Act on the assets of both production unit and head office for assessment years 2002-03 to 2005-06 respectively. Thus omission to add back the correct depreciation resulted in excess allowance of an aggregate depreciation of Rs. 10.80 crore for these years.	3.91

Five similar cases are featured at **serial number 85 to 89** of **Appendix 4**.

1.5.33 Under valuation of closing stock

Under section 145A of the Act, effective from 1.4.99, the valuation of inventories for the purpose of determining the income chargeable under the head "Profits and gains of business or profession" shall be adjusted to include the taxes actually paid or incurred by the assessee to bring the goods to the place of its location and condition as on the date of valuation. Under section 4 of Central Excise Act, central excise duty is levied on 'transaction value' even though sales are effected at varying prices to different customers/buyers. The 'transaction value' is meant to include any amount, which is paid or payable by the buyer on account of sale of goods.

Audit noticed that the above provisions were not followed correctly in valuation of closing stock in six cases involving tax effect of Rs. 33.38 crore. Three of these cases are shown in Table 14 below:

(Rs. in crore)

Table 14 : Under valuation of closing stock

Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Automobile including ancillaries sector			
1. M/s Exide Industries Ltd, Kolkata I	2002-03 2003-04 143(3)	The closing stock including excise duty was incorrectly valued at Rs. 57.51 crore and Rs. 62.56 crore instead of Rs. 74.24 crore and Rs. 99.97 crore in these years respectively. The omission resulted in short computation of profit of the year and consequent under assessment of income. The assessing officer contended that some of the assessee's main products were exempted from levy of excise duty. The reply is not tenable as audit had not taken into account the value of exempted products.	13.57
2. M/s Exide Industries Ltd, Kolkata I	2001-02 2002-03 2003-04 143(3)	The assessee in computation of income followed the practice of claiming separate deduction of excise duty under section 43B and added back the same amount for tax during next assessment year though the amount of excise duty was debited in the profit and loss account. The separate deduction on that account amounted to double deduction for the respective year. Though the amount was added back during next assessment year, the assessee (i) availed excess deduction in each year, (ii) deferred levy and payment of tax and (iii) availed exemption of payment of interest u/s 220(2).	2.99
Steel sector			
3. M/s Jindal India Ltd, Kolkata I charge	2004-05 143(3)	Finished goods valued at Rs. 342.64 crore were removed from factory and were sold. The value represented the 'transaction value' of the goods sold during the year. But the assessee accounted for Rs. 305.48 crore only towards sale price of the finished goods removed from the factory. Omission to account the transaction value as sale price of goods sold during the year resulted in under assessment of income by Rs. 37.15 crore. The department has initiated rectification action.	13.33

Three similar cases are featured at **serial number 90 to 92 of Appendix 4.**

1.5.34 Incorrect allowance of sales tax liability

Sales tax is a trading receipt as well as a trading liability to be deposited in Government account and maintaining a separate account of sales tax for receipt and payment of sales tax does not alter the nature of receipt.

Audit noticed mistake in one case during the review which is given in Table 15 below:

(Rs. in crore)

Table 15 : Incorrect allowance of sales tax liability			
Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Steel sector			
1. M/s. Ispat Industries Ltd Kolkata I charge	2004-05 143(3)	The assessee debited a sum of Rs. 9.09 crore in P&L account as a prior period expense on account of sales tax and claimed it as deduction subject to provisions of section 43B. Since the assessee maintained separate account of receipt and payment of sales tax and did not credit the corresponding amount in P&L accounts as receipt of the business, the debit of Rs. 9.09 crore in P&L accounts as prior period expense on account of sales tax was irregular. In case of non-payment, the amount was to be included in outstanding liability u/s 43B and the amount was to be added back in computation of taxable income as it was debited in the P&L accounts. However, the assessing officer while computing the income has added this amount in the outstanding liability u/s 43B but he omitted to include in the income to nullify the debit entry of the P&L accounts. This resulted in under assessment of income.	3.26(P)

1.5.35 Incorrect computation of assets after amalgamation

Audit noticed mistakes in four cases where the benefit received from the scheme of amalgamation (being excess of fair value of net assets taken over by the assessee company over the paid up value of equity shares to be allotted) was not assessed by the assessing officer correctly resulting in escapement of income and tax effect of Rs. 29.87 crore. Two such cases are given in Table 16 below:

(Rs. in crore)

Table 16 : Incorrect computation of assets after amalgamation			
Sl No./ Name of assessee/ charge	Assessment years & type of asst	Nature of mistake	Tax effect
Software sector			
1. M/s Quintegra Solutions Ltd, Chennai III	2003-04 143(3)	Pursuant to a scheme of amalgamation by the Madras High Court's order dated August 2003, M/s. Transys Technologies Pvt. Ltd. was amalgamated with the assessee with effect from July 2002. After adjusting for the assets and liabilities of the transferor company, the excess of Rs. 35.98 crore over the net asset value acquired was accounted for as goodwill of the amalgamated company. As per the terms of the High Court order, the assets and liabilities of the transferor company from the appointed date stood transferred to the assessee and were hence assessable under section 28(iv) in the hands of the assessee. However, taxability of the same was not considered. Omission to do so has resulted in escapement of income.	15.74
Trading sector			
2. M/s Spencer & Co Ltd, Chennai III	2002-03 143(1)	M/s Spencer Industrial Fund Ltd was amalgamated with effect from April 2001 with the assessee as per the scheme of amalgamation sanctioned by the Madras High Court order dated 25 October 2002. In accordance with the said scheme the assets and liabilities, rights and obligations were vested in the assessee	13.28

	<p>company, and were recorded at their respective fair values. Fair value of net assets taken over by the assessee in excess of the paid-up value of equity shares to be allotted was computed at Rs. 28.99 crore and the same was transferred to general reserve. As the assessee company had received the benefit of Rs. 28.99 crore from the scheme of amalgamations, the same was required to be treated as business income and brought to tax, which was not done.</p>	
--	---	--

One similar case is featured at **serial number 93 of Appendix 4.**

1.5.36 Income escaping due to suppression of production and sales

Audit noticed two cases of suppression of production, sales and receipts by the assessee as illustrated below:

1.5.36.1 In Karnataka, Mysore charge, the assessments of a company, **M/s. Automotive Axles Ltd**, for assessment years 2002-03 and 2003-04 were completed in summary and after scrutiny in April 2003 and December 2005 respectively on the income returned by the assessee. A comparison of total turnover of the assessee company with that of purchases made by another company [M/s Meritor HVS (India) Ltd. assessed at Mysore] belonging to the same group during the previous year relevant to assessment year 2002-03 and 2003-04 by audit revealed that M/s Meritor HVS (India) Ltd was purchasing the products manufactured by the assessee company and marketing the same and the purchases made by it from the assessee company were in excess of the sales as shown in the profit and loss account of the assessee company. The excess of purchases made by the group company over the sales of the assessee company was Rs. 4.72 crore and Rs. 6.59 crore respectively for assessment years 2002-03 and 2003-04 implying thereby that the assessee company had suppressed sales to that extent for two assessment years.

The omission to exhibit correct sales by the assessee company resulted in escapement of income by like amount with short levy of tax and interest for short payment of advance tax aggregating at Rs. 5.11 crore for both the assessment years.

1.5.36.2 In Uttaranchal, Haridwar charge, based on the yield of several companies in steel sector, ACIT, Haridwar circle had observed that yield in cases of induction furnaces should be around 92.5 % of the raw material used. Audit noticed that while some of the units have shown yield ranging between 94 to 95 %, other units of **M/s Kotdwar Steels Ltd, M/s Charu Steel Ltd and M/s Amrit Varsha Udyog** for the assessment years 2002-03 and 2004-05 have shown production below 92.5% .The respective assessing officer, however, accepted the yield and completed the assessment in the same circle without giving cognizance to the aspect of yield. Thus non-existence of a uniform rate of yield in the circle resulted in short computation of production and thereby short charge of tax. Taking 92.5 % as standard yield observed by the department the short production shown by the above companies resulted in short charge of tax of Rs. 1.83 crore.

1.5.37 Irregularities in tax deducted at source

Audit noticed that the provisions relating to tax deducted at source were not followed correctly in five cases involving tax effect of Rs. 5.02 crore. Three such cases are featured at **serial number 94 to 96 of Appendix-4.**

1.5.38 Other cases

Audit noticed 89 other mistakes such as mistakes in adoption of figures, incorrect rates, defaulting interest, under assessment of wealth, etc involving tax effect of Rs. 10.52 crore. One such case is shown below:

1.5.38.1 Underassessment of wealth

Under the Wealth Tax Act, 1957, where the net wealth of a company exceeds Rs. 15 lakh, tax is levied at one percent of the amount by which the net wealth exceeds Rs. 15 lakh. Net wealth means value of all 'assets' *interalia*, including immovable properties, motor cars, jewellery, aircrafts, urban lands and cash in hand not recorded in the books of accounts provided that where any of the assets is used by the assessee as stock in trade, such asset shall be excluded.

In Kolkata I charge, **M/s. Ispat Industries Limited**, acquired urban land situated at Peddar Road Bombay prior to 31 March 2000 at a value of Rs. 108.90 crore and held it for industrial purpose (treated as freehold land under fixed asset) for 2 years without utilization as on 31 March 2002. Under provision of Wealth Tax Act, landed property was required to be treated as 'asset' for levy of wealth tax during assessment year 2002-03. However, no wealth tax was levied. The omission resulted in non-levy of wealth tax of Rs. 1.09 crore. The assessing officer has not accepted the audit observation on the grounds that the land had been converted to stock-in-trade during assessment year 2003-04 and the same was being used for business purpose. However as per audit, wealth tax would be leviable for the assessment year 2002-03 i.e. prior to conversion and also on account of the fact that the land was being commercially developed as mentioned in the notes to accounts.

1.5.38.2 Three cases relating to short levy of interest, incorrect rate of income tax and mistakes in adoption of figures are featured at **serial number 97 to 99 of Appendix 4.**

1.6 Conclusions and recommendations

1.6.1 Effective rate of tax in respect of selected companies in selected sectors, which were assessed under the normal provisions of the Act before audit by CAG were estimated as 20 percent, 27 percent and 17 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively.

1.6.2 Effective rate of tax in respect of selected companies in selected sectors which were assessed under the normal provisions of the Act after audit by CAG were estimated as 23 percent, 28 percent and 21 percent in assessment years 2002-03, 2003-04 and 2004-05 respectively.

1.6.3 In the four selected sectors the companies showing profits and assessed under the normal provisions of the Act in all the three years under consideration have paid a higher effective tax rate than the companies who have shown profits and were assessed under the normal provisions in only one or two of the three years under consideration.

1.6.4 Tax expenditure in respect of all the provisions of the Act for all the selected companies in the four selected sectors for the assessment years 2002-03, 2003-04 and 2004-05 were Rs. 915.3 crore, Rs. 768.7 crore and Rs. 2287.6 crore respectively.

1.6.5 Tax expenditure in respect of deductions relating to Chapter VIA of the Act for all the selected companies in the four selected sectors for the assessment years 2002-03, 2003-04 and 2004-05 were Rs. 235.6 crore, Rs. 228.7 crore and Rs. 302.7 crore respectively.

1.6.6 The potential additions made by the department as a result of its assessment functions in respect of selected companies of the four selected sectors, which were assessed under the normal provisions of the Act improved during assessment year 2003-04 as compared to that in assessment year 2002-03 but decreased during assessment year 2004-05.

1.6.7 Voluntary compliance by the selected companies of the four selected sectors, which were assessed under the normal provisions of the Act has improved during the period under consideration. Further voluntary compliance in the selected sectors is more by those companies which have shown profits in all the three years under consideration and were assessed under the normal provisions of the Act as compared to the companies, which have shown profits in only one or two of the three years.

Audit recommends that variations in profit pattern of companies/assessment under the special provisions of the Act could be given a higher weightage while selecting the cases for scrutiny.

In the exit conference, Board accepted the recommendation and informed that this aspect is likely to be taken care of in the new method of computer-assisted selection (CAS) of cases for scrutiny by the department.

1.6.8 For the computer sector, the areas where more irregularities have been noticed were exemptions under section 10 A/10 B, deductions under Chapter VIA, allowance of provisions and liability and computation of business income.

1.6.9 For the automobile including ancillaries sector, the areas where more irregularities have been noticed were allowance of depreciation and set off of losses, computation of income under special provisions of the Act and allowance of provisions and liability.

1.6.10 For the steel sector, the areas where more irregularities have been noticed were computation of income under special provisions of the Act, computation of business income and allowance of depreciation and set off of losses.

1.6.11 For the trading sector, the areas where more irregularities have been noticed were allowance of depreciation and set off of losses and allowance of provisions and liabilities.

1.6.12 Taking all the four selected sectors together maximum tax effect has been noticed in incorrect allowance of depreciation and set off of losses. The reasons for these omissions have been depreciation as per Companies Act not being added back or depreciation on account of irregular valuation of assets having been allowed etc. and incorrect set off of previous losses.

Audit recommends that the claims related to depreciation and set off of losses should be linked with last available assessment records so as to ensure correctness of set off.

In the exit conference, Board accepted the recommendation and stated that the possibility of creating database in this respect will be examined. Till such time, instructions will be issued to field formations for carrying out the necessary verification at the time of assessment with reference to physical records.

1.6.13 Another area of irregularities noticed in respect of the four selected sectors pertain to sections 10A, 10B and deductions under chapter VIA such as 80HHE, 80IA, 80IB etc especially in respect of computer software.

- Several instances were noticed, where expenditure having been incurred in respect of freight, telecommunication charges or insurance and technical services outside India have been reduced from total turnover for calculating deductions under sections 10A and 10B although it should be excluded from the export turnover only.
- Instances were also noticed, where the assessee were changing their options of availing deductions under section 10A/10B in one assessment year and under section 80HHE in subsequent assessment years or vice versa though it is not allowed in the Act.
- Instances have also been noticed, where losses of undertakings availing benefits under section 10A/10B were set off against taxable income of undertakings not covered under section 10A/10B belonging to the same assessee.
- Another area of misuse noticed is incorrect computation of income under special provisions of the Act especially in the automobiles and ancillaries and steel sectors.

Audit recommends that the government may consider issuing explicit guidelines on these issues so as to ensure greater clarity. Keeping in mind the quantum of revenue loss to the Government audit recommends that the internal control mechanism of the Department be strengthened so as to have better monitoring and linking of records, improved coordination among assessing officers and higher quality assessments.

During the exit conference, Board accepted the recommendations and stated that the process of reorganisation of the internal audit of the department was already on.

Chapter II

Review on implementation of TDS/TCS schemes

- **Highlights**
- **Introduction**
- **Audit methodology**
- **Audit Findings**
 - **Identification of potential deductors/activities liable to TDS**
 - **Application of TDS provisions: Non residents**
 - **Application of TDS provisions: Residents**
 - **Issues in accounting**
 - **Evaluation of e-TDS system**
 - **Application of TDS provisions: TCS**
 - **Conclusion and recommendations**

Highlights

In this review, 246 TDS units, 174 regular assessment units and 15 international taxation units were audited and 32630 cases test-checked. Audit noticed mistakes in 12814 cases involving revenue impact of Rs. 389.20 crore; of this penalty leviable was Rs. 63.23 crore. Cases relating to income escaping assessment, non/short deduction of TDS, involving possible revenue loss was of Rs. 52.90 crore. This was also inclusive of mistakes noticed in 82 cases of non-residents/foreign companies involving revenue impact of Rs. 204.19 crore.

In spite of the increase registered in the number of transactions that are covered under the TDS scheme and the overall growth in the economy, there had been a decline in the number of effective tax deductors over the years.

(Para 2.9.1.4)

Data collected by audit indicated large potential for TDS and TCS from insurance commission, reinsurance commission, payments to non-residents and sale of liquor.

(Para 2.9.3 & 2.14.1)

Mistakes relating to tax deduction at lower rates from income of non-residents by way of royalty and fees for technical services owing to incorrect determination of PE were noticed in nine cases involving a revenue impact of Rs. 58.97 crore.

(Para 2.10.1)

Failure to disallow expenditure in cases of non deduction of TDS in respect of payment made to NRI/foreign companies were noticed in 19 cases involving revenue impact of Rs. 93.13 crore.

(Para 2.10.2)

Audit noticed mistakes in 72 cases wherein income of Rs. 39.79 crore on which TDS had been deducted escaped assessment involving revenue loss of Rs. 14.97 crore.

(Para 2.11.1)

Mistakes relating to non/short deduction of TDS were noticed in 273 cases involving possible revenue impact of Rs. 77.04 crore including interest and penalty.

(Para 2.11.2)

Failure to remit TDS into government account in 34 cases indicated possible loss of revenue of Rs. 6.92 crore.

(Para 2.11.3)

Failure to disallow the expenditure on which tax had not been deducted or after deduction was not paid into Government account during the previous year within time prescribed was noticed in 332 cases involving revenue impact of Rs. 45.45 crore.

(Para 2.11.5)

10549 cases of late filing of returns were noticed with delays ranging from 1 day to 1406 days and the penalty leviable in these cases was Rs. 5.54 crore.

(Para 2.11.7)

TDS credits held in suspense showed an increasing trend over the period 2002-03 (Rs.799.37 crore) to 2005-06 (Rs.10011.49 crore) in 5 states.

(Para 2.12.2)

Review of e-TDS indicated that e-TDS returns filed remained unprocessed for the past three years largely due to software related problems and inadequacy of trained manpower. There was also no proper system for preservation and storage of records in magnetic media.

(Para 2.13)

Audit noticed mistakes relating to omission to collect tax at source in 16 cases involving a revenue impact of Rs. 3.90 crore.

(Para 2.14.3)

Audit recommends that

- Ministry may take necessary steps to bring in all tax deductors into the tax net and enforce recovery of TDS/TCS as required under the Act.
- Adequate enforcement mechanism be evolved to ensure consistency in assessment and prevent loss of revenue, particularly in the important area of international taxation. Coordination between TDS and regular assessment units as also internal audit mechanism should be strengthened.
- Problems relating to software and inadequacy in trained manpower are attended to urgently so that e-TDS returns are processed and revenues due to Government realised. Further, arrangements for ensuring storage and preservation of records in magnetic medium need to be ensured.
- A time limit for completion of TDS/TCS assessments may be prescribed so as to ensure early realisation of any revenues due to Government

Review on implementation of TDS/TCS schemes

2.1 Introduction

Mobilisation of resources in direct taxes is carried out through levy of taxes mainly at two levels viz. pre-assessment and post assessment. Pre-assessment collections form a major portion of revenue collection in several countries as it is relatively easy to administer, cost effective, and reduces pressure on the revenue authorities as the onus for collection and deposit of taxes shifts to the persons responsible (tax deductors) for effecting payments. Post assessment collections on the other hand, requires the deployment of more resources on the part of revenue administration.

2.1.1 Direct taxes collected prior to assessment may be classified as follows:

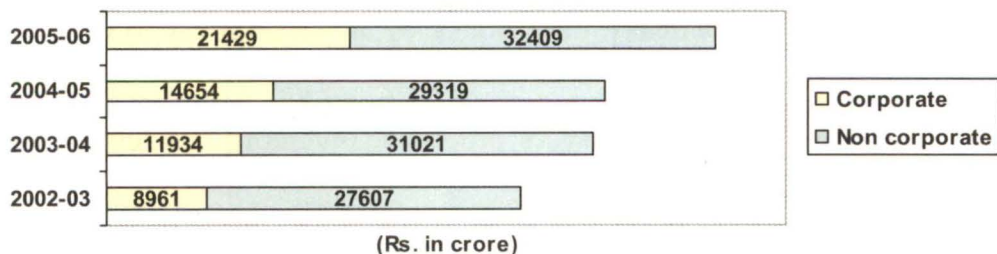
- (i) Tax deducted at source (TDS)
- (ii) Tax collected at source (TCS)
- (iii) Advance tax
- (iv) Self assessment tax

2.1.2 TDS, also referred to as ‘withholding tax’ in the case of transactions involving non residents, gives the government the whole or part of the tax on the taxable income earned by an assessee even before the relevant income is received by him. Tax collection at source is resorted to where there is an identified risk of incomes liable to tax escaping assessment as also the non viability of collection of tax at the end due to large numbers such as in the case of liquor sales and forest produce.

2.2 Trends in tax deduction at source

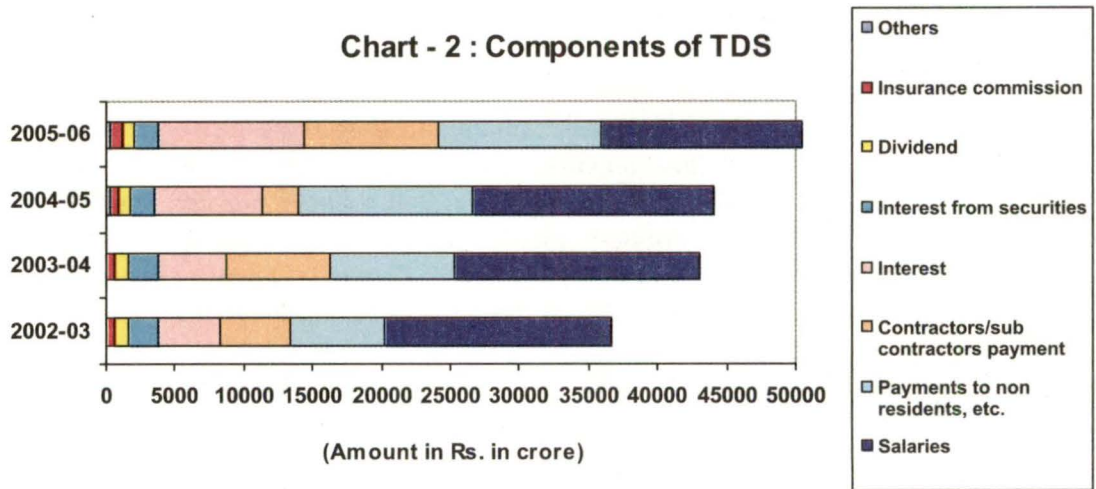
2.2.1 Pre-assessment collection (2005-06) of direct taxes in India comprises 83 percent of the total direct tax collections, of which approximately 33 percent comes from TDS. TDS is the predominant mode of revenue realisation in respect of non corporate assessees, comprising almost 52 percent of their tax payments. Trends of tax deducted at source from corporate and non corporate assessees are indicated in Chart-1 below[^].

Chart - 1 : Tax deducted at source



[^] Chapter II of Audit Reports on Direct taxes of the relevant years

2.2.2 A study of the components and growth of TDS during the past four years shows a mixed trend as detailed in Chart-2.



2.2.3 During the period 2002-03 to 2005-06, major components of TDS were from salaries, payments to non residents, interest and payments to contractors and sub-contractors. These sources together contributed about 92 percent of total TDS collections.

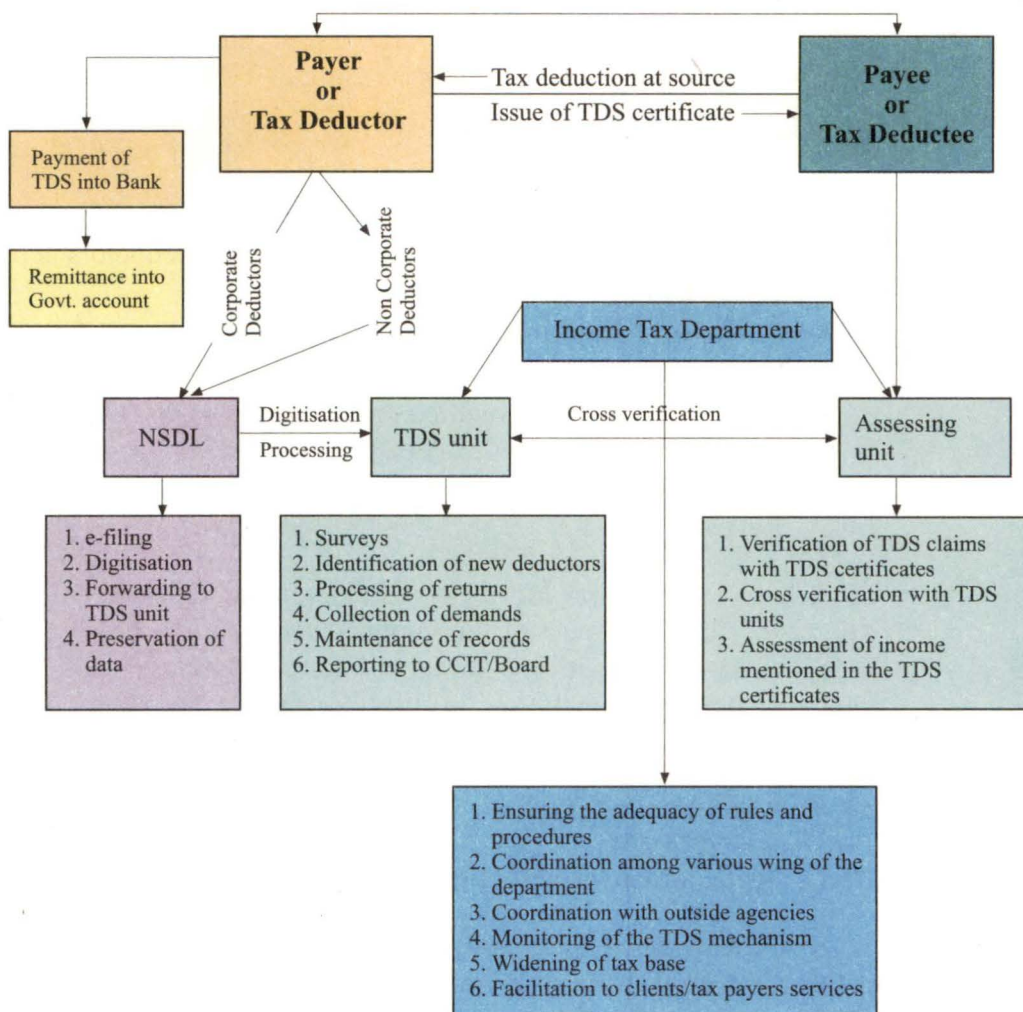
(Rs. in crore)

	2002-03	2003-04	2004-05	2005-06
Salaries	16293	17712	17341	17941
Payments to non residents, etc.	6884	8996	12711	11834
Contractors/sub contractors payment	5056	7543	2535	9638
Interest	4485	4930	7833	10585
Interest from securities	2232	2214	1849	1871
Dividend	1098	950	852	752
Insurance commission	384	434	523	967
Others	136	176	329	250
Total TDS collected	36568	42955	43973	53838

2.3 Organisational set up and functions

2.3.1 There is a dedicated set up in the ITD for administering TDS comprising of a CCIT supported by CsIT/Addl.CsIT/JCsIT/DCsIT/ACsIT/ITOs. The functions of TDS units include identifying new tax deductors through surveys, creation of database, identification of stop filers/non filers, allotment of TAN, ensuring prompt collections and remittances, processing of returns, coordination with assessing units etc. At the CBDT, Member (Revenue) monitors and coordinates the administration and implementation of TDS provisions. The flow of TDS activities in detail is as follows:

Chart 3: Flow of TDS Activities



2.3.2 In respect of non residents there is a Director General of International Taxation at New Delhi whose jurisdiction extends over the Director of Income Tax (International Taxation) located at New Delhi, Mumbai, Kolkata, Chennai, Bangalore and Hyderabad. All tax assessments including matters relating to TDS are processed by these officers. In other places the jurisdictional CCsIT exercise jurisdiction over non resident taxation matters.

2.3.3 Director General of Income Tax (Systems) is in-charge of computerisation in the Department which includes acquisition of hardware and software apart from programme implementation, delivery and support to field formations. In so far as the TDS mechanism (including e-TDS/e-TCS) is concerned their functions include troubleshooting, facilitation and change management.

2.4 Law and procedure

Detailed procedure in regard to TDS and TCS is laid down in Chapter XVII – Collection and recovery of the Income Tax Act, 1961. Other related provisions include section 40(a)(i), 40(a)(ia), 44D, 90, 92, 115A and 195. No time limit has been prescribed under the Act for processing of TDS/TCS returns.

2.5 Objectives of the review

The following specific issues were examined in audit to verify:

- the extent of identification of potential deductors/activities liable to TDS/TCS;
- the application of the provisions of the Act relating to TDS/TCS with regard to both non residents and residents;
- the correctness of accounting procedures in TDS/TCS; and
- the implementation of e-TDS scheme.

2.6 Past study

The scheme of TDS was last reviewed in audit and reported in Chapter 3 of Report No. 12 of 1999 in respect of the implementation of the newly introduced sections 194C and 194E. The review revealed failures relating to non deduction of tax at source from payments to contractors/sub contractors and non resident sportsmen/sports associations involving revenue impact of Rs. 164.24 crore.

2.7 Audit methodology

2.7.1 Scope and coverage of the review

In the current study, records at both TDS units and assessment units were test checked. Records scrutinised included returns (both TDS and income tax returns), assessment records and related registers maintained in 246 TDS units, 174 assessment units and 15 international taxation units relating to the period 2002-03 to 2005-06.

2.7.2 Sample Size

The selection of TDS units for review was as per the criteria given below:

Sl. No.	Jurisdiction	No. of CIT charges selected (in percent)	No. of units to be selected*	Coverage (Percent)
1.	4 Metros, Karnataka and Gujarat	25	TDS Circle	100
			TDS Wards	50
2.	Other	30	TDS Circles	100
			TDS Wards	50

* In selected unit sample size consisted of TDS/TCS returns of more than Rs.10 lakh (100 percent) and less than Rs.10 lakh (10 percent) subject to a minimum of 100 returns

2.8 Exit conference

An exit conference was held on 5 January 2007 wherein the audit findings and recommendations were discussed with the concerned officers in the Ministry. Ministry agreed to examine the issues raised in the audit study.

2.9 Audit findings

Section A Identification of potential deductors/activities liable to TDS

Audit sought to examine the adequacy of the procedures in the Department for ensuring compliance by existing tax deductors as also to bring in new entities into the tax net. The result of audit examination is detailed below:

2.9.1 Identification and registration of tax deductors

2.9.1.1 With a view to identifying potential tax deductors within the ambit of the TDS/TCS scheme, audit independently attempted to estimate activities/entities who should have been registered as tax deductors. The data was compiled covering colleges, public sector undertakings, local bodies, cooperative societies, banks and other financial institutions, treasury officers, drawing and disbursing officers, etc. from generally available sources in the public domain including websites of statutory organisations (RBI, UGC, etc), yellow pages and economic surveys. Audit also collected data on the number of tax deductors available on the records of the Department from the various jurisdictions.

2.9.1.2 In Assam, Delhi, Gujarat, Goa, Kerala, Maharashtra, Punjab, Chandigarh (UT), Rajasthan and West Bengal it was observed that there was a large gap in the number of tax deductors on the records of the Department as compared to those liable to be registered. As against 1.10 lakh* deductors indicated by the Department, the audit exercise revealed potential for registering about 15 lakh tax deductors (Appendix 5).

2.9.1.3 Further, audit compiled data on the number of tax deductors as available in the progress report of the Income Tax Department at the beginning and end of the year which is given in Table 3 below:

Year	No. of tax deductors as on 1 April	No. of tax deductors as on 31 March
2002-03	1026739	1101830
2003-04	653538	626055
2004-05	626055	577131
2005-06	577131	460277

* Except Andhra Pradesh, Chandigarh (UT) and Delhi where the Department did not produce records

^y Source: Progress report of the Income Tax Department by Directorate of Research and Statistics

2.9.1.4 The figures indicated that in spite of the increase registered in the number of transactions covered under the TDS scheme and the overall growth in the economy, there has been a decline in the number of effective tax deductors over the years. The number of deductors as on 31 March 2006 was 55 percent lower than as on 1 April 2002.

Ministry during exit conference while agreeing to examine the issue stated that the TAN database is being updated and cleaning of TAN master is under process to take care of redundant TAN.

2.9.2 Surveys by TDS units

In order to ensure that all entities that are liable to deduct or collect tax at source are brought on the records of the Department, TDS units are required to examine the income tax assessments, connected records and conduct surveys. Survey reports prepared thereafter by the TDS units need to be followed up for compliance from the defaulters. This protocol needs to be proactive not only to identify new tax deductors/collectors but also to ensure the correctness and completeness of the returns filed by the existing tax deductors.

Audit scrutiny of records maintained in 246 TDS units indicated that in **Jharkhand, Assam and Orissa** no surveys had been carried out. In **Uttar Pradesh (Meerut charge)** surveys had been carried out but survey reports had not been finalised (June 2006) even after a lapse of 2 years. In **Madhya Pradesh (Bhopal and Indore charges)** audit could not derive an assurance that surveys had been carried out as the relevant records were not made available.

2.9.3 Identifying activities liable for deducting tax at source

2.9.3.1 Deduction of tax at source from insurance business

Audit sought to examine the adequacy of tax deducted at source in one growing sector viz., the insurance sector. There are 29 companies (8 public sector and 21 private sector) involved in insurance activities (14 life, 14 non life and 1 reinsurance)*. Payments, commissions, rewards, etc for soliciting or processing insurance business (including for continuance, renewal or revival of policies), are liable for deduction of tax at source.

Data collected by audit indicates the potential for revenue collection (i.e. deduction of tax at source) of Rs. 1118.28 crore from regular insurance commission vis-à-vis the amount actually collected as brought out in Table 4 below:

* Annual Report 2004-05 of Insurance Regulatory and Development Authority (IRDA)

(Rs in crore)

SI No	Particulars	2001-02	2002-03	2003-04	2004-05
1.	Commission payment by life insurers*				
	Public Sector (LIC)	4519.32	5015.08	5742.92	6203.23
	Private Sector	49.09	153.03	415.42	854.73
2	Commission payment by non life insurers*				
	Public Sector	657.42	935.71	1092.29	1233.20
	Private Sector	5.92	42.56	109.65	228.20
	Total	5231.75	6146.38	7360.28	8519.36
3	Rate of TDS under section 194D (including surcharge)	10.2%	10.2%	10.2%	10.2%
4	Tax deductible at source	533.64	626.93	750.74	868.97
5	Tax deducted by the Department#	321	384	434	523
6	Revenue gap	212.64	242.93	316.74	345.97

* Annual Reports of Insurance Regulatory and Development Authority (IRDA)
Chapter II of Audit Reports on Direct taxes of the relevant years

2.9.3.2 Deduction of tax at source on reinsurance commission charges

Payments made towards reinsurance commission by insurance companies are liable for TDS as the payment is in the nature of commission. Audit scrutiny of annual reports of five insurance companies revealed that these companies in **Chennai, Delhi, Kolkata and Mumbai** had made payment towards reinsurance commission of Rs. 6189.66 crore during the period from 2001-02 to 2004-05 on which no tax had been deducted at source by the payers. The potential for revenue collection (i.e. deduction of tax at source) in this transaction worked out to Rs. 631.34 crore apart from applicable interest and penalty (Table 5):

(Rs in crore)

SI No	Particulars	2001-02	2002-03	2003-04	2004-05
1	General Insurance Corporation of India Ltd.	836.38	959.56	1116.82	1274.31
2	National Insurance Company Ltd.	69.72	27.55	25.87	19.31
3	The New India Assurance Co Ltd.	386.72	480.86	58.49	595.25
4	The Oriental Insurance Co Ltd.	76.65	36.47	33.53	28.35
5	United India Insurance Co Ltd.	74.84	39.05	35	14.93
6	Total commission paid	1444.31	1543.49	1269.71	1932.15
7	Rate of TDS under section 194D (including surcharge)	10.2%	10.2%	10.2%	10.2%
8	Tax deductible at source	147.32	157.43	129.51	197.08

* Annual Reports of the concerned companies for the relevant years

On this being pointed out in audit in **Maharashtra, Mumbai charge**, in the case of **General Insurance Corporation of India Ltd**, the Department took remedial action and raised a demand of Rs. 466.77 crore (including interest) for the assessment years 2004-05 to 2006-07 (October 2006).

2.9.3.3 Similarly, the above companies had also received payments towards reinsurance commission which is also liable for TDS as the payment is in the nature of commission. Audit study of annual reports of five insurance companies revealed that these companies in **Chennai, Delhi, Kolkata and Mumbai** had received reinsurance commission of Rs. 2820.47 crore during the period from 2001-02 to 2004-05 on which no tax had been deducted at source by the payers. The potential for revenue collection (i.e. deduction of tax at source) in this transaction worked out to Rs. 399.25 crore.

Ministry during exit conference agreed to examine the issue.

2.9.3.4 Deduction of tax at source from payments to non-residents

The quantum of outflows or payments to residents abroad on account of payments such as salaries, commission, royalties, dividends etc. which are liable for tax deduction at source subject to the conditions specified in the Act indicates the potential for revenue collection in this area (i.e. deduction of tax at source) as brought out in the following Table 6 :

(Rs. in crore)

Sl. No.	Particulars	2002-03	2003-04	2004-05
1.	Total (Services*, transfers [§] and income ^{&})	122574	120575	184222
2.	Rate of TDS (considered at lowest slab)	15%	15%	15%
3.	Tax deductible at source	18386.10	18086.25	27633.30
4.	Tax deducted as per Department[#]	6884	8996	12711
5.	Revenue gap	11502.10	9090.25	14922.30

Source: RBI -INDIA'S OVERALL BALANCE OF PAYMENTS IN RUPEES
 * Software services, business services, financial services and communication services
 § Official, Private
 & Investment income and compensation of employees
 # Chapter II of Audit Reports on direct taxes of the relevant years

Ministry during exit conference agreed to examine the issue.

2.9.3.5 Deduction of tax at source from fee for technical services (194 J)

Any person making payment to a resident by way of fees for professional services or technical services is required to deduct tax @ five percent of such sum, at source along with surcharge and education cess wherever applicable.

The Reserve Bank of India had authorised setting up of 43 centres to be managed by 13 public sector banks* for providing cheque clearing facility. Customer banks availing of these services were to pay magnetic ink character recognition (MICR) charges at the prescribed rates fixed by RBI and to deduct tax at source from these payments.

* Andhra Bank, Bank of Baroda, Bank of India, Canara Bank, Central Bank of India, Corporation Bank, Oriental Bank of Commerce, Punjab National Bank, State Bank of India, State Bank of Indore, State Bank of Travancore, State Bank of Hyderabad and Union Bank of India

In Gujarat, Orissa, Uttar Pradesh and Chandigarh (UT), State Bank of India (SBI), Bank of Baroda (BoB) and Punjab National Bank (PNB) had been authorised to run MICR centres. Test check by audit revealed that customer banks were paying MICR charges to SBI, BoB and PNB without deducting tax at source in 227 cases (221 cases in Gujarat, one case in Orissa, four cases in Uttar Pradesh and one case in Chandigarh) involving revenue impact of Rs. 5.46 crore of which two cases are given below.

(Rs. in lakh)

Sl. No	State	Name of the Bank	Tax due	Interest due	Penalty leviable	Revenue impact
1.	Uttar Pradesh	Punjab National Bank	79.59	20.79	79.59	179.97
2.	Gujarat	Bank of Baroda	5.28	0.94	5.28	11.50

On this being pointed out in audit, Department agreed to take necessary action in Gujarat (and recovered Rs. 3.16 lakh in Vadodara) and Chandigarh (UT).

Section B Application of TDS provisions : Non residents

2.10 Domestic and Treaty Law

Two main principles underlie the basis of taxation of non residents' viz. the source and residence principle. Under the source principle, a country taxes all income earned from sources within its territorial jurisdiction whereas under the residence principle, a country taxes the world wide income of persons residing within its territorial jurisdiction. India combines both the source and residence principle for taxing incomes/payments made out of India. Determination of existence or otherwise of a permanent establishment (PE) decides the applicability and leviability of tax. Where there is a regular PE in India, then the non resident is expected to file a return on incomes derived on account of activities in India. Lower rates of taxation available under Double Taxation Avoidance Agreement (DTAA) are applicable only when royalty and fees for technical services are earned other than through a PE. In other cases, taxes are deducted at source, which in the case of payments to non residents is termed as withholding tax. To safeguard against non deduction of tax, expenditure on payments made to non residents without deducting tax at source is disallowed in the assessment of the assessee (payer).

DTAAs also provide for assistance for recovery of taxes due from non residents who have left India. However, such clauses for assistance in recovery of taxes are not available in DTAAAs with some countries such as USA, Australia and Singapore. Hence, there is a risk of loss of revenue to the Government in case TDS is not effected upfront at the time of making payments to non residents. Audit sought to examine the adequacy of the controls in place not only for enforcing TDS on payments to non residents but also the disallowance of expenditure where such taxes had not been deducted so as to safeguard the interests of revenue.

Audit scrutiny of records to verify the applications of TDS and related provisions revealed mistakes relating to short deduction of tax at source owing to ambiguities in determination of income relating to permanent establishment, failure to disallow expenditure (payments made to non residents) on which tax has not been deducted at source, etc. in **82 cases** involving a revenue impact of **Rs. 209.21 crore** of which penalty was **Rs. 5.02 crore**.

2.10.1 Ambiguities in determination of income relating to permanent establishment resulting in short deduction of tax at source

The definition of the term “permanent establishment (PE)” is critical in fixing the tax rates applicable to an assessee. Though the term “PE” ordinarily denotes a place of business or management, it also includes other activities such as facilities, installations, and oil wells etc. The existence of PE depends on a range of criteria which inter alia include period of stay, nature of activities and nature of contract. Whereas incomes attributable to PEs are taxable at higher rates, lower rates are applicable to cases where no PE exists.

In **Delhi DIT (IT) charge**, audit scrutiny of **nine cases** revealed mistakes relating to tax deduction at lower rates from income of non-residents by way of royalty and fees for technical services owing to incorrect determination of PE involving a revenue impact of **Rs. 58.97 crore**. **Two cases** involving revenue impact of more than Rs. five crore are illustrated below while **four cases** involving revenue impact between Rs. 50 lakh and Rs. five crore are indicated in Table 8 and cases less than Rs. 50 lakh have been shown in **Appendix 6**.

2.10.1.1 The assessment of a company, M/s Ericsson AB (based in Sweden), for the assessment year 2002-03 was completed after scrutiny in March 2005 wherein the assessing officer held that the assessee has permanent establishment in India by way of fixed place of business. Income arising to the assessee in India from royalty and technical fee was charged to tax at ten percent. Audit scrutiny of the DTAA between India and Sweden revealed that where an assessee is earning royalty or technical fee through a permanent establishment situated in other State, such income is taxable as business income in accordance with the domestic provisions of the State of source. Hence the income from royalty and technical fee was to be charged at the rate of thirty percent under section 115A (as the agreement for the instant transaction was entered into after July 1996) and not ten percent as done by the assessing officer. Failure to do so resulted in short levy of tax of Rs. 42.72 crore including interest.

2.10.1.2 The assessment of a company, M/s Oracle Corporation for the assessment year 2002-03 was completed after scrutiny in March 2005 determining an income of Rs. 103.17 crore. Audit scrutiny revealed that in the assessment order, the assessing officer had held the Indian subsidiary of the assessee as the permanent establishment of the parent foreign company and during the previous year assessee had earned royalty income of Rs. 74.61 crore. This income was charged to tax at

the rate of 15 percent as per provisions of DTAA instead of 20 percent as per the Act. The mistake resulted in short levy of tax of Rs. 5.23 crore including interest.

In its reply the Department stated that in the assessment order the assessing officer had not found royalty income to be effectively connected with the permanent establishment. Reply of the Department is not tenable as in the assessment order the assessing officer has neither discussed this issue, nor specified any reasons as to why the royalty income was not connected to the permanent establishment.

(Rs. in crore)

Table 8 Ambiguities in determination of income relating to permanent establishment

Sl No	Name of assessee	Asst Year	Asst. u/s	Nature of mistake	Revenue impact
1	UOPP Inter American Inc	2002-03	143 (3)	TDS affected @ 20 percent instead of 30 percent.	3.56
2	Mc Donalds Corporation	1997-98 to 2001-02	143 (3)	TDS was affected @ 15 percent on income from royalty as against 30 percent applicable for incomes attributable to PE	3.26
3	World Sport Nimbus Pvt Ltd	2002-03	143 (3)	Income from royalty and technical fees taxable @ 15 percent and 20 percent respectively was not effected	2.68
4	Electricite de France	2003-04	143 (3)	TDS was affected @ 10 percent on income from royalty and fee from technical services as against 20 percent applicable for incomes attributable to PE	0.68
Total					10.18

2.10.2 Non deduction of tax at source in respect of payment made to non residents – failure to disallow expenditure

Audit scrutiny in **Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu** revealed that payments made to non residents on which tax has not been deducted at source were not disallowed by the assessing officer. Audit noticed mistakes in **19 cases** involving revenue impact of **Rs. 93.13 crore**. **One case** involving a revenue impact of **Rs. 75.68 crore** is illustrated below. **Five cases** involving revenue impact of more than Rs. one crore are indicated in Table 9 while **eight cases** involving revenue impact between Rs. 10 lakh and Rs. one crore are shown in **Appendix 7**.

2.10.2.1 In DIT (IT) Mumbai charge, scrutiny of assessment records of an assessee, M/s Ballast Nedam Dredging revealed that for the assessment years 2001-02 and 2002-03, payments of Rs. 111.65 crore and Rs. 46.02 crore had been made to the Indian project office of a foreign company engaged in contract for dredging work on which no tax had been deducted at source. Since the income related to activities in India, these amounts were chargeable to tax in India and hence liable for TDS. Audit scrutiny however revealed that these payments had not been

disallowed in the hands of the assessee for not deducting tax at source. Failure to disallow the expenditure resulted in non levy of tax of Rs. 75.68 crore.

(Rs. in crore)

Sl. No.	CIT Charge	Name of the assessee	AY	Nature of Mistake	Tax Effect
1.	Chennai	India Additives (P) Ltd.	2000-01 & 2001-02	Assessee had paid Rs. 2.65 crore as royalty and Rs. 0.89 crore as fee for technical services without deducting tax at source.	4.22
2	CIT I, Chennai	M/s. Asia net communication Ltd., Chennai	2001-02	A sum of Rs. 7.64 crore was paid to a foreign company as transponder hire charges which are in the nature of technical know-how charges without deducting tax at source.	3.91
3	CIT I, Chennai	M/s. Hanil Lear India (P) Ltd Thiruvellur	2003-04	Expenditure of Rs. 5.18 crore towards technical fee paid to foreign companies was allowed though the chartered accountant has certified in Form 3 CD that TDS has been recovered but was not remitted to Government account during the previous year.	2.27
4.	CIT-III, Chennai	M/s Polaris Software Lab Ltd.	2002-03 and 2003-04	Payment of Rs. 112.08 lakh and Rs. 293.80 lakh respectively were made by the assessee company towards professional charges in foreign currency for which no tax was deducted or paid.	2.04
5	CIT I, Chennai	M/s. Indo National Ltd. Chennai 34	2001-02	The assessee paid Rs. 311.36 lakh towards technical fee to a foreign company and failed to deduct tax at source.	1.11

2.10.3 Other observations

Where a person responsible for deducting tax at source fails to deduct it or after deducting fails to pay the amount of tax in the Government account he shall be liable to pay interest for delays in remittance apart from penalty for default.

2.10.3.1 In DIT (IT), Mumbai charge, M/s Star Television Entertainment Ltd (STAR), a non-resident assessee, belatedly filed the return for assessment year 2003-04 in August 2004 (as against October 2003) indicating 'nil' income. No TDS certificate had been enclosed to the return. Assessee had contended that the telecasting advertisement revenue received by it was not chargeable to tax in India. However the payer of advertisement charges issued a TDS certificate to the assessee (STAR) in March 2006. Audit scrutiny revealed that instead of holding the assessee to be in default and levying interest for delay in payment of tax, the assessing officer allowed credit for the TDS certificate produced by the assessee and treated it as if tax was deducted and paid in time. This resulted in short levy of interest of Rs. 35.82 crore (u/s 234A and 234B) on STAR apart from levy of interest and penalty (u/s 201A) on the tax deductor for delay in remittance into Government account. The Department accepted the observation and initiated remedial action.

2.10.3.2 In DIT (IT) Mumbai charge, audit scrutiny of the records of a company M/s Reliance Industries Ltd., for the year 2002-03 and M/s Reliance Infocomm, Mumbai for the years 2002-03 to 2003-04 revealed that tax of Rs. 2.87 crore and Rs. 1.99 crore had not been deducted at source on payments made to non residents based in USA. This resulted in short collection of Rs. 4.86 crore apart from applicable interest and penalty of Rs. 6.91 crore.

2.10.3.3 In DIT (IT) Mumbai charge, M/s Rabo India Finance Pvt. Ltd. had filed TDS return for FY 2002-03 in April 2003 depicting a remittance of Rs. 30.30 lakh as TDS on gross payments of Rs. 1.80 crore. Audit scrutiny of the document (challans) enclosed with the return revealed that assessee had also made a remittance of Rs. 2.78 crore which was not indicated in the TDS return. Department had not initiated any action to verify the unexplained credit or rectify the return filed by the assessee.

2.10.3.4 In DIT (IT) Mumbai charge in three cases there were delays ranging from 2 months to 6 months in remittance of tax deducted at source, on which interest of Rs. 46.83 lakh was not levied. On this being pointed out in audit, the Department accepted the audit contention and initiated remedial action.

2.10.3.5 In Gujarat, CCIT Ahmedabad charge, audit scrutiny of the records of a company M/s Gujarat State Petroleum Ltd, Gandhinagar revealed that remittances had been made to non resident individuals and companies (as technical fee) without deducting taxes or by applying lower rates of tax. This resulted in short deduction of tax of Rs. 3.28 crore apart from interest of Rs. 39.44 lakh. Department agreed to take remedial action.

2.10.3.6 In Kerala, Kochi charge whereas DTAA with Poland, provided for tax rates at 15 percent for dividend and interest and 22.5 percent for royalty and fee for technical services, audit scrutiny of the returns filed by an assessee (M/s Cochin Shipyard Ltd) in Form 27 revealed that TDS had been effected at a lower rate of 4.2 percent as against the lowest applicable rate of 15 percent on the payments made to a non-resident based in Poland. Records made available to audit did not show that the deductor/ deductee had made any application to the assessing officer for deduction at a lower rate or on a lower income. Short deduction of tax worked out to Rs. 13.40 lakh apart from interest of Rs. 5.83 lakh.

2.10.3.7 Further in the same charge, audit scrutiny revealed that though DTAA rates were in the range of 10-15 percent for payments to non residents based in Singapore, TDS effected on payments to an assessee from June 2002 to September 2003 ranged from 20-27 percent. No reasons were forthcoming from the records as to why different rates of deduction had been applied.

2.10.3.8 In Kerala, Kochi charge in 14 cases involving a remittance of Rs. 15.30 crore, the correctness of the rates of TDS could not be verified in audit as residency particulars of the payee were not mentioned by the assessee and the same were also not called for by the Department. Thus audit could not derive an assurance on the correctness of the tax deducted at source.

2.10.3.9 In **Bangalore, Chennai and Delhi** charges audit noticed that in **six cases** payments had been made to non-residents without deducting tax or had been short deducted involving a revenue impact of **Rs. 1.11 crore** including interest and penalty.

2.11 Application of TDS provisions : Resident

During audit scrutiny of assessment records mistakes relating to income escaping assessment, non/short deduction of tax, allowance of business expenditure, credits allowed without TDS certificates, non/short levy of interest and penalty, failure to remit TDS collections/belated remittances in Government account, non levy of surcharge/education cess and other omissions were noticed in TDS units in **12,673 cases** involving revenue impact of **Rs. 170.81 crore**, of which penalty leviable was **Rs. 55.34 crore**.

2.11.1 Income escaping assessment

A crucial check to be exercised by the assessing officers before allowing credit for TDS certificates is to see whether the corresponding incomes had been offered to tax by the assessee.

In **Andhra Pradesh, Delhi, Jharkhand, Karnataka, Tamil Nadu, Uttar Pradesh and West Bengal charges**, in **72 cases** though tax credit as claimed by the assessee had been allowed in the income tax assessments, assessing officers had not ensured that the corresponding income was offered to tax. Income of **Rs. 39.79 crore** had not been offered to tax with a revenue impact of **Rs. 14.97 crore**. **Four cases** with revenue impact of more than Rs. 50 lakh are indicated in Table 10 while **23 cases** with revenue impact between Rs. 10 lakh and Rs. 50 lakh are shown in **Appendix 8**.

(Rs. in crore)

Sl. No.	CIT charge	Name of the assessee	Nature of asst /Asst Year	Amount	Tax effect
1.	CIT-III, Chennai	M/s PSEGPPN Operations (P) Ltd.	2002-03 143(1)	11.96	3.41
	CIT-VIII, Chennai	Streamline Forwarders	2002-03 & 2003-04 143(1)	3.17	1.16
	CIT-I, Chennai	APL Logistics Pvt. Ltd.	2001-02 143(3)	1.20	0.68
2.	CIT Delhi	M/s Lear Seating (P) Ltd	2001-02 143 (3)	2.19	1.33
	CIT Delhi	M/s. Krishna Engineering Works	2003-04 143 (3)	2.12	0.90
3	CIT-Muzaffarnagar	M/s Doaba Rolling Mills Pvt. Ltd.	2004-05 143(1)	2.26	0.89
4	CIT-V Hyderabad	M/s B. Ramachandraiah & Sons	2002-03 143(3)	1.08	0.54
Total				23.98	8.91

2.11.2 Non/short deduction of TDS

If any person responsible for deducting tax at source does not deduct the whole or part of the tax or after deducting the tax fails to remit the same into Government account, he shall be deemed to be an assessee in default and subject to penalty which may be the sum equal to the amount of tax which he failed to deduct. Further, he shall also be liable to pay simple interest at the prescribed rates.

During audit scrutiny of records mistakes relating to non/short deduction of TDS were noticed in **273 cases** in **Andhra Pradesh, Assam, Delhi, Gujarat, Goa, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Maharashtra, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Uttaranchal and West Bengal** involving possible revenue impact of **Rs. 77.04 crore** (of which TDS not effected was **Rs. 37.93 crore**, interest and penalty for not effecting TDS was **Rs. 3.73 crore** and **Rs. 35.38 crore** respectively). **Twenty eight cases** with revenue impact of more than Rs. 10 lakh but less than Rs. one crore have been shown in **Appendix 9**. **Nine cases** with revenue impact of more than Rs. one crore are indicated in Table 11 below:

(Rs in crore)

Sl. No.	State	Tax deductor	F.Y.	TDS due	Interest	Penalty	Total
1.	Haryana	Haryana Roadways Engineering Corp Ltd	2002-03 & 2003-04	4.65	1.45	4.65	10.75
2.	Maharashtra	Ultra Entertainment Solutions Pvt. Ltd.	2002-03	2.88	0.60	2.88	6.36
3.	Madhya Pradesh	IDBI Bank Ltd (New)	2002-03 & 2003-04	1.10	0	1.10	2.20
4.	Andhra Pradesh	Sports Authority of Andhra Pradesh	2001-02 to 2004-05	0.73	0.34	0.73	1.80
5.	Haryana	Kaithal Co-op Sugar Mills Ltd.	2002-03 to 2004-05	0.77	0.18	0.77	1.72
6.	Kerala	Kerala Sports Council	2002-03 to 2004-05	0.65	0.29	0.65	1.59
7.	Assam	ONGC, Jorhat	2001-02 to 2002-03	0.65	0.24	0.65	1.54
8.	Tamil Nadu	Inspector General of Registrations, Government of Tamil Nadu	2000-01 to 2004-05	0.51	0.18	0.51	1.20
9.	Orissa	NTPC Kaniha	2001-02 to 2002-03	0.43	0.22	0.43	1.08
		Total		12.37	3.5	12.37	28.24

The Department accepted audit observations in cases at serial number 1, 2, 5 and 6 above.

2.11.3 Failure to remit TDS into Government account

Every person having deducted tax at source shall remit the same into Government account failing which he is liable to pay interest for the period of delay apart from penalty.

Audit scrutiny of TDS returns processed in selected units revealed that in **34 cases** in **Andhra Pradesh, Delhi, Gujarat, Maharashtra, Madhya Pradesh, Orissa, Rajasthan, Tamil Nadu and West Bengal charges**, tax deducted at source of **Rs. 6.92 crore** was not remitted into Government account. Failure to remit TDS into government account indicated possible loss of revenue of Rs. 6.92 crore. Besides, it also called for levy of interest and penalty involving a total revenue impact of Rs. 14.83 crore. **Eight cases** involving revenue impact of more than Rs. 10 lakh but less than Rs. one crore are shown in **Appendix 10**. **Four cases** involving revenue impact of more than Rs. one crore are indicated in Table 12 below:

(Rs in crore)

Sl. No.	Tax Deductor/ CIT charge	Financial year	TDS deducted	Interest	Penalty	Total
1.	M/s. Briggs Trading Co. Pvt. Ltd. Mumbai	2002-03	3.11	0.21	3.11	6.44
2.	M/s. Roofit Industries Ltd Mumbai	2001-02	1.25	0.14	1.25	2.64
3.	LMZ Energy India Ltd. Delhi	2001-02	0.57	0.25	0.57	1.40
4.	Boston Education and Software Ltd. Mumbai	2001-02	0.55	0.09	0.55	1.19
Total			5.48	0.69	5.48	11.67

Department stated that remedial action has been initiated in respect of cases noted at Sl. No 2 & 4.

2.11.4 Belated remittances of TDS into Government account

The person deducting tax at source shall pay the sum so deducted to the credit of Central Government within the prescribed time limit. Failure to do so attracts levy of interest.

In **Assam, Bihar, Gujarat, Karnataka, Maharashtra, Punjab, Rajasthan, Orissa, Tamil Nadu, Uttar Pradesh, Uttaranchal and West Bengal charges** audit noticed delays ranging from 1 month to 27 months in remitting TDS into Government account in **186 cases** on which interest of **Rs. 3.13 crore** was not levied. In **Bihar, Gujarat, Karnataka and West Bengal charges**, the audit observations were accepted by the Department and remedial action initiated.

2.11.5 Incorrect allowance of business expenditure

Section 40(a)(ia) with effect from 1 April 2004 provides that any payment to a resident in the nature of interest, commission, brokerage, fees for professional or technical services or amounts payable to a contractor/subcontractor on which tax is deductible at source and such tax has not been deducted or after deduction has not been paid during the previous year within the time prescribed, shall not be allowed as a deduction in computing the income chargeable to tax.

Audit scrutiny of assessment records in Gujarat and Karnataka revealed that in **332 cases** TDS had not been remitted into Government account. Failure of the Department to disallow the corresponding payments/expenditure resulted in short levy of tax of **Rs. 45.45 crore**. **Thirty two cases** involving revenue impact of more than Rs. 25 lakh but less than Rs. one crore have been shown in **Appendix 11**. **Seven cases** involving revenue impact of more than Rs. one crore are indicated in Table 13 below:

(Rs. in crore)

Sl. No.	CCIT Charge	Name of Company (Deductor)	Payment to be disallowed	Tax effect
1.	Vadodara	Indian Petro Chemicals Ltd	28.94	10.59
2.	Vadodara	Gujarat Electricity Board (GBPS) Utran	12.59	4.61
3.	Vadodara	Rajasthan Rajya Vidyut Utpadan Nigam Ltd. (RRVUNL)	10.73	3.93
4.	Ahmedabad	Gujarat Gas Company Ltd	10.26	3.75
5.	Vadodara	Gujarat Industries Power Co. Ltd.	6.79	2.48
6.	Vadodara	GSEC Ltd.(Duvaran)	4.67	1.71
7.	Surat	Gujarat Narmada Fertilizer Corporation	3.41	1.25

2.11.6 TDS credits allowed without certificates

While making assessments after arriving at gross demand tax deducted at source as evidenced by TDS certificates, shall be deducted from the gross demand. Where the assessee has not furnished the TDS certificates the credit therefor will not be allowed.

In **Delhi charge**, in the case of M/s. Water and Power Consultancy Services (India) Ltd. for the assessment year 2003-04, TDS credit of Rs. 11.07 lakh was erroneously allowed in assessment without production of relevant TDS certificates. On this being pointed out in audit, Department accepted and rectified the mistake (February 2005).

2.11.7 Late filing of TDS returns

Every person responsible for deducting tax at source shall after the end of each financial year submit annual returns to the jurisdictional TDS unit. Failure or delay in filing these returns would attract penalty at the rate of Rs. 100 for each day of delay subject to the maximum amount of tax deductible:

However no provision is available for levy of interest for non filing of TAN returns by tax deductors as available under section 234A for non filing or belated filing of income/corporate tax returns by the assesseees.

Test check by audit revealed **10549 cases** of late filing of returns in **Assam, Tamil Nadu, Delhi, Gujarat, Haryana, Himachal Pradesh Jharkhand, Orissa, Rajasthan, Uttaranchal and West Bengal** with delays ranging from 1 day to 1406

days. Penalty leviable of **Rs. 5.54 crore** was not levied by the Department. In **Gujarat**, the Department agreed to take remedial action at the time of processing the return.

2.11.8 Failure to ensure completeness of TDS returns and certificates

Every deductor of tax is required to obtain a tax account number (TAN) which is unique to the deductor and which is to be quoted in all transactions relating to tax deduction at source. The Department must ensure that details in the TDS certificates like TAN, PAN, GIR, TDS amount, rate of TDS, etc are accurately and completely filled up. This is to enable the Department to correlate the tax credits availed by the payees (i.e. deductees) in their income tax assessments with those claimed to have been remitted by deductors.

Audit noticed several mistakes as a result of which correlation of tax credits with income tax assessments of deductors was not possible. Neither were the mistakes identified and rectified by the Department nor were the applicable penalties (@ Rs. 10,000) levied as detailed in Table 14 below.

(Rs. in lakh)

Table 14 : Failure to ensure completeness of TDS returns and certificates					
Sl No	Charge	Nature of return	No. of returns	Defects noticed	Penalty leviable
1	Delhi	TDS	158 TAN returns	In 1750 TDS certificates issued by these deductors PAN/ GIR numbers were not recorded	175.00
2	Uttar Pradesh	TDS	178 TAN returns	TAN not recorded	17.80
		Income Tax returns	28 Tax deductors	In 801 TDS certificates issued by these deductors PAN/ GIR numbers were not recorded	80.10
3	Himachal Pradesh	TDS	301 TAN returns	TAN not recorded	30.10
4.	Gujarat	TDS	285 TDS certificates	PAN not recorded	28.50
		Income Tax returns	1 assessee (Vishal Exports Overseas Ltd)	TDS credit allowed on 15 defective TDS certificates	43.27
Total					374.77
Department accepted the audit observation in case of M/s Vishal Exports Overseas Ltd.					

2.11.9 Processing of TDS returns

No specific provision is available prescribing time limitation for processing and assessment of TDS returns filed by the tax deductors. Further, in accordance with the powers vested with the Board under section 119 of the Act, the Board has been prescribing selection criteria for picking up cases for scrutiny by the assessing officers of assessing units to ensure the correctness of the returns as also the availment of various concessions under the Act.

However no selection criteria have been prescribed so far by the Board, in any of the financial years for verification of TDS returns.

Ministry in their reply of January 2007 stated that suitable procedure is under consideration, which will specify time limit as well as procedure of verification of TDS/TCS returns.

2.11.10 Internal audit

As per the new system of internal audit (chain system), a prescribed percentage of all cases, were to be audited by the end of the following month. The percentage of TDS returns to be test checked in internal audit is specified in Board's instruction of December 2001.

In **Chandigarh (UT), Delhi, Gujarat, Jharkhand, Madhya Pradesh, Rajasthan, Uttar Pradesh, and West Bengal**, audit study revealed that no internal audit of TDS wards/circles was conducted during the period from 2002-03 to 2005-06.

2.11.10.1 In TDS unit at **Uttar Pradesh (Meerut charge)** it was stated that internal audit was held during 2002-03 and 2004-05 but these reports were not made available to audit.

2.11.11 Lack of coordination between assessing and TDS units

The Board in September 1990 laid down that a percentage of TDS certificates enclosed with the return of income was required to be cross checked by the assessing officer with the concerned TDS unit before giving credit in order to safeguard against wrong and bogus claims. The percentage of certificates to be cross verified was to be decided by the jurisdictional CCIT/CIT.

In the units test checked in **Delhi, Jharkhand, Rajasthan and Uttar Pradesh** it was noticed that such cross verification was neither prescribed by the CCIT/CIT nor was any such verification carried out by the assessing officers. In **Karnataka charge** only three cases were reported for cross verification by assessing officers to TDS units.

Thus audit could not derive an assurance that the mechanism prescribed to safeguard the exchequer against wrong and bogus claims was functioning effectively.

2.11.12 Miscellaneous observations

2.11.12.1 In **Orissa, Bhubaneswar charge** audit noticed that the tax deductor (Executive Engineer, Division II, Bhubaneswar Development Authority) had deducted a sum of Rs. 0.25 lakh only at source from the gross amount of Rs. 12.31 lakh paid to a contractor for executing works during the financial year 2002-03. However the TDS certificate was issued for a sum of Rs. 0.49 lakh.

2.11.12.2 Non levy of surcharge

While deducting tax at source, the tax deductor is also required to deduct surcharge/education cess as prescribed under the Finance Acts for the relevant period. In **Assam, Gujarat, Jharkhand, Maharashtra, Uttar Pradesh and West Bengal charges**, audit noticed **67 cases** where surcharge was either not deducted or short deducted involving revenue impact of **Rs. 1.76 crore**. In **18 cases** education cess was not deducted involving revenue impact of **Rs. 3.77 lakh**. One case is illustrated below:

In **Gujarat charge**, after detecting short deduction of TDS by the National Highway Authority of India while making payments to a foreign company during financial years 2002-03 and 2003-04, the Department raised the additional demand of tax but did not levy surcharge at prescribed rates in both these years. This resulted in short levy of surcharge of Rs. 31.61 lakh and the total revenue impact was Rs. 38.31 lakh inclusive of interest. On this being pointed out in audit, the Department accepted the observations and initiated remedial action.

2.12 Section C Issues in accounting

2.12.1 Misclassification of income tax and surcharge

In the challans prescribed for remittance of TDS into Government account, separate columns for tax and surcharge are given to enable the Zonal Accounts Officer to account for surcharge separately as the same forms part of Consolidated Fund of India and is not available for allocation to the States*.

Audit scrutiny of challans appended to returns filed in TDS units revealed that surcharge of **Rs. 18.68 crore** had been classified under income tax in **3,269 cases** in **Assam, Chandigarh (UT), Delhi, Himachal Pradesh, Madhya Pradesh, Orissa, Punjab, Tamil Nadu, Uttar Pradesh and West Bengal (Appendix 12)**. In **West Bengal** it was stated that appropriate measures were under process.

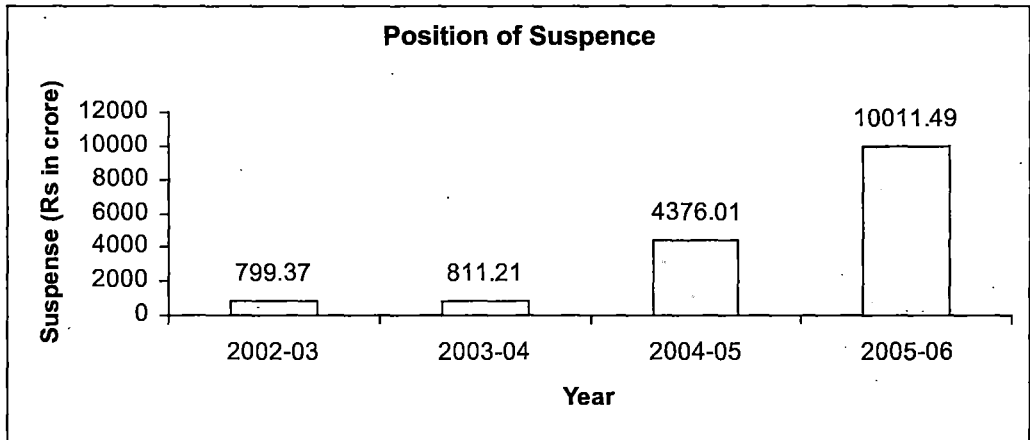
2.12.2 Position of suspense

Consequent to implementation of OLTAS, the bank at which tax remittances were being made had to enter the data contained in the challans such as TAN, date and amount of remittance. Failure to enter the TAN data or incorporation of incorrect data would result in credit of the amount under suspense. These amounts can be cleared while processing the e-TDS returns by the TDS units.

Audit scrutiny of TDS credits held in suspense in **Delhi, Karnataka, Maharashtra (except Nagpur), Punjab and Tamil Nadu** showed an increasing trend over the period 2002-03 to 2005-06 as depicted in Chart 4 below:

* Article 271 of the Constitution

Chart 4



The above table indicates that the amount of suspense is on an increasing trend. The suspense during year 2004-05 had increased by almost 500 percent over the balance in 2003-04 and by 229 percent in 2005-06 compared to the previous year.

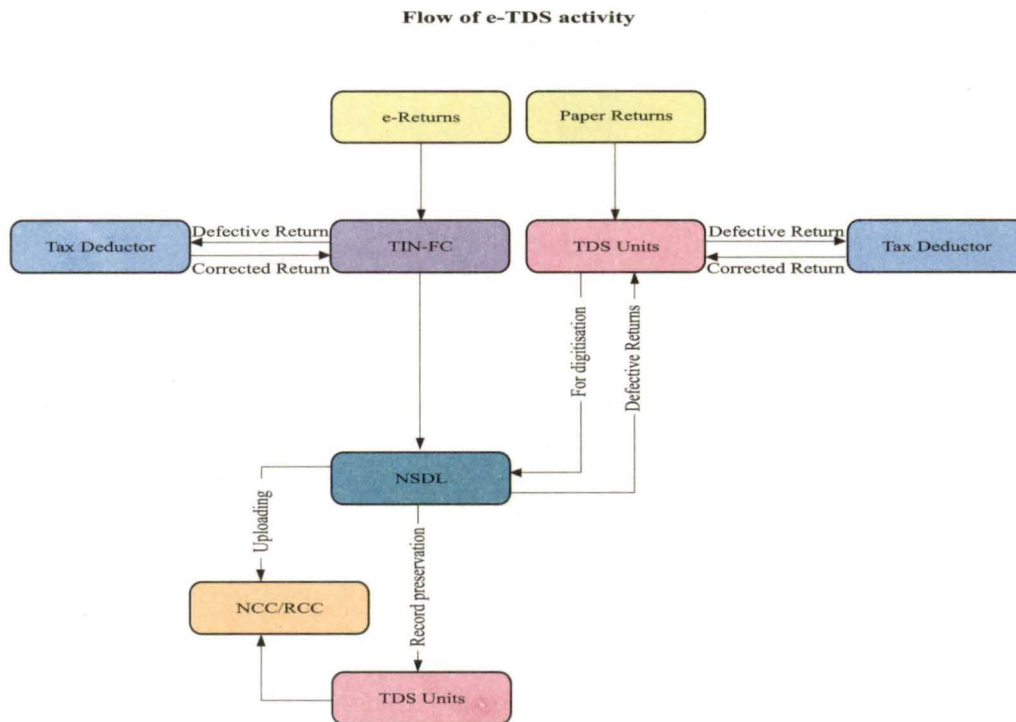
Ministry in their reply (January 2007) stated that efforts were being undertaken to improve the data quality in OLTAS which would result in reduction of the amount under suspense.

Section D Evaluation of e-TDS system

2.13 e-TDS

The 'Electronic filing of Tax Deducted at Source Scheme, 2003' was notified by CBDT with the objective of cutting down compliance cost for deductors and to correlate deduction of taxes made by deductors with the deposit of tax in the Government account, as also to correlate deduction of tax by the deductors with corresponding credits claimed by the deductees. Details of activities involved in the e-TDS process are given in the Chart 5 below:

Chart 5
Flow chart of the activities involved in filing and processing of e-TDS returns



In view of the changed, reporting and compliance requirements both on the part of the clients (tax deductors and tax deductees) and the Department, audit sought to examine the adequacy of the systems and preparedness of the Department to enforce compliance. Audit also attempted to evaluate the facilitation mechanism to clients including clarity of rules and procedures.

Electronic filing of returns

The Director General of Income Tax (Systems) was appointed as e-TDS Administrator and M/s National Securities Depository Limited (NSDL), which is also the agency hosting Tax Information Network (TIN), had been appointed as the Registrar for processing applications for registration as e-Return intermediary. NSDL opened their front offices called 'Tax Information Network - Facilitation Centers (TIN-FCs)' at 139 stations all over the country to receive the e-TDS returns. Furnishing of TDS return in electronic form was made mandatory for corporate deductors with effect from 1 June 2003 and for other offices of Government and non corporate deductors with effect from 1 April 2005 and 1 July 2005 respectively. NSDL was to digitise the returns and upload them onto the National Computer Center (NCC)/Regional Computer Centers (RCCs) of the Department.

The jurisdictional TDS authorities were required to access the RCC/NCC servers for processing of e-TDS returns to ascertain its compliance with the various provisions of the Act and the correctness of payment of requisite taxes by correlating the data available on this module with OLTAS[□]. Hence for processing of e-TDS returns availability of computers and connectivity with the server at RCC/NCC was a prerequisite. Audit scrutiny of the digitisation of paper returns and coordination with NSDL revealed the following:

2.13.1 Non availability of forms/inadequate ground work

The e-TDS scheme was made operational from 01 June 2003, but the new forms of e-TDS returns and the procedure for e-filing were notified only in July 2003 and August 2003 respectively. The facilities (TIN-FCs) for receipt of e-TDS returns in the new form also became functional in January 2004. As a result of this, tax deductors continued to file returns in paper form, which could not be digitised and were declared invalid/defective. Tax deductors who had filed paper TDS returns between June 2003 and January 2004 were asked to file their e-TDS returns again, indicating lack of adequate preparation by the Department.

In **Maharashtra, Mumbai charge**, NSDL had provided a list of filers, who had not complied with the above instruction of filing TDS returns in new forms to the ITD (August 2004). Audit scrutiny revealed that no action had been taken on these non filers.

2.13.2 Trained manpower for e-TDS system

The changed environment required a formal assessment of training needs for different categories of users and development of focused training modules for them. Hence comprehensive training programme with continuous monitoring and course correction was to be implemented. Audit sought to examine the adequacy of the mechanism for imparting training to its officers and staff for discharging their duties.

In **Tamil Nadu Chennai charge**, test check of records made available to audit revealed that only a few employees (51) in 2004-05 had been trained on the e-TDS module. In **Delhi charge** no records relating to training on the e-TDS module were made available to audit. In **Uttar Pradesh** it was noticed that no proper training had been imparted to the staff of e-TDS units. In **Karnataka, Bangalore charge**, it was stated that the officers who were holding charge of the TDS units currently had not been trained in processing of TDS returns in computer media. In **Jharkhand, Ranchi charge** and in five charges* at **Punjab** the Department stated that the staff posted on e-TDS functions had not been trained.

[□] Online Tax Accounting System is a system through which banks upload tax collection information for the tax collected at all their designated branches.

* Two ranges each at Amritsar and Ludhiana and one range at Moga, Jagraon.

Ministry in their reply (January 2007) stated that 512 officers/officials of the Department had been trained in eTDS operation. However, in view of the responses received by audit indicating inadequate training and the low volume of processing of eTDS returns (para 2.13.5 refers), Ministry may like to review the implementation of its training programme.

2.13.3 Digitisation of paper returns

The paper TDS returns for the FY 2002-03 and onwards filed with ITD were required to be sent to NSDL for digitisation and uploading by June 2004. Defective returns sent back by NSDL were to be set right by the ITD from the filer and the same resent for digitisation.

2.13.3.1 Returns not sent for digitisation

It was noticed in **Delhi, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Mumbai and Uttar Pradesh** that 1.27 lakh paper returns identified for digitisation had not been sent to NSDL for digitisation during the period of review.

2.13.3.2 Returns pending with NSDL

It was noticed in **Bihar, Delhi, Karnataka, Kerala, Madhya Pradesh, Punjab, Tamil Nadu, Uttar Pradesh, and West Bengal** that of the returns sent by the Department for digitisation, 50831 returns were yet to be acted upon by NSDL. It was also observed in **Delhi** that not a single paper return relating to the financial year 2002-03 had been digitised by NSDL (May 2006).

On this being pointed out in audit, Ministry stated (January 2007) that in Delhi charge 4687 returns relating to 2002-03 had been digitised and uploaded as on 30 November 2006.

2.13.4 Inadequacies in monitoring

In **Tamil Nadu, Chennai charge** out of 1.58 lakh TDS returns received by NSDL only 1.52 lakh returns had been uploaded into RCC, Chennai. In **Kerala, Kochi and Thiruvananthapuram charge**, it was observed that the total number of TDS returns shown as uploaded to these charges from NSDL were 32382, whereas only 11500 e-TDS returns were available online for access by the jurisdictional wards. In **Bihar, Patna charge**, it was observed that 21 TDS returns were misplaced by NSDL.

Ministry while providing the updated figures for Kerala in January 2007 stated that e-TDS returns can be tracked in the system and all e-TDS returns filed are uploaded into the income tax department's system. However, the updated figures in respect of Kerala continue to show a gap of 9,491 returns. The issue of misplaced returns in Patna also needs to be addressed by the Ministry.

2.13.5 Processing of e-TDS returns

TDS units were to check the tax due and tax deducted, timely remittances, correctness and bonafide of TDS certificates, leviability of interest and penalty wherever applicable, etc.

2.13.5.1 In three ranges of CIT (TDS) **Delhi charge**, data relating to the number of e-returns received and processed revealed that during the financial years 2002-03 to 2004-05 on an average less than 2 percent of the returns had been processed by the Department as detailed in Table 15 below:

Financial year	e-Return received	e-Return processed	Unprocessed e-Return
2002-03	5605	20	5585
2003-04	33772	1332	32440
2004-05	60820	739	60081
2005-06	49649	969	48680

On this being pointed out in audit, the Department stated (September 2006) that non processing was due to software problems, connectivity and inadequacy of manpower.

2.13.5.2 In **Tamil Nadu, Chennai charge**, Department stated that processing of returns through computer was not done since all the trial runs made to process returns resulted in demands as credit details were not available in respect of deductees whose PAN was not quoted. In spite of repeated instructions by DIT (Systems), none of the returns had been processed through computer (August 2006). Further, 25 stations in Tamil Nadu were not connected with the RCCs and hence assessing officers were not in a position to process the returns.

2.13.5.3 In **Maharashtra, Mumbai charge**, the Department processed only 2531 e-TDS returns out of 17158 returns (14.75%) received during the financial year 2002-03 to 2005-06. It was also reported that processing of e-TDS returns could not be done properly mainly due to software problems and inadequacy of trained manpower.

2.13.5.4 Test check in **Karnataka, Bangalore charge** revealed that processing of returns had not been undertaken fully as the package relating to e-TDS processing was not functioning through AST. There were also connectivity issues and inadequate trained manpower. Audit also noticed that in the case of e-TDS return relating to a company (M/s. BPL Telecom Ltd. for the assessment year 2003-04), TINFC had pointed out deficiencies in respect of several deductees (2656 deductees out of total number of 3257) (December 2004). However, neither the assessee nor the Department has taken any action to rectify these deficiencies (June 2006). Audit also noticed that the computer system was not provided to assessing officers outside Bangalore, which hampered the processing of e-TDS returns (June 2006).

2.13.5.5 In Orissa charge it was seen that only 26 e-TDS returns out of 3696 returns (0.70%) received pertaining to financial year 2003-04 to 2005-06 had been processed.

2.13.5.6 In Jharkhand, Ranchi and Dhanbad charges it was observed from records made available to audit that none of the e-TDS returns for the years 2003-04 to 2005-06 had been checked to ascertain the correctness of tax deduction at source and credit into Government account. It was further stated by the assessing officers that they were holding additional charge of the TDS units and were not aware of scrutiny, if any, done by earlier officers in-charge of the units.

2.13.5.7 In Uttar Pradesh, Meerut charge, audit observed that there were no computers in the TDS units. In **Kanpur charge,** the computers had become non functional whereas in **Agra charge,** they were partially functional. In **Himachal Pradesh, Solan, Mandi and Palampur charges** it was observed that there were no computers with online connectivity to enable the assessing officers to process the returns.

Ministry in their reply (January 2007) provided the updated details of returns received and processed as detailed below.

Returns received during the financial year 2005-06				
Sl. No.	RCC	No. of returns available for processing	No. of returns processed	Percentage of column 4 to column 3
1	2	3	4	5
1.	Delhi	2,13,491	38,823	18
2.	Bangalore	1,34,615	6,398	4
3.	Trivandrum	14,514	398	3
4.	Cochin	26,338	511	2
5.	Chennai	87,834	1,675	2
6.	Pune	49,273	471	1
7.	Mumbai	2,23,498	5,912	2
8.	Kolhapur	8,693	462	5
9.	Patiala	35,832	2,100	6
10.	Baroda	24,053	1,099	5
11.	Ahmedabad	41,921	462	1

Ministry also stated that certain changes have been made in the TDS software recently to enable faster processing of e-TDS returns. In view of the large numbers of e-TDS returns not being processed, Ministry may like to review the position so as to safeguard the interests of Government revenue.

2.13.6 Issues relating to TDS software

e-TDS software was envisaged as a self contained mechanism which would enable the Department to identify stop filers and non filers; match tax remittance data in the return with the data available in OLTAS; compute interest for delayed remittance of tax at the applicable rates; generate demand notices and apply the system fed interest and surcharge rates applicable for various categories of

assessee during a particular assessment year as also for different assessment years. Audit scrutiny of the functioning of the software revealed the following:

2.13.6.1 In **Maharashtra, Mumbai charge**, the Department had encountered problems relating to non correlation between unique return filers and the TAN allotted to tax deductors; problems with mismatching of remittance data between e-TDS return and OLTAS such as differences in date of challan (tendering and clearing date), difference in amount of tax due to exclusion of interest, non availability of validation in OLTAS thereby marking returns without TAN as defective, etc. It was seen that these anomalies continued even after two years of implementation of e-TDS scheme.

Ministry in their reply (January 2007) stated that the issue of unique e-TDS return filers and TAN allotted to deductors is being addressed and the problem of matching of remittance data between the e-TDS returns and OLTAS has been resolved to a large extent by the latest changes made to the e-TDS software.

2.13.6.2 Test check in **Karnataka, Bangalore charge** revealed that identification of jurisdiction which was decided upon the quantum of deduction availed was dysfunctional and did not provide for transfer of records in bulk which was one of the key advantages to be realised out of computerised processing of returns. It was also found that where a particular return pertains to a financial year and payments have been made corresponding to this in the next financial year, though the system provides for making changes in the ledger account, corrections were not allowed to be carried out due to problem in periodicity key. It was also found that the system did not allow generation of sorted data, though the data was available in consolidated form in Return Receipt Register (RRR).

Ministry in their reply of January 2007 stated that since different jurisdictional patterns are followed, generalised software was developed. Ministry also stated no problem has been found in the periodicity key and the system could generate reports in any sorted order. However, responses received from the field indicated practical problems at the field level which are required to be addressed.

2.13.6.3 The e-TDS software defines non-filer as a deductor, who has obtained TAN, but, did not file a return. It was noticed that the e-TDS software was not provided with a suitable validation check for linking challan entries quoted in OLTAS module with TAN returns to ensure that all deductors who had remitted tax had indeed filed the requisite returns.

Ministry in their reply (January 2007) stated that changes will be carried out in the software to link OLTAS challan entries to e-TDS software to identify deductors who have remitted tax but not filed their TDS returns.

2.13.7 Mechanism for checking and storage of soft copies of e>Returns

Under e-TDS scheme, returns received in electronic media such as floppies, CDs, etc. from the e-intermediary are required to be preserved as records for future reference. For proper account of returns received the Department had prescribed specific procedure for maintaining 'Stock Register for Magnetic Media'.

It was observed in **Delhi charge** that no stock register of floppies/CDs was maintained during financial year 2002-03 to 2005-06 nor is there a system for checking the same. Receiving returns in floppies/CDs without ensuring their content and validity as also non availability of a proper system of storage and preservation of records in magnetic media defeated the purpose of storing the same for future reference.

Ministry during the exit conference agreed to reiterate the instructions for preservation and storage of records in magnetic media.

Section E Tax collection at source

2.14 Introduction

The mandate for collecting tax at source (TCS) is provided by the Introduction of "**Part-BB-Collection at source**" in **Chapter XVII** of the Income Tax Act 1961, by the Finance Act 1988 with effect from 1 June 1988 which has been amended through successive Finance Acts.

The scope of "Part BB" earlier covered the business of trading in alcoholic liquors, forest produce, tendu leaves, scrap and timber which was later amended to include contract or license or lease of parking lots, toll plazas and mining and quarrying by the Finance Act 2004 with effect from 1 October 2004. Further rates of tax which were originally ranging from five to fifteen percent had been reduced to one percent to two percent.

Audit of TCS returns and related records were taken up simultaneously along with scrutiny of TDS records in 246 TDS units for the period from 2002-03 to 2005-06, till date of audit and observations thereon are detailed below:

2.14.1 Revenue gap in collection of tax at source

Owing to the nature of the trade and ease of collection, income tax on profits and gains from the business of trading in alcoholic liquor is collected at source. Every person shall at the time of sale of alcoholic liquor for human consumption, collect from the buyer a sum equal to one percent of the sale price with effect from 8 September 2003 (prior to this date the rate of collection of tax was 10 percent).

A study of the Finance Accounts of eight selected states of **Andhra Pradesh, Haryana, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Tamil Nadu and West Bengal** revealed that the revenues accruing to the state Government on account of sale of alcoholic liquor for human consumption showed an increasing trend. However, the collection of taxes at source is not in proportion to the excise revenues of the state Governments as detailed below:

(Rs. in crore)

States	2002-03	2003-04	2004-05
Maharashtra	1753.57	2056.13	1979.76
Tamil Nadu	2061.42	1613.20	2512.19
West Bengal	565.09	616.67	507.93
Madhya Pradesh	816.52	1001.05	1159.35
Punjab	1284.58	1398.29	1465.23
Andhra Pradesh	1797.74	1856.98	2036.44
Karnataka	1921.53	2201.42	2698.15
Haryana	823.89	865.68	922.22
Total	11024.34	11609.42	13281.27

(Rs. in crore)

Year	Rate of tax deduction	Amount	Amount of TCS as per CGA*
2002-03	@ 10%	1102.43	57.76
2003-04**	@ 10% on half of the collections	580.47	125.97
	@ 1% on half of the collections	58.04	
2004-05	@ 1% for the year	132.81	211.90
	Total	1873.75	395.63

* Controller General of Accounts

** The rate of tax to be deducted at source was reduced from ten percent to one percent w.e.f. 08.09.2003 and hence TCS computed at differential rates.

The wide discrepancies between tax collectible at source and that shown as actually collected in respect of sale of liquor requires to be examined by the Department.

Ministry during the exit conference agreed to examine the issue.

2.14.2 Application of TCS provisions

Audit noticed mistakes such as non levy of surcharge/interest/penalty; non filing, belated filing of returns, defective TCS certificates, etc. in 38 cases relating to **Bihar, Haryana, Karnataka, Maharashtra, Orissa, Rajasthan and Uttar Pradesh charges** involving a revenue impact of Rs. 3.97 crore which includes tax of Rs. 81.48 lakh and interest and penalty of Rs. 3.16 crore.

* Total turnover of liquor is conservatively estimated equivalent to the State Excise duty collections under the Major Head 0039 covering the Minor Heads 101 – Country spirits, 102 – Country fermented liquors, 103 – Malt liquor, 104 – Liquor and 105 – Foreign liquors & spirits which relate to excise duty collected on liquor for human consumption as depicted in the Finance accounts of the concerned States for the relevant year.

2.14.3 Omission to collect tax at source

Audit noticed mistakes relating to omission to collect tax at source in 16 cases involving a revenue impact of Rs. 3.90 crore of which **two cases** are illustrated below.

2.14.3.1 In Maharashtra Mumbai charge, M/s Shipping Corporation of India had derived income of Rs. 39.68 crore and Rs. 146.41 crore during the financial years 2003-04 and 2004-05 on account of sale of scrap. Audit scrutiny revealed that neither had the assessee collected tax at source nor did the Department initiate necessary proceedings. Failure to do so resulted in non-collection of tax at source of Rs. 1.94 crore including surcharge and education cess apart from interest of Rs. 45.37 lakh. On this being pointed out by audit, Department agreed to examine the issue.

2.14.3.2 In Maharashtra Mumbai charge, M/s ONGC had sold scrap amounting to Rs. 8.77 crore during the period from April 2003 to December 2003. Audit scrutiny revealed that neither had the assessee collected tax at source nor did the Department initiate necessary proceedings. Failure to do so resulted in non-collection of tax at source of Rs. 50.62 lakh including surcharge and education cess apart from interest of Rs. 14.68 lakh. On this being pointed out by audit, Department agreed to examine the issue.

2.14.4 Income escaping assessment

In **Jharkhand, Dhanbad charge** it was noticed that in assessment year 2004-05 four assessee debited purchases of liquor in excess of purchase value shown in the relevant TCS certificates resulting in income of Rs. 3.52 crore escaping assessment involving a revenue impact of Rs. 1.31 crore. The audit observations were accepted by the Department.

2.14.5 Processing of TCS returns

No specific provision is available prescribing time limitation for processing and assessment of TCS returns filed by tax deductors. In **Delhi charge**, audit scrutiny in nine selected units, revealed that for the financial years 2002-03 to 2005-06, no TCS return was processed as against 440 returns filed during these years. In **Bihar, Haryana, Karnataka, Maharashtra, Tamil Nadu and West Bengal (Kolkata charges)** also TCS returns had not been processed.

Further, in accordance with the powers vested with the Board under section 119 of the Act, the Board has been prescribing selection criteria for picking up cases for scrutiny by the assessing officers of assessing units to ensure the correctness of the returns as also the availment of various concessions under the Act.

However no such selection criteria has been so far prescribed by the Board in any of the financial years for selection of TCS returns for scrutiny by the officers of TDS units. In **Delhi charge** TDS units were unable to explain the selection criteria adopted for processing of TCS returns.

Ministry in their reply of January 2007 stated that suitable procedure is under consideration, which will specify time limit as well as procedure of verification of TDS/TCS returns.

2.15 Conclusion and recommendations

2.15.1 A wide gap was noticed between the potential for TDS and TCS in certain sectors apart from non deduction/collection of tax at source. A declining trend in the number of effective tax deductors was observed. Surveys were either not being conducted or the reports of surveys were not finalised in a number of cases. *Audit recommends that Ministry may take necessary steps to bring all tax deductors/collectors into the tax net and enforce recovery as required under the Act.*

During the exit conference, Board while agreeing to examine the issue stated that the TDS administration is being strengthened by additional manpower. Board also stated that the database of tax deductors is being updated to reduce redundancy.

2.15.2 Several mistakes relating to implementation of provisions relating to TDS/TCS were observed in respect of residents and non residents. *Audit recommends that adequate enforcement mechanism be evolved to ensure consistency in assessment and prevent loss of revenue, particularly in the important area of international taxation. Coordination between TDS and regular assessment units as also internal audit mechanism should be strengthened.*

During the exit conference, Board agreed to look into the issues raised by audit especially in the area of international taxation, and also stated that revamping of the internal audit mechanism in the department was under process.

2.15.3 Review of e-TDS indicated that e-TDS returns filed remained unprocessed for the past three years largely due to software related problems and inadequacy of trained manpower. There was also no proper system for preservation and storage of records in magnetic media. *Audit recommends that these problems be attended to urgently so that the e-TDS returns are processed and revenues due to government realised. Further, arrangements for ensuring storage and preservation of records in magnetic media are ensured.*

During the exit conference, Board stated that certain changes have been made in the TDS software recently to enable faster processing of e-TDS returns. Board also agreed to reiterate the instructions for preservation and storage of records in magnetic media.

2.15.4 The Income Tax Act does not prescribe any time limit to process the TDS/TCS returns unlike regular assessments. *Audit recommends that a time limit for completion of TDS/TCS assessments may be prescribed so as to ensure early realisation of any revenues due to government.*

During the exit conference, Board stated that a suitable process is under consideration, which will specify time limit as well as procedure for verification of TDS/TCS returns.

2.15.5 Misclassifications in accounting were noticed as also large balances under 'suspense'. *Audit recommends that Ministry may look into this aspect and take steps to reconcile the differences.*

During the exit conference, Board agreed to examine the issue in detail and intimated that measures to reduce the suspense are underway.

Chapter III

Review on Assessment of Sports Associations/Institutions and Sports Personalities

- **Highlights**
- **Introduction**
- **Audit methodology**
- **Audit Findings**
 - **Irregular exemption owing to non approval/notification**
 - **Irregular exemption owing to non investment of accumulated income/investment made not in specified modes**
 - **Irregular allowance of depreciation**
 - **Omission to deduct tax at source**
 - **Non submission/delay in submission of income tax returns**
 - **Inconsistent decisions of the department resulting in unintended benefit**
 - **Sports associations/institutions not brought under tax net by the department**
 - **Weak Internal audit/control mechanism**
 - **Irregular exemption under section 80RR**
 - **Conclusion and recommendations**

Highlights

Audit reviewed the assessments of sports associations/institutions and sports personalities with a view to ascertaining i) correctness of exemptions given to the sports associations and sports personalities ii) adequacy of department's efforts to bring all sports associations/institutions and sports personalities into tax net, iii) effectiveness of internal control mechanism in the department to avoid irregularities and errors in the assessments done, evasion of tax, and misuse of exemptions, iv) compliance of TDS provisions in respect of payments made to sports persons.

(Para 3.3)

Out of 2,696 cases requisitioned by audit, 1,050 cases were produced. Of these 1,050 cases, 514 pertained to miscellaneous category, whereas 245 cases related to cricket. Number of cases produced related to any other individual sport was less than 75. Further, out of 158 audit observations noticed during the review, 47.47%, 33.55%, 4.44% and 3.80% related to miscellaneous category, cricket, tennis and hockey respectively. However, the money value of the audit observations in percentage terms were 66.78, 31.86, 0.42 in the assessments relating to cricket, miscellaneous category and tennis respectively.

(Para 3.7)

Audit noticed

- Irregular exemption granted owing to non approval/notification of the assesseees in four cases involving tax effect of Rs. 8.26 crore.

(Para 3.8.2)

- Irregular exemption granted owing to non investment of accumulated income/investment made not in specified modes in seven cases involving tax effect of Rs. 20.83 crore.

(Para 3.12.2)

- Tax amounting to Rs. 5.41 crore not deducted at source from the payments made to sports personalities in Andhra Pradesh, Delhi, Gujarat, Karnataka, Kerala, Tamil Nadu and Pondicherry charges.

(Para 3.17.2)

- Mistake while giving effect to appellate orders resulted in short levy of tax by Rs. 4.57 crore in one case.

(Para 3.19.2)

- Non filing of returns in 10 cases resulted in non levy of tax amounting to Rs. 19.56 crore.

(Para 3.20.2)

- Inconsistent decisions of the department resulted in unintended benefit of Rs. 148.07 crore involving tax effect of Rs. 60.30 crore.

(Para 3.21.4)

- 3,273 sports associations and clubs receiving grants from different government agencies or affiliated to different associations in different States were required to be examined and brought under the tax net of the department.

(Para 3.22.2)

- Weak internal audit and internal control system in respect of checking year wise details of investment, its withdrawal and utilization for specified purposes within stipulated period and to check if income/ accumulated income has been applied to specified objectives for which the association/ institution was established.

(Para 3.23)

- Irregular deductions allowed to sports persons in respect of income from the Government of foreign State in seven cases even when income had not been earned in the capacity of sportsman involving tax effect of Rs. 4.51 crore.

(Para 3.24.2)

Audit recommends that

- The internal control mechanism in the department may be strengthened to check year wise details of investment, its utilization for specified purpose within stipulated period, and to check if income/ accumulated income has been applied to specified objectives for which the associations/ institutions were established.

(Para 3.32.7)

- Government may like to utilize its AST database to focus on potential cases to minimize the misuse of exemptions given to sports associations/institutions/clubs and sports personalities.

(Para 3.32.8)

- Government may like to strengthen its internal audit to avoid irregularities and errors in assessments done, evasion of tax and misuse of exemptions.

(Para 3.32.9)

Review on Assessment of Sports Associations/Institutions and Sports Personalities

3.1 Introduction

3.1.1 With a view to promoting and improving the standard of sports in India, income of an association or institution established in India and engaged in the promotion of sports or games has been exempted from levy of income tax subject to fulfilment of certain conditions. Promotion of sports and games is considered as charitable purpose within the meaning of section 2 (15) of the Income Tax Act.* Accordingly an association or institution engaged in the promotion of sports or games can claim exemption under section 11.

3.1.2 Sports personalities are assessed according to their status in general. Further, sports persons are entitled to have specific deductions and exemptions[†] in respect of income earned out of sports and games.

3.1.3 Income Tax Department (the Department) is required to ensure through the operations of the Income Tax Act (the Act) that incomes of only genuine and eligible sports institutions/associations and sports personalities are exempted from levy of income tax, and correct amount of tax is paid by the institutions/associations and sports personalities.

3.2 Law and procedure

3.2.1 Prior to its omission vide Finance Act, 2002 with effect from 1 April 2003, section 10(23) of the Act, inter-alia, dealt with the exemption in respect of any income of an association or institution established in India which may be notified by the Central Government in the official gazette having regard to the fact that the association or institution has as its object – the control, supervision, regulation or encouragement in India of the games of cricket, hockey, football, tennis or such other games or sports as the Central Government may, by notification in the official gazette, specify in this behalf provided:

- the association or institution makes an application in Form No.55 to the Director General (Income tax Exemptions) for the purpose of grant of exemption or continuance thereof;
- the association or institution applies its income or accumulates it for application, wholly and exclusively to the objects for which it is established, and the provisions of sub section (2) and sub section (3) of section 11 shall apply in relation to such accumulation;

* Central Board of Direct Taxes (Board) circular No. 395, dated September 24, 1984

[†] In respect of awards as may be approved by the Central Government in the public interest.

- the association or institution does not deposit its funds during the previous year otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11;
- the association or institution does not distribute any part of its income in any manner to its members except as grants to any association or institution affiliated to it;
- the association or institution applies the amount received by way of donations referred to in clause (c) of sub-section (2) of section 80G for the purpose of development of infrastructure for games or sports in India or for sponsoring of games and sports in India.

3.2.2 Section 11 of the Act deals with the exemption of income from property held for charitable or religious purposes. Further, section 2(15) defines "charitable purpose" to include relief of the poor, education, medical relief and the advancement of any other object of general public utility. Promotion of sports and games has been considered as a charitable purpose within the meaning of section 2(15), and as such, an association or institution engaged in the promotion of sports or games can claim exemption under section 11 even if it is not exempt under section 10(23)[‡].

3.2.3 For claiming exemption under section 11, conditions as discussed in the table below are to be complied with:

Section of the Act	Prescribed conditions
11	<ul style="list-style-type: none"> • Trust/institution must be for charitable or religious purpose. • The property from which income is derived should be held under trust by such charitable or religious trust/institution. • The trust must get itself registered with the Commissioner of Income tax within the prescribed time. • Where the 'property held under a trust' includes a business undertaking, the profits or gains earned from such business shall not be exempt under section 11, unless the business is incidental to the attainment of the objectives of the trust /institution, and separate books of accounts are maintained by such trust and institution in respect of such business.
11(1)	<p>The following income shall not be included in the total income of the previous year of the person in receipt of the income-</p> <ul style="list-style-type: none"> • income to the extent to which such income is applied for charitable or religious purposes in India ; and • the income accumulated or set apart for application to such purposes in India, by the trust/institution, shall not be in excess of 15 per cent of the income from such property; (25 per cent upto assessment year 2002-03).

[‡] Board's circular No. 395, dated September 24, 1984

Section of the Act	Prescribed conditions
	<ul style="list-style-type: none"> income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.
11 (2)	<p>Where 85 per cent of income (75 per cent of income till assessment year 2002-03) is not applied to charitable or religious purposes in India during the previous year but is accumulated or set apart, either in whole or in part, for application to such purposes in India, such income so accumulated or set apart shall not be included in the total income of the previous year of the person, provided:</p> <p>(a) such person specifies, by notice in writing to the assessing officer in the prescribed manner, the purpose for which the income is being accumulated or set apart, and the period for which the income is to be accumulated or set apart, which shall in no case exceed five years (ten years up to March 31, 2001) and</p> <p>(b) the money so accumulated or set apart is invested or deposited in the forms or modes specified in sub-section (5) of section 11.</p>
11(5)	<p>Accumulated or set apart funds shall be invested or deposited in the specified forms and modes such as saving certificates as defined under Government Saving Certificates Act, 1959, any other securities or certificates issued under the Small Saving Schemes of the Government, deposit with the post office, scheduled banks, units of the Unit Trust of India, deposit in public sector companies etc.</p>
12A(a)	<p>The person in receipt of the income has made an application for registration of the trust or institution in the prescribed form and in the prescribed manner to the Commissioner before the expiry of a period of one year from the date of creation of the trust/institution.</p>
12(A)(b)	<p>Where the total income of the trust or institution as computed without giving effect to the provisions of section 11 and section 12 exceeds fifty thousand rupees in any previous year, the accounts of the trust or institution for that year have been audited, and the person in receipt of the income furnishes along with the return of income, the report of such audit in the prescribed form.</p>

3.2.4 Under section 80RR, where the gross total income of an individual resident in India, being an author, playwright, artist, musician, actor or sportsman (including an athlete) includes any income derived by him in the exercise of his profession from the Government of foreign State, there shall be allowed, in computing the total income of the individual, a deduction from such income of an amount equal to-

Assessment year	Deduction as percentage of income as is brought into India
2001-02	60
2002-03	45
2003-04	30
2004-05	15
2005-06 & subsequent assessment years	No deduction

3.2.5 No deduction under section 80 RR shall be allowed unless the assessee furnishes a certificate, in prescribed form, along with the return of income, certifying that the deduction has been correctly claimed in accordance with the provisions of this section.

3.3 Objectives of the review

Audit reviewed the assessments of sports associations/institutions and sports personalities with a view to verifying the following:

- Correctness of exemptions given to sports associations/institutions as well as sports personalities and to quantify the extent of loss of revenue or underassessment of taxable income and other irregularities due to mistakes in assessments.
- Whether adequate steps have been taken by the department to bring all sports associations/institutions and sports personalities into the tax net.
- Whether there exists any internal control mechanism within the department to exercise adequate and necessary checks to avoid irregularities and errors in assessments done, evasion of tax, and misuse of exemptions.
- Whether TDS from the payments made to sports persons on winnings from sports, payment to foreign coaches etc. has been correctly deducted.

3.4 Audit methodology

3.4.1 A database of sports associations/institutions and of sports personalities was prepared from various sources such as:

- Records of DGIT (Exemptions)
- Records relating to survey operations and Central Information Branch in respect of sports associations/institutions/bodies as brought into tax net by the department
- Demand and collection register of the wards/circles
- Sports Ministry/Departments of Sports
- Sports Authority of India
- Sports Development Authority of respective states/regional sports directorates
- Apex bodies of sports associations.

- Registrar of societies
- Newspapers, books & publications etc.
- Internet
- Telephone directories and
- Any other source as deemed fit.

3.4.2 The names and addresses of sports associations/institutions, sports personalities etc so identified were furnished to the CCsIT/CsIT to ascertain the assessing wards/circles where they were being assessed and whether they were filing income tax returns or not.

3.4.3 From the information gathered as above and also from the addresses of the assesseees, the assessing wards/circles where these sports associations/institutions/sports personalities could be assessed were identified.

3.4.4 The review parties visited the assessing wards/circles, and carried out necessary audit checks in respect of assessment records made available to audit.

3.4.5 Copies of the draft review report containing observations were issued to the respective Chief Commissioners of Income Tax / Director General of Income Tax (Investigation) by the Director General/Pr. Directors of Audit/Pr. Accountants General/Accountants General during the period from July 2006 to August 2006.

3.4.6 A consolidated draft review report was issued to the Ministry/Central Board of Direct Taxes (Board) for their comments in November 2006. An exit conference to discuss the audit results of this review between the office of the Comptroller and Auditor General of India and the Board was held in January 2007.

3.5 Period covered

The review covered assessments of sports associations/institutions and sports personalities completed during the period from 1999-2000 to 2005-06 and those completed upto the date of audit.

3.6 Sample size

3.6.1 Assessments of all sports associations/institutions, whose return could be located, were selected for review, whether these were completed in a summary manner or after scrutiny.

3.6.2 All sports personalities with annual income of Rs. 15 lakh and above were selected for review. Apart from the returns of sports persons, returns of sports commentators, ex-sports persons, office bearers of sports associations/institutions etc. were also examined to ascertain whether exemptions under section 80RR were availed by persons other than those specified in the Act.

3.6.3 Audit requisitioned 2,696 cases as per the database[§] prepared, of which records were produced in 1050 cases. The state wise details are given in **Appendix 13**.

3.7 Audit findings

3.7.1 Audit test checked 1050 cases in Andhra Pradesh, Assam, Bihar, Chandigarh (UT), Delhi, Goa, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal charges. Audit observed a total of 158 cases of irregularities involving tax effect of Rs. 190.92 crore (including penalty of Rs. 50.24 crore). Of these 130 cases of irregularities involving tax effect of Rs. 179.80 crore were in respect of sports associations/institutions and 28 cases involving tax effect of Rs. 11.12 crore were in respect of sports personalities.

3.7.2 Sports category wise break up of audit findings is given in Table 1 below:

Sl. No.	Sports Category	Cases Requisitioned	Cases Produced	Audit Findings		Percentage of cases produced	Number of audit observations as a percentage of total	Money value as a percentage of total
		Number	Number	Number	Money value (Rupees in lakh)			
1	Athletics	214	18	1	4.95	8.41	0.63	0.03
2	Boxing	34	7	1	0.62	20.59	0.63	0.00
3	Cricket	400	245	53	12750.08	61.25	33.55	66.78
4	Chess	68	36	4	35.02	52.94	2.53	0.18
5	Football	80	26	4	42.33	32.50	2.53	0.22
6	Golf	75	48	3	74.73	64.00	1.90	0.39
7	Gymnastics	43	6	0	0	13.95	0.00	0.00
8	Hockey	149	32	6	6.13	21.48	3.80	0.03
9	Judo	48	9	1	1.19	18.75	0.63	0.01
10	Shooting	28	5	0	0	17.86	0.00	0.00
11	Swimming	18	6	1	0	33.33	0.63	0.00
12	Tennis	113	66	7	80.4	58.41	4.44	0.42
13	Volleyball	43	20	1	4.20	46.51	0.63	0.02
14	Weightlifting	61	11	1	11.12	18.03	0.63	0.06
15	Wrestling	38	1	0	0	2.63	0.00	0.00
16	Miscellaneous category	1284	514	75	6081.46	40.03	47.47	31.86
	Total	2696	1050	158	19092.23	38.95	100	100

[§] As the database was prepared by audit from various sources, whether all the cases which were requisitioned were assessable or were having taxable income could not be ascertained.

* This category includes cases of sports bodies/sports authorities/sports councils/ clubs etc covering more than one game. Any other game not covered in the table is also included here.

Of 1,050 cases produced to audit, 514 pertained to miscellaneous category whereas 245 cases related to cricket. Number of cases produced related to any other individual sport was less than 75. Out of 158 audit observations noticed during the review, 47.47%, 33.55%, 4.44% and 3.80% related to miscellaneous category, cricket, tennis and hockey respectively. However, the money value of the audit observations in percentage terms were 66.78, 31.86, 0.42 and 0.39 in the assessments relating to cricket, miscellaneous category, tennis and golf respectively. These audit observations are featured in the subsequent paragraphs.

3.7.3 Audit observations with money value exceeding Rupee one crore have been discussed in the paragraphs; while those between Rs. 50 lakh and Rupees one crore are featured in the table in the body of the Report and those between Rs. 20 lakh and Rs. 50 lakh are included in the appendices. The audit observations with money value below Rs. 20 lakh are not individually highlighted although their tax effect is included in the Report.

3.8 Irregular exemption owing to non approval/notification in respect of sports association under section 10 (23)

3.8.1 Prior to its omission vide Finance Act, 2002 with effect from 1 April 2003, section 10(23) of the Act, inter-alia, dealt with the exemption in respect of any income of sports association or institution established in India provided the association or institution is notified by the Central Government, and the association or institution makes an application in prescribed form to the Director General (Income tax Exemptions) for the purpose of grant of exemption or continuance thereof. Further, with effect from 24 September 1984, vide Board's circular No.395, an association/institution engaged in the promotion of sports or games can claim exemption under section 11 even if it is not exempt under section 10 (23).

3.8.2 Irregular exemption owing to non approval/notification resulted in non levy of tax of Rs. 8.26 crore in four cases in Karnataka, Kerala, and West Bengal charges. Of these, two cases are detailed below:

3.8.3 In West Bengal, DIT (Exemption), Kolkata charge, assessment of Cricket Association of Bengal (CAB), for the assessment years 1979-80 to 1983-84 was completed after scrutiny in July 2002[#]. Audit scrutiny of assessment records pertaining to the assessment years 1979-80 to 1980-81 and 1982-83 to 1983-84 revealed that the assessee was not notified under section 10 (23) for these years. Further, exemption under section 11 was also not available for these years as the same was effective from September 24, 1984 only. However, audit noticed that the assessee had claimed and was allowed exemptions under section 11(1) and 11(2). Thus, irregular allowance of exemption to the assessee resulted in short levy of tax amounting to Rs. 7.29 crore including interest.

[#] Assessee had not filed income tax returns for any of these years. Assessments for these years under section 144 underwent several revisions in earlier years in pursuance of appeal orders, and ultimately were completed in July 2002.

3.8.4 The department in its reply dated 2 December 2005 stated that the exemption was granted under section 11 of the Act on the basis of Board's circular No. 395 issued on 24 September 1984 whereby promotion of sports and games has been considered as charitable activity within the meaning of section 2(15) of the Act. The reply is not tenable as the circular cited by the department was issued on 24 September 1984 only, whereas the irregularity highlighted in the para pertains to the assessment years 1979-80, 1980-81, 1982-83 and 1983-84. Retrospective effect cannot be given to a circular unless it was specifically mentioned in the circular itself. The department, however, initiated remedial action under section 154 in December 2005.

3.8.5 Another case is given in the Table 2 below.

Sl No.	Name of the assessee/ CIT charge	Assessment year(s)	Type of assessment/ date of assessment	Nature of mistake	Tax effect (Rs. in lakh)	Department's Reply
1	Kerala Cricket Association Trivandrum	2002-03	Summary 31 October 2002	Assessee was not notified under section 10(23)	80.36	The assessment has been reopened.

3.9 Irregular exemption owing to non renewal of approval under section 10(23)

3.9.1 Under the Act, approval for exemption under section 10(23), shall at any one time have effect for a period not exceeding three assessment years.

3.9.2 Non renewal of approval beyond the period of three years resulted in irregular grant of exemption involving non levy of tax of Rs. 79.65 lakh in three cases in Delhi, Orissa and Uttar Pradesh charges. Of these, two cases are given at **serial number 1 and 2 of Appendix 14.**

3.10 Exemption granted without registration

3.10.1 The provisions of section 11 shall not apply in relation to the income of any trust or institution unless the trust or institution has made an application for registration of the trust or institution in the prescribed form, and in the prescribed manner.

3.10.2 Irregular exemption owing to non registration of trust or institution resulted in non levy of tax of Rs. 1.15 crore in 13 cases in Andhra Pradesh, Delhi, Gujarat, Haryana, Kerala, Orissa, Punjab, Rajasthan and Tamil Nadu charges. Of these, one case is given in the Table 3 below:

Table 3 : Exemption granted without registration

Sl No.	Name of the assessee/ CIT charge	Assessment year(s)	Type of assessment/ date of assessment	Nature of mistake	Tax effect (Rs. in lakh)	Department's reply
1.	Kerala Cricket Association Trivandrum	2004-05 2005-06	Summary 1 August 2005	Assessee sports association not registered under section 12 A	66.74	The assessment has been reopened.

3.11 Irregular exemption owing to application of income less than prescribed limits under section 10(23) and section 11

3.11.1 The exemption under section 10(23) shall be allowed only if the association or institution applies its income or accumulates it for application, wholly and exclusively to the objects for which it is established. Where 85[&] per cent of income is not applied for the purpose of games or sports but is accumulated or set apart for application to such purpose, such income so accumulated or set apart shall not be included in the total income of the previous year, provided assessee specifies by notice in writing to the prescribed authority in the prescribed manner, the purpose of such accumulation, and the period of accumulation does not exceed five[@] years, and the money so accumulated or set apart is invested or deposited in the form or modes specified in section 11(5).

3.11.2 Irregular exemption owing to application of income less than the prescribed limits resulted in non levy of tax of Rs. 3.35 crore in four cases in Delhi, Himachal Pradesh, Punjab and West Bengal charges. Of these, one case involving tax effect of Rs. 2.99 crore is discussed below:

3.11.3 In West Bengal, DIT (Exemption), Kolkata charge, assessment of Cricket Association of Bengal (CAB), for the assessment years 1991-92 to 1993-94 was completed after scrutiny in March 2000. Scrutiny of assessment records pertaining to the assessment years 1991-92 to 1993-94 revealed that neither was 75 per cent of the income applied for the purpose of games or sports, nor was the assessing officer informed of the same as required under section 11 (2). Further, utilization of unspent income (as required under section 11[2]) within 10 years i.e. up to assessment years 2001-02, 2002-03 and 2003-04 could also not be established as the department had not maintained the register, as prescribed by the Board's instruction No.1559 dated 23 April 1984, in order to check the accumulation of income and its proper utilization. Lack of internal controls in respect of accumulation of income, and its utilization for the specified objectives within specific period has been discussed in para 3.23.6 and 3.23.7 infra. The mistake led to short levy of tax of Rs. 2.99 crore inclusive of interest.

[&] 75 per cent up to 31-03-2003

[@] 10 years prior to 01-04-2001

3.11.4 The department did not accept the audit observation stating that since the assessee was notified under section 10(23), the entire income was to be exempted for tax purposes. The reply is not tenable as the provisions of section 11(2) and 11(3) are applicable to assessees availing the benefits of section 10(23). Department further stated in June 2006 that remedial action was being initiated.

3.12 Irregular exemption owing to non investment of accumulated income/investment made not in specified modes

3.12.1 Accumulated funds under section 11 shall be invested or deposited in the forms or modes specified in sub-section (5) of section 11. In case the trust/institution does not invest or invests or deposits its funds otherwise than in the forms or modes as specified thereunder, the benefit of the exemption will be denied.

3.12.2 Irregular exemption owing to accumulated income either not being invested or invested in the forms or modes other than those specified under section 11 (5) resulted in non levy of tax of Rs. 20.83 crore in seven cases in Chandigarh, Delhi, Gujarat, Jharkhand and Maharashtra charges. One such case is detailed below:

3.12.3 In Maharashtra, DIT (Exemption), Mumbai charge, assessments of the Board of Control for Cricket in India (BCCI), for the assessment years 2002-03 and 2004-05 were completed in summary manner in December 2002 and August 2005 respectively. Assessee had claimed exemption under section 11. Audit scrutiny revealed that out of accumulations of Rs. 87.26 crore as created pertaining to the assessment years 2002-03 and 2004-05, assessee had invested only Rs. 30.43 crore during the two years. Thus, funds accumulated during assessment years 2002-03 and 2004-05 by the assessee were not commensurate with the accretion to the investments in the Balance Sheet. As a result, there was shortfall, in the investments made, amounting to Rs. 56.83 crore. As such, assessee was not eligible for claiming exemption to the extent of shortfall in investments made under section 11. Omission had resulted in under assessment of income by Rs. 28.32 crore in the assessment year 2002-03 and by Rs. 28.51 crore in the assessment year 2004-05 with total tax effect of Rs. 20.09 crore including interest. The reply of the department is awaited.

3.12.4 Two similar cases are given at **serial number 3 and 4 of Appendix 14.**

3.13 Irregular exemption owing to carrying out business activities not incidental to the attainment of the objectives of the trust

3.13.1 Income of a trust or an institution, being profits and gains of business, shall not be included in the total income, unless the business is incidental to the attainment of the objectives of the trust/institution, and separate books of accounts are maintained by such trust/institution in respect of such business.

3.13.2 Irregular exemption owing to carrying out business activities not incidental to the attainment of the objectives of the trust resulted in non levy of tax of Rs. 78.18 lakh in four cases in Assam, Delhi, Maharashtra and West Bengal charges. One such case is given in the Table 4 below:

Table 4 : Irregular exemption owing to carrying out business activities not incidental to the attainment of the objectives of the trust

Sl No.	Name of the assessee/ CIT charge	Assessment year(s)	Type of assessment/ date of assessment	Nature of mistake	Tax effect (Rs. in lakh)	Department's reply
1.	Otters Club DIT (Exemption) Mumbai	2002-03 2004-05	Summary 21 February 2003 23 February 2005	Carrying out the activities of running card room, permit room, social functions, bar and restaurant etc., which are not incidental to the attainment of the objectives of the institution. Similar income was held as taxable during scrutiny assessment for assessment year 2003-04.	63.92	Not received

3.14 Irregular exemption granted to corpus fund without specific direction

3.14.1 Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the previous year of the person in receipt of the income.

3.14.2 However, voluntary contributions received without specific direction that these would form part of the corpus fund of the institutions were allowed exemptions in three cases in Maharashtra and Punjab charges resulting in non levy of tax of Rs. 76.98 lakh. Of these, two cases are given at **serial number 5 and 6 of Appendix 14.**

3.15 Irregular exemption owing to non fulfilment of the basic objectives of the trust/institution

3.15.1 Income derived from property held under trust wholly for charitable or religious purpose, to the extent to which such income is applied to such purpose in India, shall not be included in the total income of the previous year of the person in receipt of the income.

3.15.2 Irregular exemption owing to non application of the income for the basic objectives of charitable or religious trust/institution resulted in non levy of tax of Rs. 51.46 lakh in three cases of Tamil Nadu charge. Of these, one case is given at serial number 7 of Appendix 14.

3.16 Irregular allowance of depreciation

3.16.1 Under the Act, the income of charitable trust/institution is assessable under section 11 to 13 wherein income applied for object of the trust is eligible for deduction irrespective of nature of expenditure either revenue or capital. Where cost of an asset is allowed as application of income in the Income and Expenditure account itself, depreciation on such fixed asset cannot be allowed because aggregate depreciation allowed in respect of any asset for different assessment years cannot exceed the actual cost of the said asset. If allowed, it tantamounts to double deduction.

3.16.2 Incorrect allowance of depreciation on capital asset already treated as application of income (in the Income and Expenditure account) and given the benefit of deduction resulted in non levy of tax of Rs. 1.59 crore in 15 cases in Andhra Pradesh, Assam, Delhi, Gujarat, Jharkhand, Maharashtra, Orissa, Punjab and Uttar Pradesh charges. Of these, one case is given in the Table 5 below:

Sl No.	Name of the assessee/ CIT charge	Assessment year(s)	Type of assessment/ date of assessment	Nature of mistake	Tax effect (Rs. in lakh)	Department's reply
1.	Punjab Cricket Association, Mohali Chandigarh II	2003-04 2004-05	Scrutiny January 2006 Summary March 2005	Incorrect allowance of depreciation even though the capital expenditure was allowed as an application of income (in the Income and Expenditure account) for the object of trust	47.84 49.71 (Potential)	Department, in its reply, stated that grant of depreciation to a trust is not a double deduction. Reply of the department is not tenable as the point raised by audit is not that depreciation is not an allowable deduction. Issue highlighted in the para is that when cost of an asset has already been allowed as application of income in the Income and Expenditure account itself, depreciation on such fixed asset cannot be allowed because aggregate depreciation allowed in respect of any asset for different assessment years cannot exceed the actual cost of the said asset. If allowed, it tantamounts to double deduction.

3.17 Omission to deduct tax at source

3.17.1 The person responsible for paying to any person any income by way of winnings from any game of any sort, in an amount exceeding five thousand rupees shall, at the time of payment thereof, deduct income tax thereon at the rates in force. Failure to deduct tax at source and delay in payment of the same to the Central Government attracted levy of interest and penalty.

3.17.2 Non deduction of tax at source from the payments made to various sports personalities resulted in non levy of tax of Rs. 5.41 crore including penalty in nine cases in Andhra Pradesh, Delhi, Gujarat, Karnataka, Kerala, Tamil Nadu and Pondicherry charges: Of these, two cases are discussed below. One similar case is given at **serial number 8** of **Appendix 14**.

3.17.3 In Kerala, Trivandrum charge, it was observed that Kerala Sports Council did not deduct tax at source from the payments made to sports persons. Tax not deducted together with interest and penalty thereon was to the extent of Rs. 2.23 crore as detailed in Table 6 below:

Table 6 : Omission to deduct tax at source

Amount paid for winnings from games and sports (Rs. in lakh)	Date of payment/ credit to account of recipient	Total TDS due plus interest and penalty (Rs. in lakh)	Department's reply
1,87.03	1.11.02	145.23	Department stated that awards were given to sports persons as an incentive to encourage sports personalities, and hence section 194 B was not applicable. Department further stated that cash awards given by Government of Kerala are exempted under section 10 (17A). Reply is not acceptable since the words 'game of any sort' were inserted with effect from 1 June 2001 to widen the scope of section 194 B. Thus cash prizes given to sports persons are covered under section 194 B. Further, for getting the benefit of section 10 (17A), the awards instituted by the State Government are required to be approved/notified by the Central Government which was not done in the instant case.
5.00	1.10.03	3.49	
15.29	8.12.04	10.03	
1.00	7.10.05	0.63	
104.46	14.2.06	64.09	
312.78		223.47	

3.17.4 In Andhra Pradesh charge, it was noticed that Sports Authority of Andhra Pradesh (SAAP), Government of Andhra Pradesh, disbursed Rs. 3.62 crore to sports personalities as awards/ incentives during the period from April 2001 to March 2006. However, tax was not deducted at source from the amounts disbursed. Tax not deducted together with interest and penalty thereon was to the extent of Rs. 2.61 crore. Reply of the department is awaited.

3.17.5 The cases relating to tax deducted at source as mentioned in para numbers 3.17.2, 3.17.3 and 3.17.4 are also featured in the review 'Implementation of TDS/TCS schemes'.

3.18 Income escaping assessment

3.18.1 Under the Income Tax Act 1961, if the assessing officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently, or recompute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned.

3.18.2 Audit noticed income escaping assessment in 20 cases involving short levy of tax of Rs. 4.88 crore in Andhra Pradesh, Chandigarh (UT), Delhi, Karnataka, Maharashtra and West Bengal charges. One case is detailed below:

3.18.3 In Maharashtra, DIT (E) Mumbai charge, assessments of the Board of Control for Cricket in India (BCCI) for the assessment years 1999-2000 and 2000-01 were completed after scrutiny in March 2002 and March 2003 respectively, and for assessment years 2002-03 and 2004-05 in summary manner in December 2002 and August 2005 respectively. Audit noticed that

- Interest income amounting to Rs. 4.05 crore pertaining to the assessment years 1999-2000 and 2000-01 was credited to various funds* without treating the same as income. Similar interest income was held as taxable by the assessing officer in respect of the same assessee in scrutiny assessment for assessment year 2001-02 completed in March 2004 and for assessment year 2003-04 completed in March 2006. The omission resulted in short levy of tax of Rs. 1.90 crore. Departments reply is awaited.
- Assessee, while making payments to players/umpires during the assessment years 1999-2000, 2000-01, 2002-03 and 2004-05, had deducted certain amounts and credited these to the Benevolent Fund without treating the same as income. Similar deductions from the payments made to players/umpires were held as taxable by the assessing officer in respect of the same assessee in scrutiny assessment for assessment year 2001-02 completed in March 2004 and for assessment year 2003-04 completed in March 2006. The omission resulted in short levy of tax of Rs. 27.86 lakh. Departments reply is awaited.

3.18.4 Two similar cases are given in the Table 7 below.

* Benevolent Fund International, Benevolent Fund Domestic Tournaments, General Fund etc

Table 7 : Income escaping assessment

Sl No.	Name of the assessee/ CIT charge	Assessment year(s)	Type of assessment/ date of assessment	Nature of mistake	Tax effect (Rs. in lakh)	Department's reply
1	Punjab State Sports Council Chandigarh	2002-03 2004-05 2005-06	Summary 21 March 2003 9 March 2006 20 February 2006	Exemption claimed and granted to interest income from property not held under trust. Similar exemption was disallowed in scrutiny assessment but allowed in summary assessments.	84.99	Returns were processed in summary manner. The reply is not tenable as mistakes arising from summary assessments conferring otherwise un-entitled benefits to the assessee and prejudicial to interest of revenue could be rectified under the powers separately available to the assessing officers under the Act.
2	Bombay Presidency Golf Club Limited DIT(Exemption) Mumbai	2001-02 2002-03 2004-05 2003-04	Summary 29 October 2001 28 February 2003 26 October 2004 Scrutiny 28 March 2006	The entrance fee collected was directly credited to reserve. Further, the assessee company though liable to tax under special provision (section 115 JB) was not assessed accordingly.	67.28	Reply not received.

3.18.5 Two similar cases are given at **serial number 9 and 10** of **Appendix 14**.

3.19 Mistake while giving effect to appellate orders

3.19.1 An aggrieved assessee can appeal to the CIT (Appeals) against the order of an assessing officer who shall comply with the directions given in the appellate order. Any mistake committed while giving effect to appellate order will result in under assessment/over assessment of income.

3.19.2 Mistake while giving effect to appellate orders resulted in short levy of tax of Rs. 4.57 crore in one case of Maharashtra charge as discussed below:

In Maharashtra, DIT (E) Mumbai charge, assessments of the Board of Control for Cricket in India (BCCI) for the assessment years 1999-2000 and 2000-01 were completed after scrutiny in March 2002 and March 2003 respectively. Assessing officer had denied the exemption under section 11 to the assessee during the scrutiny assessments for both the years. CIT (A), however, allowed the exemption

under section 11 in his order dated 9 November 2004 and 7 December 2004 for the assessment years 1999-2000 and 2000-01 respectively. Audit noticed that while giving effect to appellate orders, the deduction of 25 per cent under section 11 was worked out on returned income of Rs. 148.40 crore instead of taxable income as per income and expenditure account for the two years amounting to Rs. 65.74 crore. The omission resulted in total under assessment of income by Rs. 9.67 crore with tax effect of Rs. 4.57 crore including interest. Reply of the department is awaited.

3.20 Non submission/delay in submission of income tax returns

3.20.1 Every person in receipt of income derived from property held under a trust for charitable or religious purposes is under statutory obligation to file a return of such income of the previous year, if the income (without giving effect to the provisions of sections 11 and 12) exceeds the maximum amount not chargeable to tax, in the prescribed form. Further, if any person fails to furnish the return of income as required, within the time allowed and in the manner prescribed, shall pay, by way of penalty a sum of one hundred rupees for every day during which the failure continues.

3.20.2 Non filing of return in 10 cases resulted in non levy of tax of Rs. 19.56 crore (including penalty) in Assam, Delhi, Himachal Pradesh, Kerala, Maharashtra, Tamil Nadu, Uttar Pradesh and West Bengal charges. Of these, four cases are discussed below. One case is also given at **serial number 11 of Appendix 14**.

3.20.3 In Kerala, Trivandrum charge, though Kerala Sports Council had taxable income, it did not file returns of income for the assessment years 2003-04, 2004-05 and 2005-06. This resulted in escapement of income. Based on the annual accounts and connected records with the Kerala Sports Council, tax effect worked out to Rs. 1.38 crore. The department stated that suitable action was being contemplated to bring them to tax net.

3.20.4 In Kerala, Trivandrum charge, Kerala Cricket Association, though had a taxable income, did not file returns of income for the assessment year 2001-02 and 2003-04[#]. From the examination of accounts filed by the assessee with the Kerala Sports Council, it was observed that there was income escaping assessment having tax effect of Rs. 1.04 crore. The department stated that suitable action was being contemplated to bring them to tax net.

3.20.5 In West Bengal, DIT (Exemption), Kolkata charge, Cricket Association of Bengal although had a taxable income, did not file returns of income for the assessment years 1990-91 and 1995-96 to 1998-99. As per section 144, if any person fails to submit the return under section 139(1), the assessing officer shall make the assessment of the total income to the best of his judgment, and determine

[#] Return of income was non-est

the sum payable by the assessee. The same was, however, not done by the department. This resulted in underassessment of income involving undercharge of tax of Rs. 13.37 crore including interest (as worked out on the basis of annual accounts kept in various assessment folders). In reply, department stated that no return has been filed by the Cricket Association of Bengal for the assessment years 1995-96 to 2002-03 and as such, there was no question of assessment. The department's contention is not acceptable as audit has pointed out the loss of revenue on account of non initiation of proceedings under section 144.

3.20.6 In Maharashtra, Nagpur I charge, Vidarbha Cricket Association did not furnish any return for the assessment years 2001-02 to 2005-06. Audit could collect annual reports from Vidarbha Cricket Association from which escapement of income of Rs. 9.54 crore with tax effect of Rs. 3.06 crore was noticed for assessment years 2001-02 to 2005-06. Department in its reply (December 2006) stated that assessee has since filed return of income voluntarily for the assessment year 2005-06, and for the remaining years i.e. 2001-02 to 2004-05 notice under section 148 had been issued to the assessee, and assessment proceedings were pending finalization.

3.21 Inconsistent decisions of the department resulting in unintended benefit

3.21.1 Under the Act, promotion of sports is considered as charitable purpose, and as such, income from property held for charitable or religious purposes is exempt from income tax. Up to the assessment year 2002-03, income of a notified sports association/ institution was exempt under section 10(23) which was withdrawn from the assessment year 2003-04.

3.21.2 In Maharashtra, DIT(Exemption) Mumbai charge, the Board of Control for Cricket in India (BCCI) was a notified association eligible for exemption under section 10(23) upto assessment year 1998-99. The assessee was also registered as trust under section 12A of the Act. In its returns of income, the assessee claimed exemption under section 10(23) and section 11 for assessment years 1998-99 to 2004-05. The exemptions claimed under section 10(23) and 11 were disallowed for assessment years 1998-99 to 2000-01 during scrutiny assessment on the ground that the office bearers of the association were running the organization as an end in itself, and there was no accountability of any office bearers. Further, the organization had started the process of commercialization of cricket for the personal benefit of the office bearers.

3.21.3 In appeal, CIT(A), however, allowed exemption under section 10(23) for assessment year 1998-99 on the ground that the assessing officer did not have powers to disallow the exemption to a notified association, and allowed exemption under section 11 for assessment year 1999-2000 and 2000-01. Department contested the appeal order for allowance of exemption under section 11 for assessment year 1999-2000 and 2000-01 in Tribunal, and appeal is pending.

3.21.4 Audit scrutiny revealed that though the department had contested the appeal order vide which exemption was allowed under section 11, the assessing officer allowed exemption under section 11 to the assessee during scrutiny assessment for assessment years 2001-02 and 2003-04, and for the assessment years 2002-03 and 2004-05, the returns were accepted in summary manner wherein exemption was allowed under section 11. As the department is contesting the allowance of exemption under section 11 in the ITAT, the allowance of exemption in subsequent assessment years was not justified. Thus there was inconsistency in the decisions taken by the department. Had the department acted in line with its decision to contest the appeal order as discussed above, an unintended benefit of Rs. 148.07 crore (by way of granting exemptions) would not have passed to the assessee for assessment years 2001-02 to 2004-05 involving tax effect of Rs. 60.30 crore. Reply from the Department is awaited.

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

3.22 Sports associations/institutions not brought under tax net by the department

3.22.1 In order to prevent tax evasion, and to ensure widening of the tax net, department had, with effect from 1 July 1997, commissioned Central Information Branch (CIB) under a Commissioner which collects information about assesseees from different sources with respect to their potential for yielding income tax and passes it to the concerned assessing officers. Thereafter, the assessing officers are required to initiate appropriate action under the Act to call for returns and examine the specific information in assessments. Further, assessing officers are empowered under section 133A and 133B of the Act to conduct survey operations and collect information.

3.22.2 Audit gathered information in respect of 3,273 sports associations and clubs, as detailed in Table 8 below, receiving grants from different government agencies or affiliated to different associations in Andhra Pradesh, Assam, Bihar, Chandigarh, Delhi, Goa, Himachal Pradesh, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Orissa, Punjab, Rajasthan and Tamil Nadu charges which were required to be examined and brought under the tax net of the department by virtue of their position as discussed in the following paragraph. Department has not confirmed/produced any evidence to establish that the said associations/clubs have been filing income tax returns during the assessment years 2001-02 to 2005-06. No information in these cases had been collected by the CIB. No survey operations had also been carried out.

Table 8 : Sports associations/institutions not brought under tax net by the department

Sl. No	CIT charge	Total cases identified	Status as ascertained by audit
1.	DIT (Exemption) Chennai	36 Sport associations	Sports associations as per list furnished by Sports Development Authority of Tamil Nadu. These associations are receiving grants for development of sports in the State of Tamil Nadu.
2.	DIT (Exemption) Chennai	809 Clubs/ District cricket associations	Clubs affiliated to Tamil Nadu Cricket Association. As per the 73 rd Annual Report of Tamil Nadu Cricket Association, these 809 clubs have conducted 3699 league matches.
3.	DIT (Exemption) Chennai	111 Private clubs	Clubs/ District Associations affiliated to Tamil Nadu Cricket Association.
4.	Pondicherry	21 Sport associations	Sport associations as per records of Pondicherry State Sport Council.
5	DIT(Exemption) Hyderabad	1545 Sport associations	Sport associations as per records of District Registrars of Assurances (Stamps and Registrations), and District Sports Authorities.
6	Guwahati I & II/ Shillong, Jorhat Dibrugarh	98 Sport associations	District and State sport associations.
7	Chandigarh I & II	28 Sport associations	Sport associations as per records of Director of Sports and Sports Council, U.T., Chandigarh.
8	Himachal Pradesh charge	49 Sport associations	Sport associations receiving grants in aid from the Government.
9	Kerala charge	469 Sport associations	Information gathered from sports authorities/ councils set up by the Central and State Governments, District Registrars of Societies, telephone directories, internet etc.
10	Goa	33 Sports associations	Sports associations receiving grant from Sports Authority of Goa.
11	DIT (Exemption) Bangalore	34 Sports associations	Sports associations receiving grant from Government and their annual income exceeds exemption limit.
12	DIT(Exemption) Mumbai Pune I Nagpur II, III	20 Sports associations/ club	Sports associations (some receiving grants from Government) have not filed their returns as seen from Return Receipt Register. Department, in respect of 8 sports associations pertaining to DIT (E), Mumbai, has accepted the audit observation, and issued notice under section 148 on October 3, 2006.
13	Others ^o	20 Sport associations	Sports associations receiving grant from Government .

3.22.3 In respect of serial number 1, 2 and 4 above, possible amount of penalty recoverable at the rate of Rs. 100 per day for non filing of returns for the assessment years 2001-02 to 2005-06 comes to Rs. 47.41 crore. The department replied (in respect of Sl No. 1 and 2 above) that matter would be looked into and details would be gathered as to whether they are separate entities and if they are assessable to tax and granted registration under 12 (AA) of the Act, action would be taken and progress would be intimated. In respect of Sl No.4 above, department stated that these associations are non profit bodies engaged in the promotion of various sports activities, and State Council also gives funds to these bodies to meet

^o Jaipur (Rajasthan), Ranchi, Jamshedpur, Dhanbad, Haziaribagh (Jharkhand) charges

the various sports events expenses. Department further stated that as these are not profit earning organizations, income could not be taxed. Reply of the department is not tenable as the issue raised by the audit is non filing of income tax returns. Department has not replied to this issue. Further, if conditions, as laid down under section 11 and 12 of the Act, are not complied with, income of charitable and religious institutions is also taxable.

3.22.4 In Bihar, Delhi, Madhya Pradesh, Orissa and Punjab charges, no sports association/institution and sports personalities had been brought into the tax net during assessment years 2001-02 to 2005-06. As regards Bihar, none of the sport associations/institutions was found filing return of income, nor was any action taken by the department to bring any of the sports associations/institutions into tax net.

3.22.5 Board in its reply stated that the field authorities concerned were being asked to furnish their comments on the status and action taken in this regard.

3.22.6 Board in the exit conference stated that all such cases would be monitored and taken to their logical conclusion.

3.23 Internal audit/control mechanism

3.23.1 As a part of restructuring, the existing system of internal audit was replaced by a new chain system of internal audit in the field offices of the department with a view to strengthening the internal checks of assessments and refunds. In the new system of internal audit, a prescribed percentage of all cases, where assessments were completed during a month are to be internally audited by the end of the following month. Internal audit of one range is to be conducted by another range. Audit has observed the following in this regard:

3.23.2 Out of 109 cases checked in audit in Andhra Pradesh, only one case was seen by internal audit.

3.23.3 In Karnataka, a test check in two circle offices, revealed that no chain internal audit was conducted for the assessment years 2001-02 to 2003-04 in one circle, and from 2001-02 to 2004-05 in another circle under the jurisdiction of the Director of Income tax (Exemption). Similarly, under the charge of DIT (E), Mumbai, there were six assessing charges and there was no chain system of internal audit to check whether the assessments done by the assessing officers were in accordance with the provisions of the Act.

3.23.4 In Kerala, out of 42 cases of assessments completed during the period 2001-02 to 2005-06, only five cases were seen by the internal audit, and out of 18 cases in which mistakes were pointed out by audit, only one case was checked by internal audit, and the mistake as pointed out by audit in this case was not detected by internal audit.

3.23.5 Regarding internal audit, Board in its reply stated that functioning of the internal audit chain system was being reviewed. A proposal for revamping the internal audit was under consideration of the Board.

3.23.6 Board on 23 April 1984 had issued Instruction No.1559 regarding 'Accumulation of income derived from property held under trust-Section 11 (2) and 11 (3) of the Income Tax Act, 1961-Clarification Regarding'. In the Instruction, Board had stated, "on the recommendation of the Public Accounts Committee, the Board had occasion to have a simple study conducted on the application of section 11 (2) and 11 (3) with particular reference to the term 'utilized'. The study has revealed that there is no control or even any check exercised by Income Tax Officer once he allows accumulation of income under section 11 (2) of the Act. It would be observed that a duty is cast on the Income Tax Officer to ensure that the income which is allowed to be accumulated with his permission, is brought within the discipline of section 11 (2) read with section 11 (3). With a view to ensuring that the Income Tax Officer maintains a check on the fulfilment of provisions of section 11 (2) and 11 (3), a register is prescribed. This will ensure that for every subsequent assessment, the Income Tax Officer will be in a position to know that accumulation has been allowed in the case and that the continued fulfilment of the requirements of law has to be checked up". In the instruction, Income Tax Officers have been further advised to ensure that amount accumulated is actually utilized for the permitted purpose, and in doing so, all care must be exercised to see that the accumulated income is applied in real sense of utilization. Prescribed format of the register is as follows:

Sl No.	Name and address of the Trust/Institution-PAN Number	Assessment year in respect of which application u/s 11 (2) made	Amount accumulated/ set apart	Number of years for which income accumulated/ set apart
--------	--	---	-------------------------------	---

3.23.7 Audit observed that the said register was not being maintained, and no mechanism existed in the department to verify the investment and utilization of the accumulated or set apart income on which exemption was allowed in the states of Assam, Delhi, Gujarat, Karnataka, Maharashtra, Uttar Pradesh and West Bengal charges. The correctness of the exemption (under section 11) allowed by the department, as such, could not be verified in audit due to non availability of details of investments made, their withdrawal and utilization for specified purpose within stipulated period. Thus, department did not have any internal control mechanism to check whether income accumulated were applied to specified object within the specified period or not. Department, in respect of Delhi charge, stated that in respect of many cases assessment was completed under section 143 (1), and no investigation was permitted under this section. Reply is not relevant as issue raised by the audit is regarding non existence of mechanism in the department to verify the accumulations and investments made, and their utilization for the specified objectives within specified time.

3.23.8 Regarding internal control, Board stated that the internal control mechanism in the department for checking year wise details of investment, its withdrawal and utilization for specific purposes within stipulated period and to check if the income was applied for the specified objectives and to withhold exemptions in the violations, cannot be said to be weak because as per Board's guidelines for financial year 2006-07, all cases having gross receipts more than a specified limit and claiming exemptions under section 11 are to be compulsorily scrutinized under section 143 (3) of the Act. Apart from it, other cases claiming exemption under section 11 may also be picked up for scrutiny if the authorities feel that there may be violations to the provisions.

3.23.9 Reply of the Board is not tenable in view of the following:

- Maintenance of register as per the Board's instruction number 1559, and selection of cases for scrutiny are different issues. Maintenance of register is required even after the assessment has been completed whether in scrutiny or summary manner as the assessing officer needs to watch the utilization of income accumulated for the specified objective within specified period. This contention of audit is supported by a case highlighted in this report (Para 3.11.3).
- Instruction number 1559 was issued on the recommendations of the Public Accounts Committee. The instruction has still not been implemented in the states of Assam, Delhi, Gujarat, Karnataka, Maharashtra, Uttar Pradesh and West Bengal charges as observed by audit.

3.23.10 Board, during the exit conference agreed to issue a circular to its field formations reiterating the existing instructions for maintenance of the register. Board also mentioned that the issue of bringing the desired information for six years under the ambit of section 44 AB of the Act would be examined.

3.24 Irregular exemption under section 80RR

3.24.1 Under section 80RR, where the gross total income of an individual resident in India, being an author, playwright, artist, musician, actor or sportsman (including an athlete) includes any income derived by him in the exercise of his profession from the Government of foreign State or any person not resident in India, and brought into India by, or on behalf of, the assessee in convertible foreign exchange within a period of six months from the end of the previous year, there shall be allowed, in computing the total income of the individual, deduction at prescribed percentage from such income. Further, no deduction under section 80RR shall be allowed unless the assessee furnishes a certificate in prescribed form^{*}, along with the return of income, certifying that the deduction has been correctly claimed in accordance with the provisions of this section.

^{*} Form No.10H

3.24.2 Audit scrutiny revealed that deduction under section 80 RR was allowed in respect of income i) which had not been earned in the capacity of sportsman, ii) certificate in the prescribed form (No.10H) had not been submitted, involving tax effect of Rs. 4.51 crore in seven cases in Chandigarh, Maharashtra and Tamil Nadu charges. Of these, two cases are discussed below:

3.24.3 Audit scrutiny of assessment records in respect of Shri Sachin R Tendulkar assessed under the charge of CIT- XIX, Mumbai revealed that aggregate deduction of Rs. 8.89 crore was allowed on foreign remittance received by him on account of sport endorsement i.e. advertisements and publicity activities as detailed in Table 9 below:

Assessment Year	Order under section & date:	Gross foreign exch. earning. (Rs. in lakh)	Percentage deduction allowed under section 80RR	Amount allowed (Rs. in lakh)	Tax effect (including interest) (Rs. in lakh)
1998-99	143(3) dt. 29.12.00	282.04	75	189.28	88.88
1999-2000	143(3) dt: 28.3.01	206.58	75	147.85	60.77
2000-01	143(1) dt: 20.3.02	92.86	75	69.64	30.70
2001-02	143(1) dt: 3/02	559.22	60	335.53	136.04
2002-03	143(1) dt: 25.1.03	237.11	45	106.70	32.66
2004-05	143(1) dt: 3.8.05	255.77	15	38.36	12.67
Total				887.36	361.72

3.24.4 As the income was not derived from the profession of sportsman, allowance of deduction was not in order. Department's argument that the assessee had derived it in the capacity of artist was not acceptable as the assessee had received this income in the capacity of a model which cannot be construed as an artist for purpose of this section. It was further observed that during scrutiny assessment in March 2006 for assessment year 2003-04, deduction under section 80RR was not allowed by the assessing officer on similar grounds. Thus, incorrect allowance of deduction under section 80RR for the assessment years 1998-99 to 2002-03 and 2004-05 amounting to Rs. 8.87 crore resulted in short levy of tax of Rs. 3.62 crore. Department in its reply (December 2006) stated that assessments in respect of assessment years 2000-01, 2001-02 and 2002-03 had been reopened, and assessment for assessment year 2004-05 had been selected for scrutiny. Department further stated that the audit observation would be kept in mind while finalizing the assessments.

3.24.5 One more case is given in the Table 10 below:

Table 10 : Irregular exemption under section 80 RR

Sl No.	Name of the assessee/ CIT charge	Assessment year(s)	Type of assessment/ date of assessment	Nature of mistake	Tax effect (Rs. in lakh)
1	Shri Sunil Gavaskar Mumbai V	2001-02 2000-01 2002-03	Scrutiny 25 April 2003 Summary 29 December 2000 24 February 2003	Foreign remittances received in the capacity of commentator not covered under section 80 RR	80.34

3.25 Irregular grant of exemption to the awards received by sport personalities

3.25.1 Section 10(17A) of the Act, provides that income by way of any payment made, whether in cash or in kind; in pursuance of any award instituted in the public interest by the Central Government or any State Government or instituted by any other body and approved by the Central Government in this behalf; or as a reward by the Central Government or any State Government for such purposes as may be approved by the Central Government in this behalf in the public interest, shall be exempt from income tax.

3.25.2 During test checks in Andhra Pradesh, Haryana, Maharashtra and Punjab charges, cases of awards received by the sport personalities not belonging to the above categories but not brought to tax net were noticed involving non levy of tax aggregating Rs. 87.87 lakh in 10 cases. One case involving tax effect of Rs. 23.25 lakh is given at **serial number 12** of **Appendix 14**.

3.26 Other irregularities

Audit noticed mistakes with regard to irregular exemption to the income from non members of the members' club covered under mutuality concept, loss of revenue due to non issuance of notice to the assessee within stipulated time, incorrect computation of capital gain, delay in granting of registration under section 12A, undisclosed income and exemption granted without submission of mandatory audit reports. These have been discussed in subsequent paragraphs.

3.27 Irregular exemption to the income from non members of the members' club covered under mutuality concept

3.27.1 Under the Act, charitable institutions registered under section 12A are exempt from tax subject to fulfilment of certain conditions. It has been judicially held* that members' clubs are examples of mutual undertaking, and surplus i.e. excess of receipts over expenditure, cannot be said to be income for the purpose of

* (226 ITR 97 SC)

the Act. Where a club extends its facilities to non members, to that extent element of mutuality ceases to exist. Thus a members' club is assessable in respect of profits derived from affording its facilities to non members.

3.27.2 Audit noticed cases of profits derived by members' clubs by way of extending its facilities to non members but not brought into tax net in respect of members' clubs in two cases in Maharashtra and Delhi charges, involving tax effect of Rs. 2.26 crore. One case is discussed below:

3.27.3 In Maharashtra, DIT (Exemption), Mumbai charge, in respect of three sport clubs, assessing officer had observed in the scrutiny assessment[&] that the clubs were to be covered under the concept of mutuality, and receipt from non- members and other sources such as dividend, interest etc. were to be taxed. It was, however, observed in audit that returns of these clubs, for the assessment years 2002-03 to 2004-05 claiming exemption (including income from non members) under section 11, were filed and accepted in summary manner. This resulted in allowance of inadmissible exemptions under section 11. As a result, income from non members to the extent of Rs. 4.67 crore was under assessed having a tax effect of Rs. 2.17 crore. Department accepted the audit observation in respect of MIG Cricket Club, and issued notice under section 148 on 3 October 2006.

3.28 Loss of revenue due to non issuance of notice to the assessee within stipulated time

3.28.1 Where a return has been furnished under section 139 or in response to a notice issued under section 142 (1), the assessing officer shall, if he considers it necessary to ensure that the assessee has not understated the income or has not computed excessive loss or has not under paid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return provided that no such notice shall be served on the assessee after the expiry of 12 months from the end of the months in which the return is furnished.

3.28.2 In Gujarat, Baroda III charge, Baroda Cricket Association had not filed the returns till the assessing officer issued notice under section 148 on 30 May 2001 for the assessment years 1991-92 to 1998-99. Accordingly, the assessee filed the returns on 27 June 2001. Thereafter, notices under section 142(1) and 143(2) were issued on 31 December 2002 for all the assessment years. All the assessments were finalized in March 2003, rejecting the exemption claimed by the assessee, and levying a tax of Rs. 2.01 crore including interest and penalty. The action of the assessing officer was confirmed in appeal. However, ITAT Ahmedabad allowed the exemptions as claimed by the assessee, and quashed the assessment orders for all the assessment years on the ground that notices under section 143(2) were not served upon the assessee within 12 months from the date of filing the return for all the assessment years.

[&] Khar Gymkhana for the assessment year 2003-04

3.28.3 Thus, failure on the part of the department in adhering to the provisions of the Act resulted in loss of revenue of Rs. 2.15 crore including extra burden of interest on refund granted under section 244A. The department, in its reply stated that the decision of the ITAT was not accepted by it, and, therefore, has filed an appeal to Gujarat High Court in April 2006.

3.29 Incorrect computation of capital gain

3.29.1 Under section 48 of the Act, where long term capital gain arises from the transfer of a long term capital asset, it shall be computed by deducting (i) expenditure incurred in connection with such transfer, (ii) the indexed cost of acquisition of the asset and indexed cost of any improvement from the full value of the sale consideration. Further the benefit of indexation is not permissible in the case of long term capital asset being bond or debenture other than capital indexed bonds issued by the Government.

3.29.2 The amount of capital gain shall be deposited in a specified bank if it is not appropriated by the assessee towards the purchase of new asset within one year before the date on which the transfer of the original asset took place. Further, the assessee shall be charged to income tax if the amount deposited is not utilized wholly or partially for the purchase or construction of the new asset within the period of three years from the date of the transfer of the original asset.

3.29.3 Non observance of the above provisions resulted in short levy of tax of Rs. 31.95 lakh in two cases in Andhra Pradesh and Maharashtra charges. One case involving tax effect of Rs. 28.38 lakh is given at **serial number 13** of **Appendix 14**.

3.30 Delay in granting of registration under section 12AA

3.30.1 Under section 12 AA(2), every order granting or refusing registration under clause (b) of sub section (1) shall be passed before the expiry of six months from the end of the month in which application was received under clause (a) of section 12A.

3.30.2 In three cases of Assam, Chandigarh and Rajasthan charges, delay in granting of approval for registration under section 12AA was observed. Two such cases are given in the Table 11 below:

Sl No.	Name of the assessee/ CIT charge	Date of application under section 12A	Date of approval
1.	Rajasthan Polo Club, Jaipur II	8 July 2004	Still pending (July 2006)
2.	Khanapara Krira and Sanskrtik Sanghathan Guwahati 2	26 April 2002	12 June 2003

3.31 Undisclosed income

3.31.1 Under section 158 BD of Act, where the assessing officer is satisfied that any undisclosed income belongs to any person, other than the person with respect to whom search and seizure was made, then, the documents seized shall be handed over to the assessing officer having jurisdiction over such other person, and that assessing officer shall assess such person under block assessment.

3.31.2 In Maharashtra, DIT (E), Mumbai charge it was noticed from the assessment folder of Mumbai Cricket Association (MCA) for assessment year 2002-03, that M/s Todays Writing Products Ltd., Kolkata had entered into an agreement with MCA in April 1999 for the sponsorship of MCA for Rs. 1.15 crore. The agreement was valid for three calendar years. It was further observed that the investigation wing of Kolkata had carried out search and seizure operation in the premises of M/s Todays Writing Products on 21 December 2000.

3.31.3 During search and seizure operation, assessing officer, Kolkata, found that M/s Todays Writing Products Ltd. had made a payment of Rs. 23.50 lakh for sponsorship of MCA. However, the parties to the agreement i.e M/s Todays Writing Products Ltd. and MCA had not done anything to enforce the agreement beyond the first year. The assessing officer (Kolkata XX), accordingly, made an addition of Rs. 91.65 lakh being the difference between the agreement value of Rs. 1.15 crore and the payment of Rs. 23.50 lakh. Consequent to this, the assessing officer from Kolkata had forwarded to the assessing officer in Mumbai having jurisdiction over the MCA, a report dated 22 June, 2004 along with a copy of block assessment order dated 31 January 2003 in respect of M/s Todays Writing Products Ltd., and copies of loose papers seized at the time of search and seizure operation for assessing MCA under block assessment.

3.31.4 In November, 2004, assessing officer, Mumbai expressed his inability to take any action stating that returns of MCA for assessment years 2000-01, 2001-02 and 2002-03 were accepted in summary manner, and no proceedings under the Act were pending against MCA, and as such details/documents could not have been called for from MCA under section 131 or 133 (6). Assessing officer had proposed to call for certain additional documents. However, no such additional documents had been called for by the assessing officer as noticed by audit. The assessing officer, Mumbai, as such, should have invoked the provision of section 158 BD.

3.31.5 The amount involved in non disclosure of income was Rs. 91.65 lakh for the assessment year 2001-02, involving tax effect of Rs. 64.34 lakh.

3.32 Conclusions and recommendations

3.32.1 Income of sports associations/institutions and sports personalities in 158 cases in the country have been under assessed by the department by way of granting exemptions although certain statutory conditions as laid down in the Act were not fulfilled by the assessee resulting in tax effect of Rs. 190.92 crore.

3.32.2 Out of 158 irregularities noticed by audit during this review, about 47 per cent and 34 per cent came from assessments related to the miscellaneous category and cricket respectively. Out of audit observations of Rs. 190.92 crore, about 67 per cent and 32 per cent came from the assessments relating to cricket and miscellaneous category respectively.

3.32.3 In 9 cases of sports personalities, non deduction of tax at source was noticed.

3.32.4 There are large numbers of sports associations/institutions, sports clubs etc. which have not been brought under tax net by the department.

3.32.5 Internal control mechanism in the department for checking year wise details of investment, its withdrawal and utilization for specified purposes within stipulated period and to check if income/ accumulated income has been applied to specified objectives for which the associations/ institution was established, and to withhold exemptions in case of violations, is weak.

3.32.6 Internal audit system of the department with respect to sports associations/institutions and sports personalities has been found to be weak as cases of mistakes in assessment, escapement of income, delay in granting of registration, non imposing of penalties in cases of delay and non submission of income tax returns, have been noticed.

3.32.7 *Audit recommends that the internal control mechanism in the department may be strengthened to check year wise details of investment, its utilization for specified purpose within stipulated period and to check if income/ accumulated income has been applied to specified objectives for which the association/ institution was established.*

In the exit conference, Board agreed to issue a circular to its field formations reiterating the existing instructions for maintenance of the register.

3.32.8 *Audit recommends that government may consider utilizing its AST database to focus on potential cases to minimize the misuse of exemptions given to sports associations/institutions/clubs and sports personalities.*

In the exit conference, Board accepted the audit recommendation.

3.32.9 *Audit recommends that government may strengthen its internal audit to avoid irregularities and errors in assessments done, evasion of tax and misuse of exemptions.*

In the exit conference, Board accepted the recommendation and stated that revamping of the internal audit system of the department was already under process.

Sudha Krishnan

New Delhi

Dated: 17 April 2007

(SUDHA KRISHNAN)

Principal Director of Receipt Audit

(Direct Taxes)

Countersigned

Vijayendra N. Kaul

New Delhi

Dated: 17 April 2007

(VIJAYENDRA N. KAUL)

Comptroller and Auditor General of India

Appendices

Appendix 1
(Ref. para 1.5.1)

**Review on "Assessment of selected companies in the selected sectors-
Computer Software, Automobiles and ancillaries, Steel and Trading"**

Number of companies whose income tax assessment records were checked by audit, corporate tax demand in respect of them and their tax demand as a percentage of total corporate tax collections

(Rs in crore)

Assessment year	Sector	Total number of companies whose assessment records were checked	Total tax demand as per department	Corporate tax collection during previous year	Tax demand as % of total corporate tax collection
2002-03	Automobile and ancillaries	163	845.18		
	Computer software	175	413.99		
	Steel	229	122.61		
	Trading	342	290.07		
Total		909	1671.85	36609	4.57
2003-04	Automobile and ancillaries	175	1528.22		
	Computer software	201	1228.05		
	Steel	262	533.77		
	Trading	363	395.02		
Total		1001	3685.06	46172	7.98
2004-05	Automobile and ancillaries	179	1808.79		
	Computer software	212	503.83		
	Steel	270	932.43		
	Trading	389	579.32		
Total		1050	3824.37	63562	6.02

Appendix 2

Effective rate of tax and tax expenditures in respect of selected profit making companies of automobile and ancillaries, computer software, steel and trading sectors assessed under the normal provisions of the Act (Ref. para 1.5.2 & 1.5.3)

(Rs in crore)

Sector	No. of companies checked by audit	Net profit before tax as per P&L account	Deductions under chapter VIA	Total taxable income assessed by the department	Total taxable income as per audit	Tax demand as per department	Tax demand due as per audit	Part(d)	Part(a)	Total deductions under the Income tax Act	Deductions other than those under chapter VIA of the IT Act	Total tax expenditure	Tax expenditure in respect of Ch VIA	Tax expenditure in respect of deductions other than Ch VIA
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Assessment Year 2002-03														
A&ancillary	118	3303.7	90.6	2543.3	2571.1	816.5	826.3	25	25	732.6	641.9	256.4	31.7	224.7
C.Software	126	2854.9	250.3	1129.9	1499.8	410.3	552.9	14	19	1355.1	1104.7	474.3	87.6	386.7
Steel	143	512.2	97.7	303.3	362.1	106.5	157.7	21	31	150.1	52.4	52.5	34.2	18.3
Trading	277	1165.7	234.5	732.7	788.3	258.9	292.3	22	25	377.4	142.9	132.1	82.1	50.0
Total	664	7836.4	673.2	4709.2	5221.3	1592.2	1829.2	20	23	2615.1	1941.9	915.3	235.6	679.7
Assessment Year 2003-04														
A&ancillary	131	3610.5	189.0	3383.2	3416.2	1229.3	1237.2	34	34	194.2	5.2	68.0	66.2	1.8
C.Software	162	4097.7	302.5	2066.1	2386.8	853.1	896.2	21	22	1710.9	1408.4	598.8	105.9	492.9
Steel	173	534.1	81.3	310.5	308.3	113.6	106.7	21	20	225.7	144.4	79.0	28.5	50.5
Trading	309	1247.5	80.6	1096.2	1181.9	393.3	430.7	32	35	65.6	(-)15.0*	23.0	28.2	(-)5.3*
Total	775	9489.7	653.4	6856.0	7293.3	2589.1	2670.7	27	28	2196.4	1543.0	768.7	228.7	540.0
Assessment Year 2004-05														
A&ancillary	146	7354.1	276.8	5150.9	6373.1	1780.3	2069.4	24	28	981.1	704.3	343.4	96.9	246.5
C.Software	173	7484.0	273.1	1312.6	2476.5	487.6	889.9	07	12	5007.5	4734.4	1752.6	95.6	1657.0
Steel	199	811.9	147.3	492.9	546.8	180.7	193.4	22	24	265.1	117.7	92.8	51.6	41.2
Trading	334	2062.5	167.6	1728.2	1780.0	575.7	594.9	28	29	282.5	114.8	98.9	58.7	40.2
Total	852	17712.5	864.8	8684.6	11176.4	3024.3	3747.6	17	21	6536.1	5671.3	2287.6	302.7	1984.9

Continued ..

* This figure is negative because net profit before tax as per profit and loss account has been shown to be lower than what it actually should be to the extent of mistakes pointed out during assessments. If such mistakes were addressed in the profit and loss account, this figure would become a positive figure.

Appendix 2

Effective rate of tax and tax expenditures in respect of selected companies of automobile and ancillaries, computer software, steel and trading sectors with profits in all 3 years and assessed under the normal provisions of the Act

(Rs in crore)

Sector	No. of companies checked by audit	Net profit before tax as per P&L account	Deductions under chapter VIA	Total taxable income assessed by the department	Total taxable income as per audit	Tax demand as per department	Tax demand due as per audit	Part(d)	Part(a)	Total deductions under the Income tax Act	Deductions other than those under chapter VI A of the IT Act	Total tax expenditure	Tax expenditure in respect of Ch VIA	Tax expenditure in respect of deductions other than Ch VIA
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Assessment Year 2002-03														
A&ancillary	84	2468.2	80.2	2222.0	2238.3	706.1	712.1	29	29	229.9	149.6	80.5	28.1	52.4
C.Software	67	1331.1	177.8	475.3	518.8	172.2	184.8	13	14	812.3	634.4	284.3	62.2	222.1
Steel	67	104.4	32.6	42.8	46.7	15.7	17.0	15	16	57.6	25.1	20.2	11.4	8.8
Trading	182	776.5	170.6	533.3	588.6	185.8	219.2	24	28	187.9	17.3	65.8	59.7	6.0
Total	400	4680.1	461.3	3273.4	3392.5	1079.8	1133.0	23	24	1287.7	826.4	450.7	161.4	289.2
Assessment Year 2003-04														
A&ancillary	84	3110.8	184.9	3016.0	3031.4	1103.6	1110.5	35	36	79.4	(-105.5)*	27.8	64.7	(-36.9)*
C.Software	67	1376.9	107.6	655.7	766.2	252.0	283.4	18	21	610.7	503.0	213.7	37.7	176.1
Steel	67	94.3	30.4	63.1	66.0	26.3	25.3	28	27	28.4	(-2.1)*	9.9	10.7	(-0.7)*
Trading	182	936.1	67.6	811.0	889.5	299.3	341.1	32	36	46.6	(-21.0)*	16.3	23.7	(-7.4)*
Total	400	5518.2	390.7	4545.8	4753.1	1681.1	1760.3	30	32	765.1	374.5	267.8	136.7	131.1
Assessment Year 2004-05														
A&ancillary	84	4177.3	161.7	3650.9	3652.2	1282.3	1282.5	31	31	525.1	363.4	183.8	56.6	127.2
C.Software	67	1703.5	158.6	470.9	495.7	170.5	179.5	10	11	1207.8	1049.2	422.7	55.5	367.2
Steel	67	158.9	20.8	98.5	150.2	40.0	54.3	25	34	8.7	(-12.1)*	3.0	7.3	(-4.2)*
Trading	182	1401.4	104.0	1016.3	1056.7	363.1	381.1	26	27	344.7	240.7	120.6	36.4	84.3
Total	400	7441.2	445.1	5236.7	5354.8	1856.0	1897.3	25	25	2086.3	1641.2	730.2	155.8	574.4

Continued

* This figure is negative because net profit before tax as per profit and loss account has been shown to be lower than what it actually should be to the extent of mistakes pointed out during assessments. If such mistakes were addressed in the profit and loss account, this figure would become a positive figure.

Appendix 2

Effective rate of tax and tax expenditures in respect of selected companies of automobile and ancillaries, computer software, steel and trading sectors with profits in one or two of the 3 years and assessed under the normal provisions of the Act in those years

(Rs in crore)

Sector	No. of companies checked by audit	Net profit before tax as per P&L account	Deductions under chapter VIA	Total taxable income assessed by the department	Total taxable income as per audit	Tax demand as per department	Tax demand due as per audit	ert(d)	ert(a)	Total deductions under the Income tax Act	Deductions other than those under chapter VI A of the IT Act	Total tax expenditure	Tax expenditure in respect of Ch VIA	Tax expenditure in respect of deductions other than Ch VIA
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
Assessment Year 2002-03														
A&ancillary	34	835.5	10.4	321.3	332.8	110.4	114.2	13	14	502.7	492.3	175.9	3.6	172.3
C.Software	59	1523.8	72.5	654.6	981.0	238.1	368.2	16	24	542.8	470.3	190.0	25.4	164.6
Steel	76	407.8	65.2	260.5	315.4	90.9	140.6	22	34	92.4	27.3	32.4	22.8	9.5
Trading	95	389.2	63.9	199.4	199.7	73.1	73.1	19	19	189.5	125.6	66.3	22.4	44.0
Total	264	3156.3	211.9	1435.8	1828.9	512.5	696.2	16	22	1327.4	1115.5	464.6	74.2	390.4
Assessment Year 2003-04														
A&ancillary	47	499.6	4.1	367.2	384.9	125.6	126.7	25	25	114.8	110.7	40.2	1.4	38.7
C.Software	95	2720.8	194.8	1410.4	1620.6	601.1	612.8	22	23	1100.2	905.4	385.1	68.2	316.9
Steel	106	439.7	50.9	247.4	242.4	87.3	81.4	20	19	197.4	146.5	69.1	17.8	51.3
Trading	127	311.3	13.0	285.3	292.4	94.0	89.6	30	29	19.0	6.0	6.6	4.6	2.1
Total	375	3971.5	262.8	2310.2	2540.2	908.0	910.5	23	23	1431.3	1168.5	501.0	92.0	409.0
Assessment Year 2004-05														
A&ancillary	62	3176.8	115.0	1500.0	2720.8	498.0	786.9	16	25	456.0	341.0	159.6	40.3	119.3
C.Software	106	5780.4	114.5	841.8	1980.8	317.1	710.5	05	12	3799.7	3685.2	1329.9	40.1	1289.8
Steel	132	652.9	126.5	394.3	396.6	140.6	139.1	22	21	256.3	129.8	89.7	44.3	45.4
Trading	152	661.1	63.7	711.9	723.4	212.6	213.8	32	32	(-)62.2*	(-)125.9*	(-)21.8*	22.3	(-)44.1*
Total	452	10271.3	419.7	3448.0	5821.5	1168.3	1850.3	11	18	4449.8	4030.1	1557.4	146.9	1410.5

Continued

* This figure is negative because net profit before tax as per profit and loss account has been shown to be lower than what it actually should be to the extent of mistakes pointed out during assessments. If such mistakes were addressed in the profit and loss account, this figure would become a positive figure.

Effective rate of tax and tax expenditures in respect of selected companies of automobile and ancillaries, computer software, steel and trading sectors

1. Only the companies, whose incomes have been assessed under the normal provisions of the Act are included here. The loss-making companies or those assessed under the special provisions of the Act, have not been included here.
2. Effective rate of tax has been taken as:

ert(d) as the ratio between ' tax demand as per the Department' (column 7) and ' net profit before tax as per profit and loss account' (column 3)

ert(a) as the ratio between ' tax due as per audit ' (column 8) and ' net profit before tax as per profit and loss account' (column 3)

The difference between ert(a) and ert(d) is a measure of additions made at the instance of audit.
3. The difference between 'total income as per audit' (column 6) and 'net profit before tax as per profit and loss account' (column 3) has been taken as sum total of deductions available under the Act (column 11).
4. The difference between ' total deductions under the Act' (column 11) and ' deductions under Chapter VI A' (column 4) has been taken as ' deductions, other than those under Chapter VI A' (column 12).
5. 35 per cent of deductions have been treated as an estimate for tax expenditure (considering the corporate tax rate of 35% and ignoring the surcharge).

Appendix-3

Additions made by department/voluntary tax compliance (all profit making companies of selected sectors)
(Ref. para 1.5.11)

Assessment year	Sector	Number of profit-making companies assessed under the normal provisions of the Act	Total income returned by the companies	Total income assessed by the department	Total income as worked out by audit	Addition by Department (cl5-cl4)	Difference between total income as worked out by audit and total income returned (potential additions) (cl6-cl4)	Potential not realized as a percent of total income (as per audit) (cl8-cl7) cl6	Non compliance by the companies at filing of the return stage (cl8 as a percent of cl4) in %
1	2	3	4	5	6	7	8	9	10
2002-03	Automobile	118	1881.08	2543.3	2571.1	662.22	690.02	1.08	27
	Software	126	473.99	1129.9	1499.8	655.87	1025.85	24.67	68
	Steel	143	143.58	303.3	362.1	159.75	218.52	16.23	60
	Trading	277	599.29	732.7	788.3	133.37	189.01	7.06	24
	Total	664	3097.9	4709.2	5221.3	1611.21	2123.39	9.81	41
2003-04	Automobile	131	3106.5	3383.2	3416.2	276.65	309.73	0.97	09
	Software	162	2021.44	2066.1	2386.8	44.68	365.39	13.44	15
	Steel	173	186.94	310.5	308.3	123.53	121.38	(-)0.70	39
	Trading	309	973.31	1096.2	1181.9	122.94	208.60	7.25	18
	Total	775	6288.2	6856.0	7293.3	567.81	1005.10	6.00	14
2004-05	Automobile	146	5065.7	5150.9	6373.1	85.15	1307.3	19.18	21
	Software	173	3018.73	1312.6	2476.5	(-)1706.1	(-)542.22	47.00	22
	Steel	199	431.20	492.9	546.8	61.67	115.59	9.86	21
	Trading	334	1666.16	1728.2	1780.0	62.05	113.85	2.91	06
	Total	852	10181.8	8684.6	11176.4	(-)1497.2	994.53	22.29	09

Continued.....

Appendix -3

Additions made by department/voluntary tax compliance (selected companies with profits in all the three years)

Assessment year	Sector	Number of companies, declaring profits in all the three years under consideration and assessed under the normal provisions of the Act	Total income returned by the companies	Total income assessed by the department	Total income as worked out by audit	Addition by dept (cl5-cl4)	Difference between total income as worked out by audit and total income returned (potential additions) (cl6-cl4)	Potential not realized as a percent of total income (as per audit) (cl8-cl7) cl6	Non-compliance by the companies at filing of the return stage (cl 8 as a per cent of cl 4)
1	2	3	4	5	6	7	8	9	10
2002-03	Automobile	84	1618.12	2222.0	2238.3	603.93	620.21	0.73	28
	Software	67	358.18	475.3	518.8	117.10	160.65	8.39	31
	Steel	67	25.08	42.8	46.7	17.70	21.63	8.41	46
	Trading	182	505.29	533.3	588.6	27.98	83.30	9.40	14
	Total	400	2506.7	3273.4	3392.5	766.71	885.79	3.51	26
2003-04	Automobile	84	2829	3016.0	3031.4	186.96	202.34	0.51	07
	Software	67	555.51	655.7	766.2	100.20	210.71	14.42	28
	Steel	67	43.56	63.1	66.0	19.55	22.41	4.33	34
	Trading	182	747.08	811.0	889.5	63.89	142.45	8.83	16
	Total	400	4175.2	4545.8	4753.1	370.59	577.90	4.36	12
2004-05	Automobile	84	3617.2	3650.9	3652.2	33.704	34.984	0.04	01
	Software	67	542.08	470.9	495.7	(-)71.227	(-)46.35	5.02	09
	Steel	67	104.17	98.5	150.2	(-)5.63	46.04	34.40	31
	Trading	182	1039.33	1016.3	1056.7	(-)22.99	17.34	3.82	02
	Total	400	5302.8	5236.7	5354.8	(-)66.145	52.02	2.21	01

Continued.....

Appendix -3

Additions made by department/voluntary tax compliance (selected companies with profits in any one or two of the three years under consideration)

Assessment year	Sector	Number of companies, with profits in anyone or two of the three years under consideration and assessed under the normal provisions of the Act	Total income returned by the companies	Total income assessed by the department	Total income as worked out by audit	Addition by dept (cl5-cl4)	Difference between total income as worked out by audit and total income returned (potential additions) (cl6-cl4)	Potential not realized as a percent of total income (asper audit) (cl8-cl7)/cl6	Non-compliance by the companies at filing of the return stage (cl 8 as a per cent of cl 4)
1	2	3	4	5	6	7	8	9	10
2002-03	Automobile	34	262.97	321.3	332.8	58.29	69.81	3.46	21
	Software	59	115.81	654.6	981.0	538.77	865.20	33.28	88
	Steel	76	118.50	260.5	315.4	142.05	196.89	17.39	62
	Trading	95	94.00	199.4	199.7	105.39	105.70	0.16	53
	Total	264	591.28	1435.8	1828.9	844.49	1237.60	21.49	68
2003-04	Automobile	47	277.47	367.2	384.9	89.693	107.39	4.60	28
	Software	95	1465.94	1410.4	1620.6	(-)55.52	154.68	12.97	10
	Steel	106	143.39	247.4	242.4	103.98	98.97	(-)2.07	41
	Trading	127	226.23	285.3	292.4	59.06	66.16	2.43	23
	Total	375	2113.03	2310.2	2540.2	197.21	427.20	9.05	17
2004-05	Automobile	62	1448.51	1500.0	2720.8	51.446	1272.3	44.87	47
	Software	106	2476.65	841.8	1980.8	(-)1634.9	(-)495.88	57.50	25
	Steel	132	327.03	394.3	396.6	67.30	69.55	0.57	18
	Trading	152	626.83	711.9	723.4	85.04	96.52	1.59	13
	Total	452	4879.03	3448.0	5821.5	(-)1431.1	942.52	40.77	16

Appendix 4

Mistakes in assessments

(Rs. in crore)

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
Incorrect exemption u/s 10A & 10B due to incorrect computation of total income				
1/1.5.21 Software	M/S. Penta Media Graphics Ltd, Chennai-III	2004-05 143(1)	While computing exemption u/s 10B, the total turnover was taken after reducing the "expenditure incurred in foreign currency". Further, the assessee had stated that out of Rs. 82.25 crore to be realized in convertible foreign currency, Rs.56.53 crore only was realized but the exemption u/s 10B was not restricted for the export sales realized in convertible foreign currency.	1.33
2/1.5.21 Software	M/s. Larsen & Toubro InfoTech Ltd, City 2 Mumbai	2002-03 2003-04 143(3)	During the assessment year 2002-03, the assessee had opted out of section 10A in respect of units located at Pune, and Vashi. However, during the assessment year 2003-04 the assessee claimed exemption in respect of these units amounting to Rs.3.50 crore which was not correct.	1.28
3/1.5.21 Software	M/s. Melstar Information Technologies Ltd City 8 Mumbai	2002-03 2003-04 143(3)	The assessee had three STP units. Out of these, two STP units earned profits while one unit suffered losses. The assessee claimed and was allowed exemption u/s.10A in respect of profits earned by two units by ignoring losses incurred by the other unit amounting to Rs.2.84 crore.	1.03
4/1.5.21 Software	M/s L & T Infotech Ltd, Mumbai, city 2	2003-04 143(3)	The assessee got business income of Rs.9.05 crore against which exemption u/s.10-A of Rs.10.74 crore was allowed. Excess allowance of exemption of Rs.1.69 crore was incorrectly set-off against income from other sources of Rs.1.24 crore and balance of Rs 44.81 lakh was allowed to be carried forward.	0.79
5/1.5.21 Software	M/s L & T Infotech Ltd, Mumbai, city 2	2002-03 2003-04 143(3)	The assessee was allowed exemption u/s.10-A on interest amounting to Rs.1.48 crore. As the interest amount was not derived from export of software, the same was required to be reduced from the profits for working for exemption. Department has stated that net amount of interest expenses should be considered as paid in the normal course of business. The reply is not tenable as interest income is to be assessed as income from other sources, hence allowing deduction u/s 10A is not in order.	0.74
6/1.5.21 Software	M/s Satyam Enterprises Solutions Limited Hyderabad- Central	1999-2000 143(3)	The assessee company was allowed exemption under section 10 A in respect of one unit and a loss derived from second unit was allowed to be carried forward to subsequent assessment years. The assessment was completed in March 2002. The income from both the units was not clubbed. Department has accepted the audit observation.	0.62
7/1.5.21 Software	M/s Intel Technology P Ltd, Bangalore I	2002-03 143(3)	Deduction u/s.10A was allowed on the profits of the STP unit before setting off of losses of the non-STP unit. The omission to restrict the deduction to the extent of profits available resulted in excess carry forward of loss at Rs.1.52 crore with a potential tax effect of Rs.54.31 lakh. Department has accepted the audit observation.	0.54

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
Excess exemption due to incorrect computation of turnover u/s 10A/10B				
8/1.5.22 Software	M/s Sankhya Infotech Ltd, Bhubhneswar Orissa	2002-03 2003-04 2004-05 143(1)	As the assessee has not brought the whole amount of export turnover in convertible foreign exchange into India, exemption u/s 10A is not available on the whole amount of export turnover. Department has accepted the audit observation.	1.51
9/1.5.22 Software	M/s. Geometric Software Solution Ltd City 10 Mumbai.	2002-03 2003-04 143(3)	Assessee incurred the expenses in foreign currency and deduction was allowed without carrying any adjustment in export turnover.	1.16
10/1.5.22 Software	M/s Kshema technologies Ltd, Bangalore -I	2002-03 143(1)	Incorrect reduction of the expenditure incurred in foreign currency for providing technical services outside India at Rs.12.05 crore from the total turnover. The above omission resulted in short computation of income by Rs.2.66 crore Department has accepted the audit observation.	1.12
11/1.5.22 Software	M/s Atos Origin(I) Ltd, City 8 Mumbai	2002-03 2003-04 143(3)	While allowing deduction u/s 10A &B, no adjustment to export turnover was carried out though the assessee incurred the expenses in foreign currency amounting to Rs.6.44 crore and Rs.8.56 crore in these year.	0.99
12/1.5.22 Software	M/s HSBC Electronic Data Processing India Pvt Ltd Hyderabad I	2001-02 143 (1)	While computing exemption u/s 10 A, income from other sources, not directly derived from business activity, was reduced from the profits of the business. Department has accepted the audit observation.	0.64
13/1.5.22 Software	M/s Speck Systems Limited Hyderabad-III	2002-03 143 (1)	The exemption was not quantified on proportionate basis as per the modified provisions of section 10A applicable from assessment year 2001-02. The mistake in quantification of admissible exemption resulted in excess claim of exemption. Department has accepted the audit observation.	0.61
14/1.5.22 Software	M/s Quintegra Solutions Ltd, Chennai III	2002-03 143(1)	Mistake in computation of exemption u/s 10A with reference to the details filed in the form 56F resulting in determination of loss of Rs.2.54 crore against income of Rs.1.38 crore.	0.53 0.91 (P)
Incorrect exemption u/s 10A & 10B in respect of splitting up /reconstitution of undertakings				
15/1.5.23 Software	M/s Mastek Ltd Ahemadabad II	2004-05 143 (1)	The assessee claimed and was allowed exemption of Rs.1.39 crore in respect of one of the units, which was not a newly established unit but an extension of an existing unit. Exemption allowed to the assessee was therefore irregular.	0.56
Excess exemption u/s 10A & 10B allowed due to non adjustment of arm length price				
16/1.5.24 Software	M/s Zensar Technologies Ltd, city 2 Mumbai	2002-03 143 (3)	The assessee received Rs.11.58 crore by providing software personnel to USA for which an amount of Rs.1.16 crore was adjusted to the total income on account of arm length price by the Transfer Pricing Officer. While computing book profit, the amount of Rs.1.16 crore added to the total income as arm length price should have been reduced in working out allowable deduction u/s 10A. However, while computing book profit, this was not considered in working out deduction under section 10A.	0.72

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
Irregular exemption u/s 10A & 10B without furnishing certificate/accountant report				
17/1.5.25 Trading	M/s Ambika Agarbathies and Aroma Industries Limited, Chennai-I	2002-03 143(1)	The assessee company had claimed deduction u/s 10 A to the extent of Rs.2.07 crore. However, the assessee had not furnished certificate in Form 56F along with the return of income as stipulated in the provisions of the Act. As such the assessee was not eligible for the claim of deduction u/s 10A.	0.84
Incorrect deduction allowed under chapter VI-A				
18/1.5.26 Software	M/S DSL Software Ltd Bangalore I	2003-04 143(3)	While computing the deduction u/s 80HHE, the profits of foreign branches amounting to Rs.7.56 crore were not excluded from the profits of the business eligible for deduction u/s 80HHE. This resulted in excess allowance of deduction at Rs. 3.77 crore.	1.89
19/1.5.26 Software	Honeywell Technologies Solutions (P) Ltd, Bangalore-I	2003-04 143(1)	The profits relating to rendering technical services abroad have not been reduced from the profits eligible for deduction under section 10 A.	1.84
20/1.5.26 Software	Hewlett Packard Global Software Ltd Bangalore-I	2003-04 143(3)	The profits relating to rendering technical services abroad have not been reduced from the profits eligible for deduction under section 10 A.	1.76
21/1.5.26 Software	M/s Mahendra British Telecom Ltd, City 2 Mumbai	2002-03 143(3)	The assessee company engaged in the development and export of computer software had claimed and was allowed deduction of Rs.3.70 crore u/s 80JAA. As the assessee was not engaged in the manufacture of articles or things, deduction allowed was not in order.	1.32
22/1.5.26 Software	M/s Zensar Technologies Ltd, city 2 Mumbai,	2002-03 143(3)	The assessee was allowed deduction u/s.80-HHE amounting to Rs.2.05 crore without considering carried forward losses. The assessee had got huge carried forward losses to the extent of Rs 41.41 crore. If the same was adjusted in working of deduction u/s.80-HHE, no deduction could be allowed under this provision to the assessee.	0.73
23/1.5.26 Automobile	M/s Maruti Udyog Ltd, Delhi II	2004-05 143(1)	While calculating the deduction u/s 80HHC, the assessee had excluded excise duty from the total turnover which increased the ratio between export turnover and total turnover resulting in calculation of higher amount of deduction. The mistake resulted in excess allowance of deduction of Rs.5.39 crore.	1.93
24/1.5.26 Automobile	M/s Daimler Chrysler India P Ltd, City 5 Pune	2002-03 143(1)	The assessee was allowed deduction u/s 80IB on income including profits of Rs.10.54 crore derived from traded goods and on miscellaneous receipts of Rs.1.13 crore. Since deduction u/ 80 IB is allowable when the income is derived from manufacturing activity, the above deduction was incorrect which resulted in excess allowance of Rs.3.50 crore. Department has accepted the audit observation.	1.91
25/1.5.26 Steel	M/s Bhushan Steel and Strips Ltd, Delhi I	2004-05 143(1)	While calculating the book profit, the assessee had reduced eligible profit in respect of deduction u/s 80HHC of Rs.17.60 crore instead of Rs. 1.13 crore. The mistake resulted in underassessment of income.	1.47

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
26/1.5.26 Steel	M/s. Tata Steel Ltd City 2 Mumbai	2003-04 143 (3)	While computing deduction under section 80-HHC, the assessing officer had not correctly adopted the figure of profit of business, i.e. not reduced the income added u/s 92 C. Also depreciation on account of Cement Division amalgamated with the assessee company was not reduced from business income. Thus profit was considered in excess to the extent of Rs.41.78 crore for computing deduction u/s 80HHC.	1.23
27/1.5.26 Trading	M/s PEC Ltd, Delhi V	2002-03 143(3)	The assessee had taken Rs.338.98 crore as export turnover of the business whereas the notes no 22 forming part of the accounts reflected that FOB value of exports of Rs. 335.44 crore. The mistake resulted in excess allowance of deduction u/s 88HHC of Rs.1.19 crore.	0.50
Incorrect computation of business income				
28/1.5.27 Software	M/s Pentagon Global Solutions Ltd, Chennai III	2003-04 2004-05 143(1)	The assessee had incorrectly claimed loss on sale of assets amounting to Rs.2.19 crore and Rs.1.97 crore in these years.	1.51 (P)
29/1.5.27 Software	M/s Maars Software International Ltd, Chennai III	2002-03 143(3)	While computing income for STP unit, depreciation of Rs.3.36 core was allowed against the eligible depreciation of Rs.5.21 crore. Income of Rs.83.66 lakh derived from other sources was also omitted to be excluded while computing business income of STP unit.	1.01 0.22 (P)
30/1.5.27 Software	M/s Penta Media Graphics Ltd, Chennai III	2003-04 143(3)	The assessee had claimed a deduction of Rs.2.85 crore towards 'bad debts written off' in the computation of income. Thus, the debts were not actually written off in the accounts.	0.83
31/1.5.27 Software	M/s TVS Electronics Ltd, Chennai I	2004-05 143(1)	Assessee claimed one and one half times of the research expenditure as allowable deduction u/s 35(2AB). However, necessary certificates mandatory for claiming the weighted deduction of Rs. 1.52 crore for which he was not entitled on quantum of revenue or capital expenditure incurred on scientific research.	0.66
32/1.5.27 Software	M/s Sagar Soft (India) Limited Hyderabad-III	2004-05 143(1)	The assessee incorrectly adopted net loss as per P&L A/c pertaining to earlier assessment year instead of the current assessment year.	0.53
33/1.5.27 Automobile	M/s India Motor Parts & Accessories Ltd, Chennai I	2001-02 2002-03 143(1)	The assessee had received a sum of Rs.3.50 crore and Rs.28.75 lakh from M/s Royal and Sun Alliance Insurance Pvt Ltd and it was directly taken to balance sheet as "Capital Reserve" terming the receipt as amount received for "restrictive covenant". It was noticed that the assessee and M/s Sundaram Finance along with M/s Royal and Sun Alliance Insurance Company, UK, promoted a non-life insurance company as M/s Royal Sundaram Alliance Insurance Company Ltd. A non-compete fee for restrictive covenant will arise only if the recipient is already in the line of business and he is not a member of the business going to be promoted. Since, the assessee was not in the line of insurance business and also the assessee was one of the partners in the new business to be promoted the amount received from	1.48

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
			the UK company was required to be treated as business income. The incorrect classification of receipts resulted in under computation of income of Rs.3.50 crore and Rs.28.75 lakh for the assessment years 2001-02 & 2002-03 respectively.	
34/1.5.27 Automobile	M/s Eicher Ltd. Delhi IV	2002-03 143(3)	An amount of Rs.1.39 crore on account of interest disallowed by the assessing officer was not added back in computation of income. Department has accepted the audit observation.	0.50
35/1.5.27 Steel	M/s Grinar Impex Ltd, Ludhiana Central	2004-05 144	The assessing officer had adopted incorrect figure of Rs.2.17 core instead of Rs.67.49 lakh. Department has accepted the audit observation.	0.72
36/1.5.27 Trading	M/s. Indian Potash Ltd Chennai I	2002-03 143 (3)	The assessee has included in the value of closing stock the element of exchange gain/loss arising out of exchange rate variation during the period between date of transaction and date of settlement/translation of payables at year-end rates. However, while valuing closing stock as on 31 st March 2002, the assessee had excluded similar exchange rate difference to the extent of Rs.3.32 crore which was in contravention of the provisions of section 145 A of the Act resulting in under valuation of profit.	1.68
37/1.5.27 Trading	M/s Mas Enterprises, Kottayam, Kerala	2002-03 143(3) 2004-05 143(1)	The assessee was engaged in business activities, manufacturing as well as plantation of tea etc and agriculture produce was being used as raw material. The gross receipts from agriculture and non agriculture operations during assessment year 2002-03 were Rs.4.16 crore and Rs.96.51 crore respectively totalling to Rs.100.67 crore. Total expenditure of Rs.98.50 crore (97 % of total receipts) were apportioned in such a way that 99.88% of non-agricultural income was shown as expenditure, whereas only 50.47% of agricultural income was shown as expenditure. This apportionment was done, despite the fact that the details of agriculture produce were not available in the accounts. In the absence of such details, expenditures should have been apportioned between agricultural and nonagricultural incomes proportionately as justified by Supreme Court in November 2000 in the case of Consolidated Coffee Ltd Vs State of Karnataka (248 ITR 432). The capital work in progress during the year for which interest was charged in the P&L account is not admissible with effect from assessment year 2004-05. However, such interest was allowed during assessment year 2004-05.	1.41
38/1.5.27 Trading	M/s. Spencer & Co. Ltd Chennai-III	2002-03 143(1)	The assessee company had obtained loan of Rs.31.74 crore and paid interest of Rs.3.38 crore. Further it was noticed that assessee company had invested a sum of Rs.38.21 crore in its sister concern. As the entire loan taken for which interest paid was diverted to sister concern, the interest payment of Rs.3.38 crore is required to be disallowed and added back. Omission to do so has resulted in under assessment of income.	1.50

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
39/1.5.27 Trading	M/s 3M India Ltd Banagalore-III	2003-04 143(3)	An amount of Rs.1.80 crore was deducted as "amount of sales tax deposited with the authorities" which is disputed in appeal with sales tax authorities. Further an amount of Rs. 67 lakh was treated as sales tax liability discharged by deducting the same from the amount of sales tax deposited. The omission to disallow contingent liability and amount unpaid on the date of filing the return of income has resulted in short computation of income by Rs.2.47 crore. Department has accepted the audit observation.	0.93
40/1.5.27 Trading	M/s Shapoor ji Pallonji & Co P Ltd, City 3 Mumbai	2004-05 143(3)	Tax was computed @ 35% plus surcharge on the entire income, whereas the taxable income also included capital gains of Rs.35.18 lakh on which rates of tax applicable was 10% and Rs.5.24 lakh on which tax was applicable @ 20% which resulted in overcharge. Department has accepted the audit observation.	0.90
41/1.5.27 Trading	M/s Khaitan India (I) Ltd Kolkata IV	2002-03 143(1) 2003-04 143(3)	The expenses on accountant of agricultural activity were not added back while computing the agricultural income.	0.79
Incorrect allowance of provisions and liabilities				
42/1.5.28 Software	M/s Mastek Limited Gujarat Ahmedabad II	2002-03 143 (3)	The assessee was allowed excess deduction u/s 10-A of Rs.3.27 crore while implementing the appellate order. Department has accepted the audit observation and rectified the mistake.	1.16 (P)
43/1.5.28 Software	M/s Moser Baer India Ltd, Delhi II	2002-03 143(3)	The assessee was allowed depreciation of Rs. 2.20 crore @ 25 percent on the fixed assets of Rs.8.80 crore added during the year on account of increase of rupee liability of term loan, due to foreign exchange fluctuation, in the cost of fixed assets. As the amount represented intermediate exchange fluctuation not backed by actual remittance, the depreciation on the increased amount of foreign exchange fluctuation was an inadmissible expenditure, which should have been disallowed.	1.04
44/1.5.28 Software	M/s Mascon Global Ltd Chennai III	2002-03 143(3) 2004-05 143(1)	The assessee had provided for and included under "Interest and Finance charges" sum of Rs.2.43 crore and Rs.21.70 lakh respectively for these assessment years towards interest on delayed payment of withholding taxes but the same was omitted to be disallowed as per provisions of section 40(a)(ii) resulting in under assessment of income. Department did not accept the audit observation stating that the assessee had gone in appeal for which proceedings was pending. The reply is not acceptable as interest payment for default /delay in filing of the return is not allowable in the Act.	1.10
45/1.5.28 Software	M/s Moser Baer India Ltd, Delhi II	2003-04 143(3)	Provisions for bad debts amounting to Rs.3.01 crore was omitted to be added back in the income while computing the income in the scrutiny assessment.	1.25
46/1.5.28 Software	Motorola India Ltd., Gurgaon	2002-03 143(3)	The assessee company created provisions for doubtful advances for Rs.3.10 crore, but Rs.49.44 lakh only were added back in the taxable income.	0.93

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
			The remaining amount of Rs.2.60 crore needed to be disallowed.	
47/1.5.28 Software	M/s Megasoft Ltd. Chennai III	2002-03 2003-04 143(1) 143(3)	The assessee was allowed payments made towards the employers and employees' contribution totaling Rs.117.97 lakh and Rs.78.32 lakh for assessment year 2002-03 and 2003-04 respectively, though the same were remitted after the due date, resulting in underassessment of income.	0.37 0.39 (P)
48/1.5.28 Software	M/s Computech International Ltd, Kolkata I	2002-03 2003-04 143(3)	The assessee was allowed excess amount of depreciation of Rs.1.44 crore to STP software unit towards adding back the depreciation charge under the company Act which increased the profit of the unit.	0.72
49/1.5.28 Automobile	M/s Hindustan Motors Ltd Kolkata II	2002-03 143(1)	The assessing officer disallowed the expense of Rs. 17.20 lakh pertaining to the business of Earth Moving Division (EMD) sold by the assessee but omitted to disallow the expense of Rs. 4.03 crore debited to "payments to and provisions for employees" on account of gratuity for employees of erstwhile EMD which resulted in over assessment of loss by the same amount. The assessing officer did not accept the audit observation stating that the assessee was obliged to discharge the liability on account of gratuity for period prior to date of transfer. The reply was not tenable in view of the fact that the liability to pay the gratuity amount was to the purchaser as the liability was quantified /ascertained on the date of sale of unit.	1.43 (P)
50/1.5.28 Automobile	M/s Hero Auto Ltd, Delhi IV	2004-05 143(1)	The assessee made a provision of Rs.4.91 crore for doubtful debts & gratuity in the accounts and added back only Rs. 2.07 crore in the computation of income. The remaining amount of Rs. 2.84 crore should also have been added back in the computation of income.	1.27
51/1.5.28 Automobile	M/s Hero Honda Motors Ltd, Delhi IV	2004-05 143(1)	The assessee was allowed provision of Rs.1.79 crore on account of warranty expenditure, which was not allowable expenditure.	0.74
52/1.5.28 Automobile	M/s. LUK India Pvt. Ltd Salem Chennai	2002-03 143(1) 2003-04 143(3) 2004-05 143(1)	The assessee had claimed Rs.12.08 lakh, Rs.103.83 lakh and Rs.84.79 lakh transferred to 'provision account' included in "Product Support Expenses", for the assessment years 2002-03, 2003-04 & 2004-05 respectively but were omitted to be disallowed resulting in under assessment of income.	0.73 (P)
53/1.5.28 Automobile	M/S Hwashin Automotive India Pvt Ltd Chennai I	2003- 04 143(3)	The assessee was allowed certain expenses viz., Rate reduction (190.77 lakh) and Supervisory allowance(Rs.19.78 lakh) included in the Contingent Expenditure debited in the profit and loss account as seen from the Auditors report in Form 3CD resulting in over - assessment of loss to an extent of Rs.210.55 lakh.	0.78 (P)
54/1.5.28 Automobile	M/s French Motor company, Kolkata IV	2002-03 2003-04 143(1)	The assessee was allowed deduction of Rs.1.12 crore & Rs.1.01 crore as expense of business under bill marketing scheme discounting charges (being reimbursement to the principal of the dealer	0.77

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
			assessee). As the expenditure was not related to business of assessee, allowance of deduction was irregular.	
55/1.5.28 Automobile	M/s. Rane Trw Steering Systems Ltd. Chennai-III	2002-03 143(1)	The assessee company had claimed a sum of Rs.130.31 lakh towards "Warranty Provision" for the products sold by the assessee which is a contingent liability and the same is required to be disallowed. If this is considered, the income of the assessee company will be increased by a like sum. Department has accepted the audit observation.	0.53
56/1.5.28 Steel	M/s Mandavi Pellets Goa, Margao	2004-05 143(1)	The plant was closed during the assessment year and no production had taken place. Therefore the depreciation of Rs.4.57 crore claimed on the plant and machinery was incorrect.	1.64
57/1.5.28 Steel	M/s Met Rolla Steels Ltd, Kerela Kochi	2002-03 143(1)	An amount of Rs.1.90 crore shown as liability as on 31 March 2002 was assessable as profit of business u/s 41(1) but no liability exist as this was the concession receivable by the company as per the agreement with KSIDC.	0.79
58/1.5.28 Steel	M/s Steel Authority of India Ltd, Delhi III	2004-05 143(1)	The assessee had claimed and was allowed exemption of dividend income of Rs.8.22 crore without reducing the proportionate management expenses of Rs.2.09 crore attributable to the above exempt income.	0.75
59/5.28 Steel	M/s Karthik Alloys Ltd, Goa Margao	2002-03 to 2004-05 143(1)	Pre paid expenses of Rs.19.85 lakh, Rs.1.87 crore and Rs.16.24 lakh respectively included in the P&L account during these assessment years was not added back for working out tax liability.	0.81
60/1.5.28 Steel	M/s Satavahana Ispat Ltd, Hyderabad III	2004-05 143(1)	The assessee claimed a deduction of Rs.8.20 crore towards profits of industrial undertaking u/s 80IB being 30 percent on gross total income of Rs.27.33 crore. While quantifying the deduction, other incomes representing interest income (Rs.68.93 lakh), income from foreign exchange fluctuation (Rs.1.51crore) and income derived from sale of empty barrels and scrap (Rs.2.10 crore) were not reduced from the profits of business, even though these receipts were not derived from the business activity of the industrial undertaking.	0.54
61/1.5.28 Trading	M/s Jute Corporation of India, Kolkata I	2003-04 143(3)	Provision for leave salary benefit on retirement was incorrectly allowed as deduction. Department has accepted the audit observation.	0.97
62/1.5.28 Trading	M/s Samtain Sales Pvt Ltd, City 8 Mumbai	2002-03 143(1)	An amount of Rs.2.71 crore incurred towards promoting the products was allowed though it was not the assessee's liability and the same were disallowed during the subsequent assessment year.	0.97 (P)
63/1.5.28 Trading	M/s NRK Merchants Ltd, Kolkata I	2004-05 143(3)	The assessing officer allowed exemption of the dividend of Rs.2.44 crore u/s 10(33) but did not invoke the provision of section 94(7) of the IT Act, which required that the loss be limited to the extent of the amount by which it exceeded the dividend. Omission in that regard resulted in under assessment of income. Department has accepted the audit observation.	0.88

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
64/1.5.28 Trading	M/s GMM Co. Kolkata I	2003-04 143(3)	The assessee as agent of principals got reimbursements of Rs.2.61 crore from the principals in respect of warranty replacements but did not credit the amount either as reduction of purchase cost or as income. The department has initiated remedial action.	0.96
65/1.5.28 Trading	M/s Sembcorp Logistics (India) Pvt Ltd, Chennai III	2002-03 143(1)	A sum of Rs.2.15 crore relating to capital works was debited in the P&L accounts which was required to be disallowed.	0.77 (P)
Incorrect allowance of capital and non business expenditure				
66/1.5.29 Software	M/s Data Access India Ltd, Delhi IV	2004-05 143(1)	The assessee had debited Rs.5.27 crore on account of interest paid for delay in payment of interconnect charges to BSNL/MTNL which was in the nature of penalty and not allowable as deductible expenditure. The same should have been added back to the taxable income.	1.89
67/1.5.29 Software	M/s Cashtech Solutions India P Ltd City 8 Mumbai	2002-03 143(1)	A deduction of Rs.4.14 crore towards software development expenses was allowed. Department did not accept the observation stating that the programmes that were developed during the year were required to be taken as software produced in the normal course of the business. The reply is not tenable as the department had disallowed similar expenses for assessment years 2001-02 & 2003-04. finalized after the scrutiny.	1.48
68/1.5.29 Software	M/s. Telesys Software Ltd Chennai I	2003-04 2004-05 143(1)	The assessee had claimed expenditure of Rs.5.69 crore and Rs.1.16 crore respectively towards "cost of software packages" used as tools for developing products delivered to clients, as revenue expenditure resulting in under assessment of income to an extent of Rs.2.58 crore and Rs.46.38 lakh respectively.	1.25
69/1.5.29 Software	M/s Data Access (India) Ltd, Delhi IV	2004-05 143(1)	Assessee debited Rs.2.95 crore on account of Initial Public Offer (IPO). During the previous year the assessee had also increased its authorized capital. As IPO cost is related to issue of company's share in market, it was a capital expenditure and should have been disallowed.	1.06
70/1.5.29 Automobiles	M/s. Brakes India Ltd. Chennai I	2002-03 143(3)	During the scrutiny assessment for 2003-04, expenditure of Rs.4.29 crore towards 'power purchase charges' on a protective measure was disallowed. However, the assessment for the year 2002-03 was not reopened to consider similar disallowance of Rs.3.98 crore despite the specific directions of the Additional Commissioner of Income tax (INV), Unit III to disallow the 'power purchase charges' for the relevant assessment years which resulted in escapement of income. The department did not accept the audit observation stating that if the power charges were to be disallowed, then depreciation on wind mills should be allowed as the assessee would be real owner of the wind mills. The reply was not acceptable as the assessing officer himself in a letter to Addl CIT stated that it was difficult to hold the assessee as the real owner of the wind mill and as such the observation is reiterated.	1.86

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
71/1.5.29 Automobiles	M/s Fiat India P Ltd City 10 (1) Mumbai	2002-03 2003-04 143(3)	Loss arising out of foreign exchange fluctuation in respect of fixed asset was allowed as revenue expenditure. The said loss was required to be adjusted in the value of fixed assets. Incorrect treatment of the same as revenue expenditure and allowance of deduction resulted in under assessment of income of Rs.2.10 crore and Rs.1.92 crore respectively.	1.45 (P)
72/1.5.29 Automobiles	M/s. Sakthi Auto Components Coimbatore-I	2002-03 143(1)	The assessee claimed a deduction of Rs.3.71 crore towards "product development expenses" which were capitalized and taken to balance-sheet as 'miscellaneous expenses'. Further, it was noticed that the assessee has written off one-fifth of the product development expenses amounting to Rs.74.95 lakh in the accounts relating to assessment year 2003-04. As the entire expenditure has been capitalized and no part of the expenditure is debited in the profit and loss account write-off is required to be disallowed.	1.32 (P)
73/1.5.29 Automobiles	M/s. Keihin Fie P. Ltd City 5, Pune	2002-03 143(3)	The assessee was allowed a deduction of Rs.2.31 crore on account of technical service fees paid to its joint venture partner M/s Keihin Corporation, Japan as revenue expenditure. The payment was made towards product information, improvement, vendor development, location for cost reduction etc. Since the benefit from these services received was of enduring nature the payment was required to be treated as capital expenditure. Incorrect treatment of the above Rs.2.31 crore as revenue expenditure and allowance of deduction resulted in under assessment of income of Rs.1.93 crore. Department has accepted the observation.	1.09
74/1.5.29 Automobile	M/s Alpha Toyo ltd, Haryana Faridabad	2002-03 2003-04 143(1)	Capital expenditure incurred in earlier years on new projects was allowed as deduction.	0.56
75/1.5.29 Automobile	M/s Sona Koya Steering Systems Ltd, Delhi III	2004-05 143(1)	Technical know how fees, professional charges and development expenses amounting to Rs.2.49 crore. were capital in nature as they provided enduring benefit to the assessee. These should have been capitalized instead of treating DRE.	0.64
76/1.5.29 Automobile	M/s Sona Koyo Steering Systems Ltd, Delhi III	2003-04 143(3)	The assessee deducted a sum of Rs.2.80 crore on account of technical know how fees in computation of income charged to DRE. The assessing officer had added back only Rs.1.23 crore instead of Rs.2.80 crore.	0.59
77/1.5.29 Automobile	M/s. Rane (MADRAS) LTD Chennai-III	2002-03 143(1)	The company had claimed a sum Rs.264 lakh as compensation towards change/variation in the rights of the preference shares by modification of the subscription which do not relate to business of the ongoing concern but squarely related to capital base of the company and hence to be disallowed.	0.94 (P)
78/1.5.29 Steel	M/s Ispat Industries Ltd, Kolkata I	2003-04 143(3)	An expenditure of Rs.3.49 crore on account of installation charges of the hired plant was required to be capitalized instead of allowing as revenue expenditure as it was related to installation of a capital asset. Thus, excess debit of Rs.2.61 crore (Rs.3.49 crore less 25% of Rs.3.49 crore) resulted	0.96

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
			in over assessment of loss.	
79/1.5.29 Automobile	M/s Bombay Cycle & Motors Agency Ltd, City 5, Mumbai	2002-03 143(1)	An amount of Rs.1.54 crore debited in P&L account on account of renovation of rental premises was required to be treated as capital expenditure. Incorrect treatment of capital expenditure as revenue expenditure allowance resulted in underassessment of income.	0.55 (P)
80/1.5.29 Automobile	M/s Automotive Mfg P Ltd, City 10 Mumbai	2002-03 143(3)	While computing the taxable income, assessing officer had not added an amount of Rs.1.77 crore debited to P&L account towards 'provision for liability on accrued employees unavailed leave'.	0.63
Incorrect computation of income under special provisions of the Act				
81/1.5.30 Software	M/s 3I Infotech Ltd, city 10 Mumbai	2003-04 143(3)	Book profit was not computed correctly due to non adjustment and irregular deduction from the net profit. Department has accepted the observation.	0.69
82/1.5.30 Software	M/s Helios and Matheson Information technology Ltd, Chennai I	2000-01 2001-02 143(1)	Though the assessee had book profit of Rs.3.03 crore and Rs.3.47 crore , no action was taken to assess the book profit under the special provision of the Act.	0.70
Incorrect computation of capital gains				
83/1.5.31 Automobile	M/s. Mahendra & Mahendra Ltd, City 2, Mumbai	2000-01 143(3)	The assessee had sold its two divisions as slump sale. In consideration, the assessee was allotted redeemable preference shares and debentures. While computing the capital gains, the face value of the shares and debentures were taken instead of market value resulting in under assessment of income of Rs.1.69 crore.	1.01
84/1.5.31 Automobile	M/s Tata Motor Ltd, city 2 Mumbai	2002-03 143(3)	The assessee had purchased and cancelled 1.84 lakh bonds as an open market operation and had considered income of Rs.4.47 crore, being excess of face value over cost of US Dollar Bonds, as capital receipt. The same was accepted by the department instead of short term capital gain which resulted in excess allowance of carry forward of long term capital loss of Rs.4.47 crore. Department has accepted the observation.	0.91
Incorrect depreciation and set off of losses				
85/1.5.32 Automobile	M/S Tractor and Farm Equipments Ltd Chennai I	2002-03 143(1)	The assessee had incorrectly claimed a sum of Rs.2.30 crore under "Entry Tax Paid" for the year ended March 2002 though the above expenditure is adjustable only against the sales tax and the assessee had also not accounted for the sales tax collections / payments through the profit and loss account.	0.82
86/1.5.32 Automobile	Eicher Motor Ltd, Indore I	1997-98 143(1)	Unabsorbed depreciation loss was incorrectly set off.	0.64
87/1.5.32 Automobile	M/s TVS Motors Co. Ltd, Chennai	2003-04 143(1)	The assessee had claimed depreciation on "vehicle parking shed" @ 100 percent totaling Rs.189.72 lakh as against eligible 10 percent. Department has accepted the audit observation.	0.63
88/1.5.32 Trading	M/s. Food World Super markets Ltd, Chennai I	2002-03 2004-05 143(1)	The assessee had claimed depreciation @ 25% on "Goodwill" amounting to Rs.2.29 crore and Rs.1.29 crore. As depreciation on goodwill is not covered under the Act the same has to be disallowed.	1.28 (P)

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
89/1.5.32 Trading	M/s Vishal Export Overseas Ltd, Ahmedabad IV, Gujarat	2003-04 143(1)	The assessee was allowed depreciation at 100 percent on "Wind Turbine Generator" amounting to Rs.7.50 crore during the assessment year 2002-03 It was however noticed that though the written down value of plant and machinery was nil, depreciation of Rs.3.00 crore was again allowed on same asset during assessment year 2003-04. Department has accepted the audit observation and rectified the mistake.	1.10
Under valuation of closing stock				
90/1.5.33 Automobile	M/s Hindustan Motor Ltd, Kolkata I	2003-04 143(1)	The assessee was allowed a deduction of Rs. 3.51 crore from the amount of 'increase in stock' during the year which represented the difference of excise duty between the opening stock and closing stock of finished goods. Thereby the assessee understated the "increase in stock" by Rs.3.51 crore.	1.06 (P) & 0.22
91/1.5.33 Automobile	M/s Premier Automobiles Ltd, City 10, Mumbai	2000-01 143(3)	The excise duty was not included in the finished stock amounting to Rs.1.89 crore.	0.73
92/1.5.33 Steel	M/S Ispat Industries Ltd Kolkata I charge,	2002-03 2004-05 143(3) 2003-04 143(1)	The assessee deducted an amount of Rs.4.14 crore being the difference of excise duty between the opening stock and closing stock of finished goods from the determined value of stock including excise duty. In reply, the assessing officer stated that the valuation of the closing stock has been done as per the provision of Section 145 A of the Act. The same is not acceptable as the effect of inclusion of excise duty in the closing stock finalized as per provisions of section 145A has been nullified by reducing excise duty element.	1.48 (P)
Income escapement after amalgamation of company				
93/1.5.35 Software	M/s Polaris Software Lab, Chennai III	2003-04 143(3)	Benefit received from the scheme of amalgamation of Rs. 1.42 crore was not assessed by the assessing officer correctly resulting in escapement of income.	0.72
Irregularities in tax deducted at source				
94/1.5.37 Trading	M/s Gujarat Gas Trading Company, Gujarat Ahmedabad - II	2003-04 2004-05 143(1)	Tax credit was allowed on defective challans of advance tax/self assessment tax paid by the assessee.	1.90
95/1.5.37 Automobile	M/s Luk India Pvt Ltd. Chennai, Salem	2002-03 2004-05 143(1) 2003-04 143(3)	The assessee had not deducted TDS on royalty and technical guidance fees payments.	1.69 (P)
96/1.5.37 Trading	M/s Doaba Rolling Mills Pvt. Ltd, M/s R.A. Nariman Co. Ltd. and M/s KIPPS Sales (P) Ltd. Uttar Pradesh, Muzaffarnagar and Bareilly charges	2004-05 143 (1)	The assessee had received Rs.2.34 crore on account of commission & brokerage receipts, contract receipts and availed the benefits of TDS in the previous year, whereas the relevant income was not taken into computation of total income of that assessment year. This resulted in short computation of income by Rs.2.34 crore.	0.91

Sl No./Para no. of the report/ sector	Assessee company and charge	Assessment year & asstt	Nature of mistake	Tax effect
(Other cases)				
97/1.5.38 Software	M/s. Cognizant Technology Solutions India (P) Ltd., Chennai I	2002-03 143(3)	Though the entire demand pertaining to assessment year 2002-03 was collected between September 2005 and March 2006 by way of adjustment against the refunds due for the Assessment Years 2001-02, 2004-05 and 2005-06 respectively, no interest u/s 220 (2) for the belated payment of tax aggregating to Rs.61.89 lakh was levied.	0.62
98/1.5.38 Software	M/s Orbitech Solutions Ltd, Mumbai, city 8.	2003-04 143(3)	Interest on bank deposit under the head 'income from other sources' was taken as Rs 92.16 lakh instead of Rs 2.30 crore.	0.57
99/1.5.38 Software	M/s Tata sons Ltd, Mumbai, city 2	2002-03 143(3)	The assessing officer had applied the rate at 10 percent on an income of Rs.3.72 crore on account of capital gains in respect of which the indexation benefit was availed instead of at 20 percent plus surcharge.	0.52

Appendix-5

Review on implementation of TDS/TCS schemes

Identification and registration of tax deductors
(Ref. para 2.9.1.2)

Sl. No.	Name of charge	Sector wise effective tax deductors										Sector wise total	Total effective tax deductors as indicated by the Department.
		Colleges	Public sector undertakings	Autonomous Bodies	Companies	Co-op. societies	Financial Institutions	Treasury Officers/ DDO's under State Govt.	DDO's and PAO's under Central Govt.	Local Bodies	Others		
1	Maharashtra	904	76	192	142948	184390	9995	5050	659	28251	228160	600625	27899
2	Gujarat	731	63	311	49294	59346	2	2455	96	162	0	112460	300
3	Delhi	216	177	275	128561	5302	4852	1614	6344	283	44156	191780	0
4	H.P	0	451	3	0	0	0	3644	0	3379	0	7477	5140
5	Goa	2201	19	3	3314	2148	0	217	22	13	0	7937	4492
6	Punjab	182	68	2	0	21230	4082	5223	57	12588	916	44348	6337
7	Punjab (UT)	18	5	18	7429	333	312	296	93	1	58	8563	0
8	West Bengal	584	0	154	82728	18433	56	11801	257	4378	8322	126713	22345
9	Assam	17	50	179	5118	23030	19	14388	0	87	2727	45615	5350
10	A.P	4466	58	417	45298	36	5314	99283	259	22051	0	177182	0
11	Rajasthan	420	37	233	19768	88	401	20544	94	452	0	42037	13361
12	Kerala	727	322	171	14929	10178	3534	18875	367	1223	0	50326	7707
13	Tamil Nadu	2153	90	1089	54038	15002	4892	5264	68	1133	9921	93650	45227
	Total	12619	1416	3047	553425	339516	33459	188654	8316	74001	294260	1508713	110259

In Andhra Pradesh, Chandigarh (UT) and Delhi the department did not provide the relevant data.

Appendix –6

Ambiguities in determination of income relating to permanent establishment
(Ref. para 2.10.1)

						(Rs. in lakh)
Sl No	Name of assessee	Asst Year	Asst. u/s	Nature of mistake	Revenue impact	
1	Jal Hotels Co Ltd	1999-2000 to 2003-04	143 (3)	TDS was affected @ 20% on income from royalty and technical fees as against 30% applicable for incomes attributable to PE	33.75	
2	Tractebel Industry Engineering	2002-03	143 (3)	Income from royalty and technical fees was taxed at the rate of 10% instead of 20% applicable since the company was operating through a PE	27.47	
3	L.G.Engineering and Construction Corporation	2002-03	143 (3)	Income from royalty and technical fees was taxed at the rate of 15% instead of 20% since the company was operating through a PE	21.83	

Appendix –7

Non deduction of tax at source in respect of payment made to non residents – failure to disallow expenditure
(Ref. para 2.10.2)

							(Rs. in lakh)
Sl. No.	CIT Charge	Name of the assessee	Assessment year	Nature of payment	Amount to be disallowed	Tax effect	
1	DIT (IT) 3(II) Mumbai	M/s. ONGC Ltd.	2004-05	Service charges	0	95.70	
2	Hyderabad	M/s. BHC Agro India	2004-5	Technical fee	221.00	87.65	
3	CIT-I, Chennai	M/s JBM Sung woo Pvt. Ltd	2002-03	Royalty	121.36	43.32	
4	Ahmedabad	Meghmani Dyes & Intermediates	2003-04	Technical fee/Royalty	104.27	42.63	
5	CIT-I, Chennai	M/s V.A. Tech Wag Tag Ltd.	2002-03	Technical fee	115.36	41.18	
6	Ahmedabad	Shah Alloys	2003-04 2004-05	Technical fee/Royalty	29.58 23.45	19.28	
7	CIT-III, Chennai	M/s Safe Sony Pvt. Ltd	2001-02 & 2002-03	Royalty	28.06 10.32	14.78	
8	Ahmedabad	Vishal Exports	2002-03 2003-04 2004-05	Technical fee/Royalty	13.03 16.35 10.56	14.45	

Appendix-8

Income escaping assessment
(Ref. para 2.11.1)

(Rs. in lakh)					
Sl. No	CIT charge	Name of the assessee	Assessment Year	Income escaping asstt	Tax effect on escaped income (incl intt.)
1	Delhi	M/s. Multi Mentech Internatinal (P) Ltd	2001-02	83.56	46.76
2	Delhi	M/s. J G Electros (P) Ltd.	2003-04	111.63	46.46
3	CIT-VI, Delhi	M/s Zappelin Mobile Systems India Ltd.,	2003-04	98.69	36.27
4	CCIT-I, Bangalore	J.L. Omniserver (P) Ltd.	2004-05	83.41	36.02
5	CIT-II, Coimbatore	Marbsman Paper Boxes	2002-03	91.66	32.72
6	CIT-I, CBE	S. Abbas	2004-05	67.79	24.32
7	CIT-VI, Delhi	M/s Zeco Aircon Industries (P) Ltd.	2003-04	54.94	22.26
8	Delhi	M/s.K.B.T. Plastics (P) Ltd.	2004-05	55.62	21.64
9	Delhi	Smt Gyan Devi Kapoor	2003-04	45.76	17.09
10	Delhi	M/s.Molly Kamani Freight Ltd.	2001-02	28.31	15.76
11	Delhi	Shri Iswar Singh Prop. M/s. New Sheo Tankers		43.04	15.62
12	CIT Jalpaiguri	Sitaram Agarwal	2003-04 & 2004-05	41.80	13.48
13	CIT XIX Kolkata	Birendra Kr. Mohanty	2003-04	37.46	13.42
14	CIT-II, Delhi	M/s. MKR Frozen Foods Exports Ltd.	2002-03	26.45	12.96
15	CIT-II, Kolkata	Commercial Cleaning agencies	2003-04	34.63	12.72
16	CIT-II, Delhi	M/s. Maruti Builders and Promotors (P) Ltd.	2002-03	25.36	12.70
17	Hyderabad	M/s Prasad Homes (P) Ltd.	2005-06	33.36	12.21
18	CIT XXI, Kolkata	M/s Muber Ice & Co.	2003-04	31.02	12.11
19	CIT XX, kolkata	M/s Sisir Kr. Adhikary	2003-04	23.47	11.43
20	CIT-IX, Delhi	Ms.Nidhi Mittal Prop. Of Matrix Solutions	2004-05	28.44	10.79
21	Delhi	M/s. Lerk Auto Engineering (P) Ltd.	2004-05	26.78	10.57
22	Delhi	M/s. Ambience Interiors	2002-03	20.98	10.50
23	CIT IV, Kolkata	M/s Shree Automobiles	2003-04	40.83	10.41
Total				1134.99	458.22

Appendix-9

List of cases of non deduction of TDS/short deduction of TDS
(Ref. para 2.11.2)

Sl. No.	CIT charge	Tax deductor	Financial year	TDS due	Interest	Penalty	(Rs. in lakh)
							Total
1.	Vadodara	TDW India Ltd.	2002-03	43.18	0	43.18	86.36
2	Gurgaon	M/s Honda Motor Cycles and Scooter India Ltd.	2002-03	23.69	8.84	23.69	56.22
3	Pune.	Spl. Land Acquisition Officer-14, 15&16	2004-05 & 2005-06	26.07	2.79	26.07	54.93
4	Dibrugarh	M/s UBI, New Delhi	2004-05 & 2005-06	26.40	0	26.40	52.80
5	Gwalior	Jamana Auto Industries (P) Ltd	2002-03 & 2003-04	24.99	2.25	24.99	52.23
6	Indore	Hindustan Motors	2002-03 & 2003-04	22.95	0.40	22.95	46.30
7	Dhanbad	M/s Mahanadi Coal fields Ltd.	2002-03	17.20	7.67	17.20	42.07
8	Chennai	Smt. Bina J. Mehta	2001-02	18.97	0	18.97	37.94
9	Hyderabad	M/s Kapil Chit Funds Pvt. Ltd.	2004-05	17.71	0.92	17.71	36.34
10	Delhi	Drawing and Disbursement Officer, Ministry of Home Affairs	2004-05	14.97	3.60	14.97	33.54
11	Tamil Nadu	Pondicherry Sports Authority	2001-02 to 2004-05	15.70	0	15.70	31.40
12	Sonipat	Atlas Cycles Ltd.	2002-03 & 2003-04	12.67	2.23	12.67	27.57
13	Hyderabad	M/s Indo American Professional Education Network Pvt. Ltd.	2004-05	11.04	1.38	11.04	23.46
14	Hyderabad	M/s Bio Tech Medical Ltd.	2002-03	9.09	4.21	9.09	22.39
15	Indore	Pietheco Pharmaceuticals Ltd.	2002-03 & 2003-04	11.08	0	11.08	22.16
16	Indore	LIC of India	2002-03 & 2003-04	8.33	0	8.33	16.66
17	Kolkata	AFT Industries Ltd.	2001-02, 2002-03 & 2003-04	6.79	3.06	6.79	16.64
18	Chennai	Chettinadu Logistics (P) Ltd.	2000-01 2001-02	6.16	3.68	6.16	16.00
19	Karnal	Karnal Improvement Trust	2002-03	6.35	2.37	6.35	15.07
20	Delhi	M/s. Sharsta Properties (P) Ltd.	2002-03	6.43	2.15	6.43	15.01
21	Indore	Computer Science Corporation (P) Ltd.	2002-03 & 2003-04	7.47	0	7.47	14.94

Sl. No.	CIT charge	Tax deductor	Financial year	TDS due	Interest	Penalty	Total
22	Hyderabad	M/s Johnson Grammar School Education Society	2002-03	5.82	2.34	5.82	13.98
23	Indore	Dhar Textile Mills	2002-03 & 2003-04	6.84	0	6.84	13.68
24	Ranchi	Jiwan Enterprises	2004-05	6.50	0	6.50	13.00
25	Mumbai	M/s Shree Balaji Textile.	2001-02	4.74	2.57	4.74	12.05
26	Kolkata	India Steam Ship Co. Ltd.	2002-03 & 2003-04	5.10	1.04	5.10	11.24
27	Mumbai	Shri Vinod. B. Khanna.	2003-04	4.85	1.26	4.85	10.96
28	Jorhat	M/s Techno Power Enterprises (P) Ltd	2002-03 & 2003-04	4.83	0.43	4.83	10.09
		Total		375.92	53.19	375.92	805.03

Appendix-10

Failure to remit TDS into Government account
(Ref. para 2.11.3)

							(Rs. in lakh)
Sl. No.	CIT charge	Tax Deductor	Financial year	TDS	Interest	Penalty	Total revenue effect
1	Bhopal	M/s M.P. Rural Road Development Authority	2002-03	36.33	0	36.33	72.66
2	Mumbai	M/s. Precision Fasteners Ltd.	2002-03	29.66	2.00	29.66	61.32
3	Mumbai	M/s. Standard Contract Management Solution Pvt. Ltd.	2002-03	18.11	2.18	18.11	38.40
4	Hyderabad	M/s Shirine Finance & Investment (P) Ltd.	2002-03	11.06	4.48	11.06	26.60
5	Bhopal	M/s Gwalior Sugar Co. Ltd.	2000-01	7.91	5.65	7.91	21.47
6	Bhubaneswar	Principal, Rajdhani College	2002-03	6.31	2.55	6.31	15.17
7	Hyderabad	M/s India Rubber Pvt. Ltd.	2002-03	4.77	1.93	4.77	11.47
8	Ahmedabad	MSK Projects	2001-02	4.49	2.24	4.49	11.22
		Total		118.64	21.03	118.64	258.31

Appendix-11

Incorrect allowance of business expenditure
(Ref. para 2.11.5)

				(Rs. in lakh)
Sl.	CCIT	Name of deductor	Payment required	Tax effect
1	Surat	Gujarat Glass (P) Ltd	263.41	96.36
2	Surat	Videocon Narmada Glass Ltd.	238.56	87.27
3	Surat	Gujarat Guardian Ltd	200.08	73.19
4	Surat	Haryana Sheet Glass Ltd	190.55	69.70
5	Surat	Gujarat Borosil Ltd	189.05	69.15
6	Vadodara	Bell Granito Ceramica Ltd.	174.37	63.78
7	Surat	Gujarat Glass (P) Ltd	169.30	61.93
8	Ahmedabad	Gujarat-Maharashtra Roadways	144.44	52.85
9	Surat	Primax Services	135.00	49.39
10	Vadodara	Gujarat Industries Power Company Lt	126.95	46.43
11	Ahmedabad	Reliance Ind Ltd	124.17	45.42
12	Vadodara	Savana Ceramics Ltd	116.26	42.53
13	Vadodara	Alembic Limited	93.55	34.22
14	Vadodara	Alembic Glass Industries Ltd.	85.57	31.30
15	Vadodara	Gujarat State Electricity Corporation	76.04	27.81
16	Surat	Clean Glass (Pvt) Ltd	69.98	25.60
17	Vadodara	Schott Glass India Pvt Ltd	64.01	23.41
18	Surat	Pragati Glass Pvt Ltd	59.93	21.92
19	Vadodara	Haldyn Glass Guj.Ltd.	56.16	20.14
20	Surat	Metas Of Seventh Day Adventists	54.01	19.76
21	Ahmedabad	Nirma Limited	46.35	16.95
22	Surat	Videocon Narmada Electrical Ltd	43.88	16.05
23	Surat	Nahar Colours & Coating Ltd	40.30	14.74
24	Surat	Shrushti Corporation	39.52	14.46
25	Surat	Amarlila Traders	36.71	14.16
26	Ahmedabad	Shyam Industries	38.44	14.06
27	Vadodara	Sapana Chemical Industries	37.87	13.85
28	Vadodara	Indu Nissan Oxo Chemicals Industrie	29.82	11.91
29	Ahmedabad	Cera Sanitaryware Ltd	32.05	11.72
30	Ahmedabad	Reliance Ind Ltd	31.74	11.61
31	Bangalore-I	Shanker Perfumery Works	26.22	10.50
32	Vadodara	Kaira District Co-Op Milk Producers	28.64	10.48
		Total	3062.93	1122.65

Appendix 12

Misclassification of income tax and surcharge
(Ref. para 2.12.1)

(Rs. in lakh)

Sl. No.	Charge	No. of cases	Tax effect
1.	Delhi	241	594.36
2.	West Bengal	84	308.07
3.	Himachal Pradesh	1840	447.47
4.	Madhya Pradesh	577	100.00
5.	Tamil Nadu	137	76.24
6.	Uttar Pradesh	74	58.45
7.	Assam	130	10.17
8.	Orissa	127	168.97
9.	Chandigarh (UT)	47	91.05
10.	Punjab	12	13.45
	Total	3269	1868.23

Appendix 13

Review on Assessment of Sports Associations/Institutions and Sports Personalities

**State wise details of cases requisitioned and cases produced/checked in audit
(Ref. para 3.6.3)**

State	No. of CIT charge	Cases requisitioned	Cases produced/checked in audit	Cases not produced
Andhra Pradesh	13	135	109	26
Assam	5	105	7	98
Bihar	0	0	0	0
Chandigarh	2	365	79	286
Delhi	1	221	134	87
Goa	1	2	2	0
Gujarat	4	45	34	11
Haryana	5	91	52	39
Himachal Pradesh	1	6	5	1
Jharkhand	4	237	17	220
Karnataka	10	130	94	36
Kerala	6	63	34	29
Madhya Pradesh	7	40	32	8
Maharashtra	11	402	179	223
Orissa	3	565	17	548
Punjab	11	117	99	18
Rajasthan	3	29	27	2
Tamil Nadu	1	46	46	0
Uttar Pradesh	17	51	51	0
West Bengal	11	46	32	14
Total	116	2696	1050	1646

Appendix 14
(Ref. para 3.9 to 3.29)

Sl No.	Name of the Assessee/ CIT charge	Assessment Year(s)	Section under which Assessment is made/ Date of Assessment	Nature of Mistake	Tax effect (Rs. in lakh)
Refer para No.3.9.2:Irregular exemption owing to non renewal of approval under section 10(23)					
1	U.P. Cricket Association Kanpur I	2002-03	Summary February 2003	Non renewal of approval for exemption under section 10(23).	49.21 (including interest)
2	Orissa Cricket Association Cuttack	2001-02	Summary 22 October 2002	Non renewal of approval under section 10(23).	21.38
Refer para No.3.12.4:Irregular exemption owing to non investment of accumulated income/investment made not in specified modes					
3	Bihar / Jharkhand Cricket Association Jamshedpur	2001-02	Summary October 2002	Surplus amount was not invested in specified mode.	25.37
4	Saurashtra Cricket Association Rajkot	2001-02 2002-03 2003-04 2004-05 2005-06	Summary July 2003 July 2003 April 2004 June 2005 April 2006	Surplus amount was not invested in specified mode.	20.77
Refer para No.3.14.2:Irregular exemption granted to corpus fund without specific direction					
5	Mumbai Cricket Association DIT (E), Mumbai	2002-03 2003-04	Summary 28 August 2003 17 March 2005	Exemption granted to income without specific direction that they would form part of the corpus fund.	38.14
6	Maharashtra Cricket Association Pune I	2002-03	Summary 29 March 2003	Revenue income of Rs.1.46 crore incorrectly taken to corpus fund considering the same as voluntary contribution.	38.56
Refer para No.3.15.2:Irregular exemption owing to non fulfilment of the basic objectives					
7	The Organising Committee for conducting a benefit match for Gujarat Earthquake Relief Fund DIT(Exemption), Chennai	2001-02	Scrutiny 24 March 2005	With the purpose of generating and donating funds for the relief of Gujarat Earthquake, a one-day cricket match was organized and conducted on 23rd March 2001. It was decided to donate the entire excess of income over expenditure to the Gujarat Earthquake Relief Fund. Audit observed that the surplus amount of	48.54

				Rs.50.25 lakh was not remitted to Gujarat Earthquake Relief Fund for which the match was conducted.	
Refer para No.3.17.2:Omission to deduct tax at source					
8	Pondicherry State Sports Council Pondicherry	2001-02 to 2005-06	Not applicable	Pondicherry State Sports Council did not deduct tax at source from payments made to various sport personalities.	31.40 (including penalty)
Refer para No.3.18.5:Income escaping assessment					
9	Karnataka State Lawn Tennis Association DIT (Exemption) Bangalore	2001-02	Summary 28 November 2002	Short accountal of advertisement income by Rs.1.43 crore.	46.89
10	United Mohun Bagan Football Team Kolkata IV	2001-02 2002-03	Summary March 2002 February 2003	Short accountal of income of sponsorship fee by Rs.51.06 lakh.	23.75
Refer para No.3.20.2:Non submission/delay in submission of income tax returns					
11	Pondicherry State Sports Council Pondicherry	2002-03 to 2004-05	Not applicable	Return not filed.	28.08
Refer para No.3.25.2:Irregular grant of exemption to the awards received by sport personalities					
12	Kum. Koneru Humpy & Sri Koneru Ashok Vijayawada	2001-02 to 2005-06	Summary	Irregular exemption of awards not notified.	23.25
Refer para 3.29.3: Incorrect computation of capital gain					
13	Shri Sachin R. Tendulkar Mumbai XIX	2000-01 2002-03	Summary, 20.03.02 Summary, 25.01.03	Incorrect allowance of benefit of indexation on transfer of bonds other than capital indexed bonds.	28.38

Glossary of acronyms and terms

1. **ACIT**- Assistant Commissioner of Income Tax
2. **Addl. CIT**- Additional Commissioner of Income Tax
3. **AG (A&E)**- Accountant General (Accounts & Entitlement)
4. **AO** - Assessing Officer
5. **AST**- Assessment Information system
6. **AY**- Assessment Year
7. **CBDT**- Central Board of Direct Taxes
8. **CCIT**-Chief Commissioner of Income Tax
9. **CIT**- Commissioner of Income Tax
10. **DCIT**- Deputy Commissioner of Income Tax
11. **DGIT**- Director General of Income Tax
12. **DIT (IT)**- Director of Income Tax (International Taxation)
13. **DIT (S)** – Directorate of Income Tax (Systems)
14. **DRE**- Deferred Revenue Expenditure
15. **DTAA**- Double Taxation Avoidance Agreement
16. **EOU**- Export Oriented Units
17. **FII**- Financial Institutional Investors
18. **FY** - Financial Year
19. **IRLA** – Individual Running Ledger Account
20. **ITAT**-Income Tax Appellate Tribunal
21. **ITD** – Income Tax Department
22. **ITO**- Income Tax Officer
23. **JCIT**- Joint Commissioner of Income Tax
24. **LCV/HCV**- Light Commercial Vehicle/Heavy Commercial Vehicle
25. **MAB** – Member Audit Board
26. **MAT**- Minimum Alternate Tax
27. **MICR**- Magnetic ink character recognition
28. **NCC** –National Computer Centre
29. **NRI**- Non resident Indian
30. **NSDL** - National Securities Depository Ltd
31. **OCBs** – Overseas Corporate Bodies
32. **OLTAS**- Online Tax Accounting System
33. **PAG**- Principal Accountant General
34. **PAN**- Permanent Account Number
35. **PAO**- Pay and Accounts Office
36. **PE**- Permanent Establishment

37. **RBI-** Reserve Bank of India
38. **RCC-** Regional Computer Centre
39. **SEZ-** Special Economic Zone
40. **STP-** Software Technology Park
41. **TAN-** Tax Deductors Account Number
42. **TAS -** Tax Accounting System
43. **TCS-** Tax Collected at Source
44. **TDS-** Tax Deducted at Source
45. **TIN-FCs-** Tax Information Network- Facilitation Centers
46. **UGC-** University Grants Commission
47. **UT-** Union Territory
48. **ZAO-** Zonal Accounts Office



Bibliography

1. Progress report of the Income Tax Department by Directorate of Research and Statistics
2. Annual Reports of Insurance Regulatory and Development Authority (IRDA) for the relevant years
3. Annual Reports of the General Insurance Corporation of India Ltd, National Insurance Company Ltd., The New India Assurance Co Ltd., Life Insurance Commission, The Oriental Insurance Co Ltd, United India Insurance Co Ltd for the relevant years
4. RBI -India's Overall Balance of Payments in Rupees
5. Economic Survey of India for the relevant years
6. Finance Accounts of Andhra Pradesh, Haryana, Karnataka, Madhya Pradesh, Maharashtra, Punjab, Tamil Nadu and West Bengal.

